Agenda Item 11—Leases

Project management: Stock take

Road Map – progress to date and future meeting plans

Board Decisions – previous decisions taken and key future issues

Board Instructions – satisfied with actions taken?

Other Issues?
Leases

Outline

- Project strategy and public interest (Agenda Item 11.2.1)
- Leases project phasing and management (Agenda Item 11.2.2)
- Framework of analysis for the options to make a decision on the Leases project (Agenda Item 11.2.3)
- IFRS 16 variant (Agenda Item 11.2.4)
- Stop or continue with the Leases project? (Agenda Item 11.2.5)
- Which option should the IPSASB develop: Option 2–IFRS 16 or Option 3–ED 64? (Agenda Item 11.2.6)
Leases

Project Strategy and Public Interest (Agenda Item 11.2.1)

June 2016 (Project Brief)
- Objective: Convergence with IFRS 16

Scope expansion
- Lessor accounting
- Concessionary Leases

Polarized views from IPSASB’s constituents
- ED 64 supporters
- IFRS 16 supporters

2019 IPSASB Actions
- Extend timeline
- Creation of Task Force
- Guest speakers

Staff’s recommendation

Required: IPSASB's Strategic Decision at the March 2020 Meeting
Leases

Project Strategy and Public Interest (Agenda Item 11.2.1)

- Decision required from IPSASB
  - Agree with the staff’s recommendation that a decision on the direction of the Leases project is needed now?
Leases

Leases Project Phasing and Management (Agenda Item 11.2.2)

Phase 1:
Lease Accounting Model

Phase 2:
Concessionary Leases

Staff’s recommendation
Leases Project Phasing and Management (Agenda Item 11.2.2)

- Decision required from IPSASB
  - Agree with the staff’s recommendation to adopt a phased project management approach?
Framework of analysis for the options to make a decision on the Leases project (Agenda Item 11.2.3)

Factors

Public financial management (PFM) benefits
Implementation costs/challenges
Government Finance Statistics (GFS) alignment impact
IPSASB Conceptual Framework
IFRS alignment
Feasibility of Leases project

Traffic Light

Factors

Factors

Factors
Framework of analysis for the options to make a decision on the Leases project (Agenda Item 11.2.3)

- Decision required from IPSASB
  - Agree with the staff’s recommended revised framework of analysis for the options to make a decision on the Leases project?
Leases

IFRS 16 variant (Agenda Item 11.2.4)

• Background
  – December 2019 meeting—IPSASB instructed staff to consider an IFRS 16 variant for lessor accounting

• IFRS 16 variant
  – Lessor to account for all leases as operating leases only—revenue as cash received
  – Underlying asset always recognized by the lessor prevents IPSAS 13 practical issues:
    • Possible recognition of the underlying asset by both the lessor and the lessee
    • Possible non-recognition of the underlying asset by either the lessor or the lessee
Leases

IFRS 16 variant (Agenda Item 11.2.4)

**Issues raised**
- Lack of economic rationale
- Inconsistent approach to the same transaction
- A lease is not a service
- Consolidation issues
- Mixed group issues
- Subleases issues

**Conceptual**
- Right-of-use asset
- Lease liability

**Practical**
- Revenue as cash received

**Lessee**
- Right-of-use asset
- Lease liability

**Lessor**
- Revenue as cash received
IFRS 16 variant
(Agenda Item 11.2.4)

• **Staff’s views:**
  - No respondent to ED 64 proposed such a model for lessor accounting;
  - No such model has been considered or developed previously by an international or national standard setter; and
  - Might raise IPSASB credibility issues by pursuing an accounting model that removes judgement, by eliminating any assessment of risks and rewards as it is implicit in the model.
Leases

IFRS 16 variant
(Agenda Item 11.2.4)

• **Staff’s recommendation:**
  – Staff does not recommend the IPSASB consider the IFRS 16 variant.

• **Decision required from IPSASB:**
  – Agree with staff’s recommendation not to consider IFRS 16 variant?
Continue with the Lease project? (Agenda Item 11.2.5)

- Problems with IPSAS 13:
  - Might not be recognized by both the lessor and the lessee
  - Might be recognized by both the lessor and the lessee
  - Lessee might not recognize a lease liability if the lessee classifies the lease as an operating lease
  - Lessor does not recognize a lease receivable and the lessee recognizes a lease liability arising from the same lease contract or vice-versa
Leases

Continue with the Lease project? (Agenda Item 11.2.5)

Option 1
IPSAS 13

Option 2
IFRS 16

Option 3
ED 64

Lessor
Risks and rewards model

Lessee
Risks and rewards model

Right-of-use model

Right-of-use model
## Continue with the Lease project? (Agenda Item 11.2.5)

<table>
<thead>
<tr>
<th>Factors \ Options</th>
<th>No change/Stop</th>
<th>Change/Continue with Leases Project</th>
</tr>
</thead>
<tbody>
<tr>
<td>IPSAS 13</td>
<td></td>
<td>Option 1: IPSAS 13</td>
</tr>
<tr>
<td>IPSASB Conceptual Framework</td>
<td></td>
<td>Option 2: IFRS 16</td>
</tr>
<tr>
<td>IFRS alignment</td>
<td></td>
<td>Option 3: ED 64</td>
</tr>
<tr>
<td>Implementation costs / challenges</td>
<td></td>
<td></td>
</tr>
<tr>
<td>GFS alignment impact</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Feasibility of Leases project</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>PFM benefits</th>
<th>Lessee</th>
<th>Lessor</th>
</tr>
</thead>
<tbody>
<tr>
<td>R&amp;R</td>
<td></td>
<td></td>
</tr>
<tr>
<td>RoU</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lessee</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lessor</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Continue with the Lease project? (Agenda Item 11.2.5)

