IPSASB Exposure Draft 75 on *Leases*

&

Request for information

ACCOUNTING STANDARDS BOARD

Disclaimer

***The views and opinions expressed in this presentation are those of the individual. Official positions of the ASB on accounting matters are determined only after extensive due process and deliberation*.**

Outline

- Objective and history of the project
- Overview of ED 75
- Scope and definitions
- Lessee accounting
- Lessor accounting
- Sale and leaseback transactions
- Disclosures
- Specific matters for comment

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Objective and history of the project

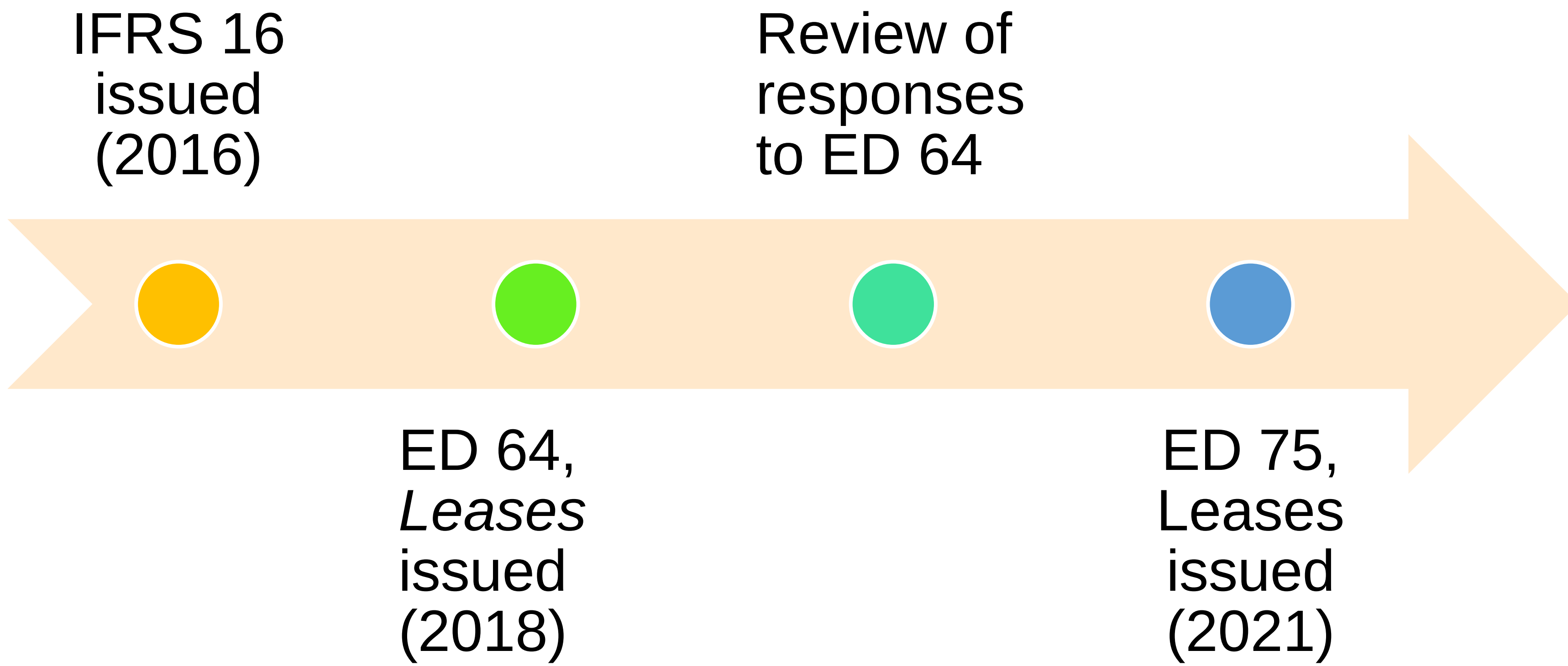
Project objective

- ED 75 proposes new requirements for lease accounting aligned to IFRS 16.
- IFRS 16 was issued by the IASB in January 2016 (replacing IAS 17).
- ED 75 will replace IPSAS 13, *Leases.*
- IPSASB requesting comment by **17 May**.

Responding to the IPSASB

- IPSASB proposals discussed locally to formulate a comment letter to the IPSASB
  - ASB comment deadline: **30 April**
- GRAP 13 is based on IPSAS 13. The Board will consider whether similar changes are necessary in GRAP 13 (policy decision).

History of the project



ED 64 - Overview

Lessee accounting

- Align to IFRS 16 “right-of-use” model.
- Majority of respondents supported the accounting.

Lessor accounting

- Depart from IFRS 16 “risk and rewards incidental to ownership” model and introduce “right-of-use” model for lessors.
- Respondents equally divided on whether departure is justified.

