Agenda Item 5: Leases

Supporting diagrams for Agenda Item 5.2.2 – Lessor – Options to account for the subsidy component in a concessionary lease

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Lessor – General guidance – Historical cost model
(Option 1 – Cash-flow approach to the lease)

Classification

Is the lease at market terms or at below market terms?
- At market terms
  - Exchange transaction
    - Lease receivable
    - Liability (unearned revenue)
    -Present value of contractual lease payments.
    -Discount rate:
      -Interest rate implicit in the lease.
      -(ED 64.26)

Concessionary lease

Is it a lease for zero or nominal consideration?
- No
  - Exchange component
    - Lease receivable
    - Liability (unearned revenue)
    -Present value of contractual lease payments.
    -Discount rate:
      -Interest rate implicit in the lease.
      -(ED 64.28)

Yes

Refer to relevant international or national standard (ED 64.AG60(b))

Recognition

- Lease receivable
- Liability (unearned revenue)
-Initial value of the lease receivable
-Discount rate:
  -Interest rate implicit in the lease.
  -(ED 64.30)

Initial Measurement

Principle: Liability (unearned revenue) is based on the lease receivable (cost model)

Lease receivable: 100
-Initial value of the lease receivable
-(ED 64.30)

Liability (unearned revenue): 100
-Initial value of the lease receivable
-(ED 64.30)

Lease receivable: 80
-Initial value of the lease receivable
-(ED 64.30)

Liability (unearned revenue): 80
-Initial value of the lease receivable
-(ED 64.30)

Cash flows
At market terms

At below market terms

Lease receivable: 80
- Present value of contractual lease payments
- Discount rate:
  - Market rate.
  (ED 64.29)

Liability (unearned revenue): 100
- Present value of market lease payments
- Discount rate:
  - Market rate.
  (ED 64.31)

- Debit – Expense
- Credit – Liability (unearned revenue)
  (ED 64.AG61(b))

Recognition

Classification

Is the lease at market terms or at below market terms?

Exchange transaction

Concessionary lease

Exchange component

Non-exchange component

Is it a lease for zero or nominal consideration?

No

Principle: Liability (unearned revenue) is based on the lease receivable (cost model)

Lease receivable: 100
- Present value of contractual lease payments.
- Discount rate:
  - Interest rate implicit in the lease.
  (ED 64.26)

Liability (unearned revenue): 100
- Initial value of the lease receivable
  (ED 64.30)

Cash flows

Debit – Expense: 20
Liability (unearned revenue): 20
- Difference between the present value of market lease payments and contractual lease payments
  (ED 64.AG61(b))

Initial Measurement

No cash flows

Refer to relevant international or national standard (ED 64.AG60(b))
Lessor – General guidance – Fair value model
(Option 3 – Performance obligation approach to the exchange component of the lease)

**Classification**
- Is the lease at market terms or at below market terms?
  - At market terms
  - At below market terms
- Concessionary lease
  - Is it a lease for zero or nominal consideration?
    - Yes
      - Refer to relevant international or national standard (ED 64.AG60(b))
    - No
      - Exchange transaction
      - Exchange component
      - Non-exchange component

**Recognition**
- Debit – Expense
  - Credit – Net assets/equity (ED 64.AG61(b))

**Initial Measurement**
- Principle: Liability (unearned revenue) is based on the lease receivable (cost model)
  - Lease receivable: 100
    - Present value of contractual lease payments
    - Discount rate: Interest rate implicit in the lease.
      (ED 64.73)
  - Liability (unearned revenue): 100
    - Initial value of the lease receivable
      (ED 64.29)
- Principle: Liability (unearned revenue) is based on the lease receivable (cash flow model)
  - Lease receivable: 80
    - Present value of contractual lease payments
    - Discount rate: Market rate.
      (ED 64.29)
  - Liability (unearned revenue): 80
    - Present value of contractual lease payments
    - Discount rate: Market rate.
      (ED 64.31)
- Principle: No performance obligation on the non-exchange component of the lease
  - Debit – Expense: 20
    - Credit – Net assets/equity: 20
    - Difference between the present value of market lease payments and contractual lease payments using a market interest rate
      (ED 64.AG61(b))

**Cash flows**
- No cash flows
**Lessee – General guidance**

**Classification**
- Is the lease at market terms or at below market terms?
- Concessionary lease
- Exchange transaction

**Initial Measurement**
- Principle: Right-of-use asset is based on the lease liability (cash-flow model)
  - Right-of-use asset: 100
    - Initial measurement of the lease liability.
    - Lease liability:
      - Present value of contractual lease payments.
      - Discount rate:
        - Interest rate implicit in the lease; or
        - Lessee’s incremental borrowing rate.

- Principle: Right-of-use asset is independent of the lease liability (fair value model)
  - Right-of-use asset: 100
    - Present value of market lease payments.
    - Discount rate:
      - Lessee’s incremental borrowing rate; or
      - Market rate.