- **Staff’s recommendation:**
  - Not to pursue Option 1—IPSAS 13 (Despite this being the most feasible and lowest cost option)
    - Allows off-balance sheet financing of operating leases for lessees
    - Underlying asset not being recognized by either lessee or lessor
    - Inconsistent with the Conceptual Framework
    - Different from IFRS 16 for both lessees and, to a smaller degree, lessors
    - Mixed groups issues
    - Frustrate constituents’ expectations
    - No IPSASB member supported retention of IPSAS 13 at the December 2019 meeting
Leases

Continue with the Lease project? (Agenda Item 11.2.5)

• **Staff’s recommendation:**
  – It is in the **public interest** (for reasons of transparency, accountability and decision making) to address:
    • Lessee’s off-balance sheet financing through leases;
    • The different accounting outcomes resulting from independent lease classifications by each entity to the same lease contract which leads to:
      – Possible disappearance or recognition in duplicate of the underlying asset in the financial statements; and
      – Possible non-recognition of the lease receivable by the lessor, while the lessee possibly recognizes a lease liability
Leases

Continue with the Lease project? (Agenda Item 11.2.5)

- Decision required from IPSASB:
  - Agree with staff’s recommendation to continue with the Leases project?
Which option should the IPSASB develop: Option 2–IFRS 16 or Option 3–ED 64? (Agenda Item 11.2.6)

<table>
<thead>
<tr>
<th>Lessor</th>
<th>Lessee</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Option 2–IFRS 16</strong></td>
<td><strong>Option 3–ED 64</strong></td>
</tr>
<tr>
<td><strong>Underlying Asset</strong></td>
<td><strong>Underlying Asset</strong></td>
</tr>
<tr>
<td>• Finance lease: derecognized</td>
<td>• Continues to be recognized and measured according to the applicable Standards</td>
</tr>
<tr>
<td>• Operating lease: continues to be recognized and measured according to the applicable Standards</td>
<td></td>
</tr>
<tr>
<td><strong>Lease Contract</strong></td>
<td><strong>Lease Contract</strong></td>
</tr>
<tr>
<td>• Finance lease</td>
<td>• Debit: Lease receivable</td>
</tr>
<tr>
<td>✓ Debit: Lease receivable</td>
<td>✓ Credit: Underlying asset</td>
</tr>
<tr>
<td>✓ Credit: Underlying asset</td>
<td>• Operating lease</td>
</tr>
<tr>
<td>• Operating lease</td>
<td>✓ Revenue on straight-line basis</td>
</tr>
<tr>
<td>✓ Revenue on straight-line basis</td>
<td></td>
</tr>
<tr>
<td>• Debit: Right-of-use asset</td>
<td>• Debit: Right-of-use asset</td>
</tr>
<tr>
<td>• Credit: Lease liability</td>
<td>• Credit: Lease liability</td>
</tr>
</tbody>
</table>
Which option should the IPSASB develop: Option 2–IFRS 16 or Option 3–ED 64? (Agenda Item 11.2.6)

<table>
<thead>
<tr>
<th>Factors \ Options</th>
<th>Change/Continue with Leases project</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Option 2 IFRS 16</td>
</tr>
<tr>
<td></td>
<td>RoU</td>
</tr>
<tr>
<td>PFM benefits</td>
<td>Green</td>
</tr>
<tr>
<td>Implementation costs / challenges</td>
<td>Red</td>
</tr>
<tr>
<td>GFS alignment impact</td>
<td>Red</td>
</tr>
<tr>
<td>IPSASB Conceptual Framework</td>
<td>Green</td>
</tr>
<tr>
<td>IFRS alignment</td>
<td>Green</td>
</tr>
<tr>
<td>Feasibility of Leases project</td>
<td>Green</td>
</tr>
</tbody>
</table>
Which option should the IPSASB develop: Option 2–IFRS 16 or Option 3–ED 64? (Agenda Item 11.2.6)

• **Staff’s views:**
  - PFM benefits not clear for both Options 2 and 3;
  - Option 3 entails greater implementation costs/challenges than Option 2;
  - Option 2 requires more effort from a GFS perspective than Option 3, but can be resolved;
  - Option 2 is aligned with IFRS, but it is less consistent with the IPSASB Conceptual Framework, and there might be also a variability of views on an ED based on IFRS 16 that the IPSASB will need to manage;
  - Options 3 will be more challenging from a project management perspective because of the variability in views on ED 64 lessor accounting proposals, which make the timeline unpredictable;
Which option should the IPSASB develop: Option 2—IFRS 16 or Option 3—ED 64? (Agenda Item 11.2.6)

- **Staff’s recommendation:**
  - **Option 2—IFRS 16 (RoU model for lessees and R&R model for lessors)**
    - It is less costly/challenging to implement;
    - It is aligned with the IPSASB’s Strategy & Work Plan strategic theme of Maintaining IFRS Alignment, which was the original objective of the Leases project; and
    - It is the most feasible option as allows greater certainty on the:
      - Timeline: and
      - Outcome for a new IPSAS on Leases.
Which option should the IPSASB develop: Option 2–IFRS 16 or Option 3–ED 64? (Agenda Item 11.2.6)

- Decision required from IPSASB:
  - Support the staff’s recommendation to move ahead with developing a revised Leases Exposure Draft based on IFRS 16 (Option 2)?