Concessionary lease accounting

- Introduce public sector specific requirements for leases at below market terms.
- Respondents agreed that guidance is necessary but expressed diverse views on the accounting.

Sale and leaseback

- Recognise right-of-use assets and related liabilities for all sale and leasebacks. Apply concessionary lease requirements where applicable.

Approach to the leases project

Phase One

- Deal with lease accounting model(s) for both lessees and lessors
- Issue an Exposure Draft i.e. ED 75
- IPSASB to consider responses
- Issue final IPSAS on Leases

To be finalised in first half of 2022

Phase Two

- Deal with public sector specific issues, such as concessionary leases and other types of "lease-like" arrangements.
- Issue a Request for Information
- IPSASB to consider responses
- Next steps to be determined

To be finalised in second half of 2023

PART A:

Exposure Draft 75

Overview of ED 75

Overview of ED 75

Lessee accounting

- Align to IFRS 16 “right-of-use” model.

Lessor accounting

- Align to IFRS 16 “risk and rewards incidental to ownership” model.
- Similar to IPSAS 13 accounting for lessors.
- Additional guidance and clarifications.

Sale and leaseback

- Recognise right-of-use assets and related lease liabilities for all sale and leasebacks.

Scope

Scope

ED 75 includes all leases EXCEPT

Leases for biological assets within the scope of IPSAS 27

Service concession arrangements within the scope of IPSAS 32

Licences of intellectual property granted by lessor within the scope of IPSAS 9

Leases to explore or use minerals, oil, natural gas etc

Rights held by lessee under licencing agreements within the scope of IPSAS 31

Lessee may elect to apply ED 75 for such rights.

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Recognition exemptions

- ED 75 proposes exemptions for short-term leases and low-value asset leases
  - These are accounted for as expenses on straight line basis over lease term or other systematic basis.
- IPSAS 13 does not have recognition exemptions.

Practical expedient

Short-term leases

- Lease term < 12 months
- Lease cannot include a purchase option
- Exemption applies to the class of underlying leased asset
- If lease term changes or lease is modified →the lease is a new lease

Low-value assets

- Low-value asset conditions:
  - Lessee benefits from use on its own or with other readily available resources; and
  - Asset is not highly dependent/interrelated with other assets.
- Assessment based on value of new asset (regardless of age).
- Applies regardless of item's materiality to lessee.
- E.g. cellphones, computers, furniture, tablets.

Combining contracts

- ED 75 proposes the combination of two or more contracts entered into at or near the same time with the same counterparty (or related parties of the counterparty).
- The contracts are accounted for as a single contract if one or more of the criteria are met.

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Criteria for combining contracts

The contracts are negotiated as a package with an overall commercial objective that cannot be understood without considering the contracts together;

The amount of consideration to be paid in one contract depends on the price or performance of the other contract; or

The rights to use underlying assets conveyed in the contracts (or some rights to use underlying assets conveyed in each of the contracts) form a single lease component.

Portfolio application

- ED 75 proposes the application of the requirements to a portfolio of leases with similar characteristics rather than individual leases.
- Portfolio accounting applies only if its effects on financial statements would not differ materially if the leases were accounted for individually.

Practical expedient

What is a lease?