**Recognition**
- Right-of-use asset: 100
- Lease liability: 100

**Non-exchange component**
- Non-exchange transaction

**IPSAS**
- Refer to IPSAS 23 (ED 64.AG61(a))
- Refer to IPSAS 23 (ED 64.AG60(a))

**Cash flows**
- Cash flows of 80
- No cash flows

**Is it a lease for zero or nominal consideration?**
- Yes
- No

**Exchange component**
- Exchange transaction

**Principle**
- Difference between the value of the right-of-use asset and the lease liability (IPSAS 23.105D)
- 20

**Lessee – General guidance**

**Is the lease at market terms or at below market terms?**
- Yes
  - Concessionary lease
  - Exchange transaction

**Non-exchange transaction**
- Non-exchange component

**Principle**
- Revenue or liability (unearned revenue)
  - IPSAS 23.105D

** toddo sas **
- Revenue or liability (unearned revenue)
  - IPSAS 23.105D

**Principle**
- Right-of-use asset
  - Revenue or liability (unearned revenue)
    - IPSAS 23.105D

**Cash flows**
- Cash flows

**Principle**
- Present value of market lease payments.
- Discount rate:
  - Interest rate implicit in the lease; or
  - Lessee’s incremental borrowing rate.

**Principle**
- Present value of contractual lease payments.
- Discount rate:
  - Lessee’s incremental borrowing rate; or
  - Market rate.

**Principle**
- Present value of market lease payments.
- Discount rate:
  - Lessee’s incremental borrowing rate; or
  - Market rate.

**Principle**
- Present value of contractual lease payments.
- Discount rate:
  - Lessee’s incremental borrowing rate; or
  - Market rate.

**Principle**
- Present value of market lease payments.
- Discount rate:
  - Interest rate implicit in the lease; or
  - Lessee’s incremental borrowing rate.

**Principle**
- Present value of contractual lease payments.
- Discount rate:
  - Lessee’s incremental borrowing rate; or
  - Market rate.

**Principle**
- Present value of market lease payments.
- Discount rate:
  - Interest rate implicit in the lease; or
  - Lessee’s incremental borrowing rate.

**Principle**
- Present value of contractual lease payments.
- Discount rate:
  - Lessee’s incremental borrowing rate; or
  - Market rate.

**Principle**
- Present value of market lease payments.
- Discount rate:
  - Interest rate implicit in the lease; or
  - Lessee’s incremental borrowing rate.

**Principle**
- Present value of contractual lease payments.
- Discount rate:
  - Lessee’s incremental borrowing rate; or
  - Market rate.
Comparison between a concessionary loan and a concessionary lease

### Lender – Concessionary Loan

**Loan**: CU5,000  
**Contractual Interest Rate**: 5%  
**Market Interest Rate**: 10%  
**Loan Term**: 5 years

<table>
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<th>Year</th>
<th>Op Bal</th>
<th>Int (5%)</th>
<th>Princ</th>
<th>Cash Flow</th>
<th>Cl Bal</th>
<th>Year Op Bal Int (5%) Princ Cash Flow Cl Bal</th>
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<td>1,155</td>
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**Total**  
- **Loan Plan Cash Flow**: 5,000  
- **Present Value**: 5,774  
- **Dif.**: 4,378  
- **Coef. 10%**: 1,396

### Lessor – Concessionary Lease (Option 2)

**Annual Market Lease Payments**: CU1,500  
**Annual Contractual Lease Payments**: CU1,155  
**Market Interest Rate**: 10%  
**Lease Term**:

| Year | Undiscounted Annual Market Lease Payments | Present Value of Annual Market Lease Payments | Undiscounted Annual Contractual Lease Payments | Present Value of Annual Contractual Lease Payments | Off-market portion of the lease  
<table>
<thead>
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</table>

**Total**  
- **Present Value of Annual Market Lease Payments**: 7,500  
- **Present Value of Annual Contractual Lease Payments**: 4,378  
- **Off-market portion of the lease**: 1,308

### Fair Value of Loan Plan

<table>
<thead>
<tr>
<th>Year</th>
<th>Op Bal</th>
<th>Int (10%)</th>
<th>Cash Flow</th>
<th>Cl Bal</th>
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<th>FV Loan</th>
<th>Subsidy</th>
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**Total**  
- **Fair Value of Loan Plan**: 5,774

**Comparison between a concessionary loan and a concessionary lease**

- **Capital balance**: 4,378  
- **Interest payable**: 438  
- **Principal**: 717  
- **Contractual Lease payments**: 1,155  
- **Capital balance**: 3,661
### Lender – Concessionary Loan

<table>
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<tr>
<th>Expense (subsidy)</th>
<th>4,378</th>
<th>1,155</th>
<th>622</th>
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<tr>
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<td>1,155</td>
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</tbody>
</table>

Conclusion:
In a concessionary loan, the subsidy is recognized:
(a) As expense at initial recognition; and
(b) As interest revenue over the loan term.

### Lessor – Concessionary Lease (Option 2)

<table>
<thead>
<tr>
<th>Expense (subsidy)</th>
<th>4,378</th>
<th>1,155</th>
<th>1,137</th>
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<tbody>
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<td>438</td>
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</tr>
<tr>
<td>105</td>
<td>1,155</td>
<td></td>
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</tr>
</tbody>
</table>

Conclusion:
In a concessionary lease, the subsidy is recognized:
(a) As expense at initial recognition; and
(b) As lease revenue over the lease term.

### Overall conclusion:
The net impact on surplus or deficit of concessionary loans and concessionary leases is the contractual interest/lease payments, respectively.