Definition

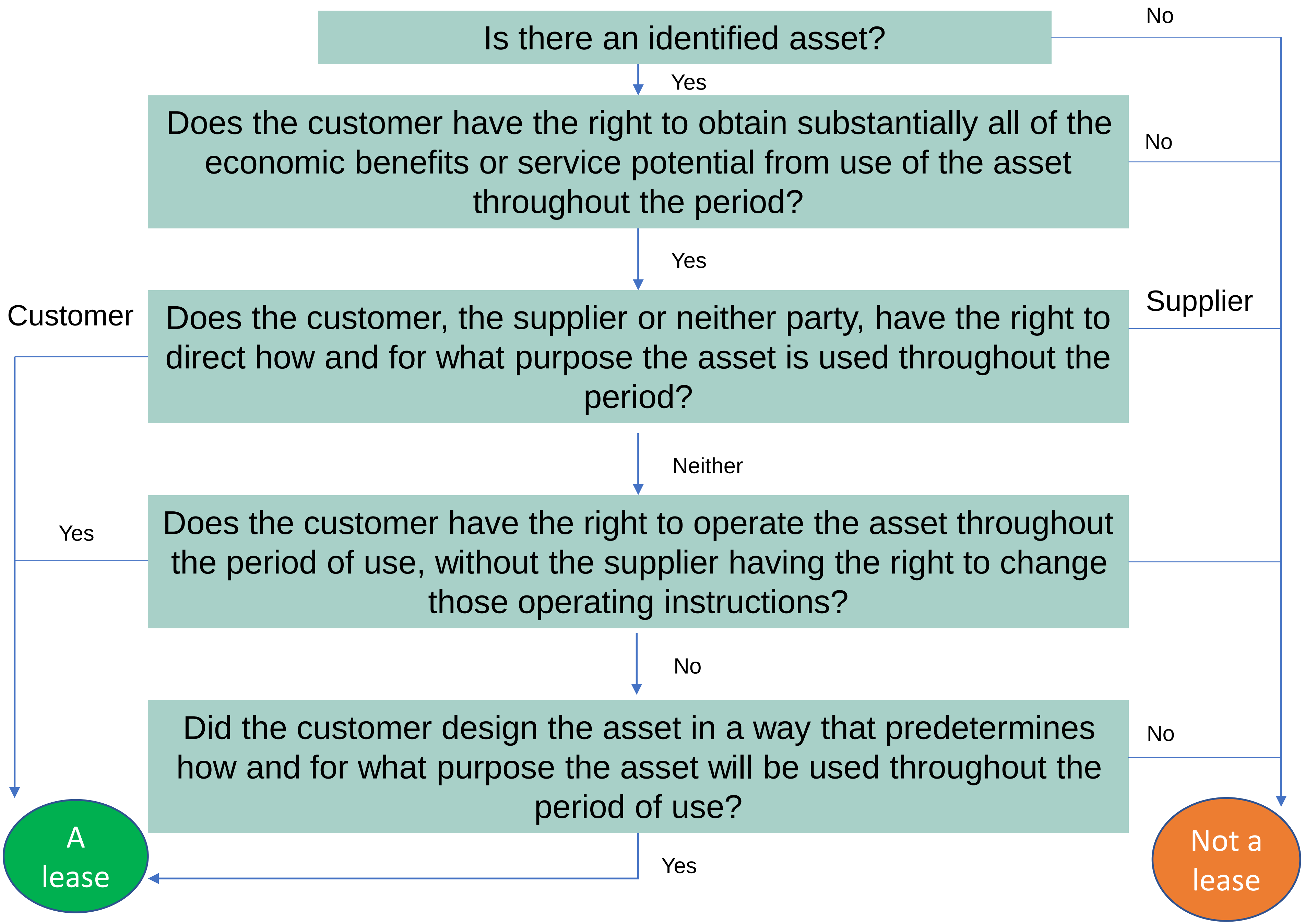
A lease is a contract, or part of contract that conveys the right to use an asset (the underlying assets) for a period of time in exchange for consideration.

Definition

- Definition of a lease is consistent with IPSAS 13.
- ED 75 proposes changes to the guidance on how to apply the definition.
  - These changes are based on the concept of control within the definition of a lease.

Identifying a lease

- ED 75 proposes guidance to help in determining whether a contract conveys the right to control the use of an identified asset over a period of time.
- An entity should assess whether, throughout the period of use, the customer has both of the following:
  - The right to obtain substantially all of the economic benefits or service potential from use of the identified asset; and
  - The right to direct the use of the identified asset.


Is there an identified asset?
No
Yes
Does the customer have the right to obtain substantially all of the economic benefits or service potential from use of the asset throughout the period?
No
Yes
Customer
Supplier
Does the customer, the supplier or neither party, have the right to direct how and for what purpose the asset is used throughout the period?
Neither
Yes
Does the customer have the right to operate the asset throughout the period of use, without the supplier having the right to change those operating instructions?
No
Did the customer design the asset in a way that predetermines how and for what purpose the asset will be used throughout the period of use?
No
Yes
A lease
Not a lease

Identified asset

- A contract may identify an asset explicitly or implicitly.
- An asset is **not identified** if supplier has a substantive right to substitute the asset throughout the period

1. Supplier has practical ability to substitute alternative asset;
AND
2. Supplier would benefit economically from the substitution.

Not substantive right if substituting due to repairs

Substantially all of eco benefits/service potential

- To control the identified asset, customer must have right to obtain substantially all of the economic benefits/service potential.
- Can be obtained directly or indirectly e.g.
  - exclusive use of asset; sub-leasing; primary and by-product cashflows.

IPSASB added reference to service potential so entities that use identified asset for service delivery don't conclude there is no lease.

Right to direct the use

- Customer can direct how and for what purpose the asset is used; OR
- Relevant decisions about how and for what purpose are predetermined, and:
  - Customer has right to operate the asset (or direct others); or
  - Customer has designed the asset in a way that predetermines how and for what purpose it will be used.

Components of a contract

Lease component

Allocate consideration based on relative stand-alone price of lease component

Non-lease component

Allocate consideration based on aggregate stand-alone price of non-lease component

Practical expedient

Lessees can account for both components without separating.

Period of time

Lease term =

Non-cancellable period + Periods covered by option to extend + Periods covered by option to terminate

Non-cancellable period		Periods covered by option to extend	Periods covered by option to terminate
Period for which lease is enforceable	Starts at commencement date and includes rent-free periods	Lessee reasonably certain to exercise option	Lessee reasonably certain not to exercise option

Lessee accounting

Lessee accounting

Accounting for the lease—General guidance			
Recognition		Right-of-use asset	Lease liability
Measurement	Initial	Lease liability	Present value of lease payments Interest rate implicit in lease or lessee's incremental borrowing rate
	Sub .	Cost or fair value	Amortized cost

Source: IPSASB

Initial measurement - lease liability

Lease payments

=

Fixed payments

(including in substance fixed payments)

less lease incentives receivable

+

Variable lease payments

+

Amounts expected to be payable by lessee under residual value guarantee

+

Exercise price of a purchase option

+

Payments of penalties for terminating lease

Initial measurement - asset

Cost of right-of-use asset

=

Amount of initial measurement of lease liability

+

Lease payments at/before commencement date

(less lease incentives received)

+

Initial direct costs incurred by lessee

+

Estimated costs to be incurred by lessee for dismantling and removal

Subsequent measurement

Carrying amount of lease liability

Increased to reflect interest on the lease liability

Decreased to reflect the lease payments made

Remeasured to reflect

- Reassessment (see next slides)
- Lease modification (see next slides)
- Revised in-substance fixed lease payments

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Reassessments

If there is a change in lease term or option to purchase asset

Determine revised lease payments and new discount rate

If there is a change in amount payable under a residual value guarantee or change in future lease payments due to change index or rate used to determine lease payments

Determine revised lease payment and use the same discount rate

Remeasure the lease liability and adjust the right-of-use asset.

If asset is reduced to zero – recognise remaining remeasurement amount to surplus or deficit

Modifications

Does the lease modification satisfy these two conditions:
1. increase the scope of the lease; and
2. consideration received for the lease increases by an amount commensurate with the stand alone price for the increase in scope?

Yes

Account for modification as a separate lease

Modifications

Does the lease modification satisfy these two conditions:
1. increase the scope of the lease; and
2. consideration received for the lease increases by an amount commensurate with the stand alone price for the increase in scope?

No

Modify the existing lease by
1. Allocating the consideration in the modified contract;
2. Determine the lease term of the modified contract; and
3. Remeasure the liability based on the revised lease payments and revised discount rate.

Reduction in scope:
Adjust right-of-use asset to reflect the partial/full termination. Recognise gain/loss in surplus or deficit

Increase in scope:
Adjust the right-of-use asset

Subsequent measurement

Cost model

- Measure at cost less accum. depreciation and impairment losses
- Depreciate over the shorter of the lease term or useful life; or
- Depreciate over useful life if lease transfers ownership or purchase option exercisable

Other models

- Apply fair value model in IPSAS 16 to all right-of-assets –if fair value model applied to other investment properties
- Elect to apply revaluation model in IPSAS 17 to all right-of-use assets in that class of assets

Lessor accounting

Main changes from IPSAS 13

- No substantial changes to lessor accounting compared to IPSAS 13.
- Lessor still classifies leases as either finance or operating.
- Classification depends on whether
  - substantially all of the risk and rewards incidental to ownership of the underlying asset have been transferred.

Main changes from IPSAS 13

Initial direct costs

- Defined to be consistent with the definition of incremental costs of obtaining a binding arrangement in ED 70 (i.e. equivalent of IFRS 15).

Fair value definition for lessors

- IPSASB decided that fair value should be the same as in IPSAS 13 and not an exit-price as per IFRS 13.
- The IASB followed a similar approach in IFRS 16.

Modifications – finance lease

The finance lease modification DOES satisfy these two conditions:
1. increase the scope of the lease; and
2. consideration received for the lease increases by an amount commensurate with the stand alone price for the increase in scope?

Account for modification as a separate lease

Modifications – finance lease

The finance lease modification DOES NOT satisfy these two conditions:
1. increase the scope of the lease; and
2. consideration received for the lease increases by an amount commensurate with the stand alone price for the increase in scope?

Assess lease classification as if the modification was effective from inception:

Operating lease

- Account for modification as a new operating lease.
- The carrying amount of the underlying asset that has to be recognised = net investment in the original lease before the lease modification.

Finance lease

- Account for the lease modification in accordance with IPSAS 41.

Modifications – operating lease

- Account for a modification to a operating lease as a new lease from the effective date of the modification by:
  - considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

Subleases

- IPSAS 13 classified a sublease with reference to the underlying asset.
- ED 75 proposes to classify subleases by intermediate lessors by reference to the right-of-use assets arising from the head lease.
- If the head lease is a short-term lease, the sublease is as an operating lease.

Subleases

Lessee in headlease	Right-of-use asset	Lease liability

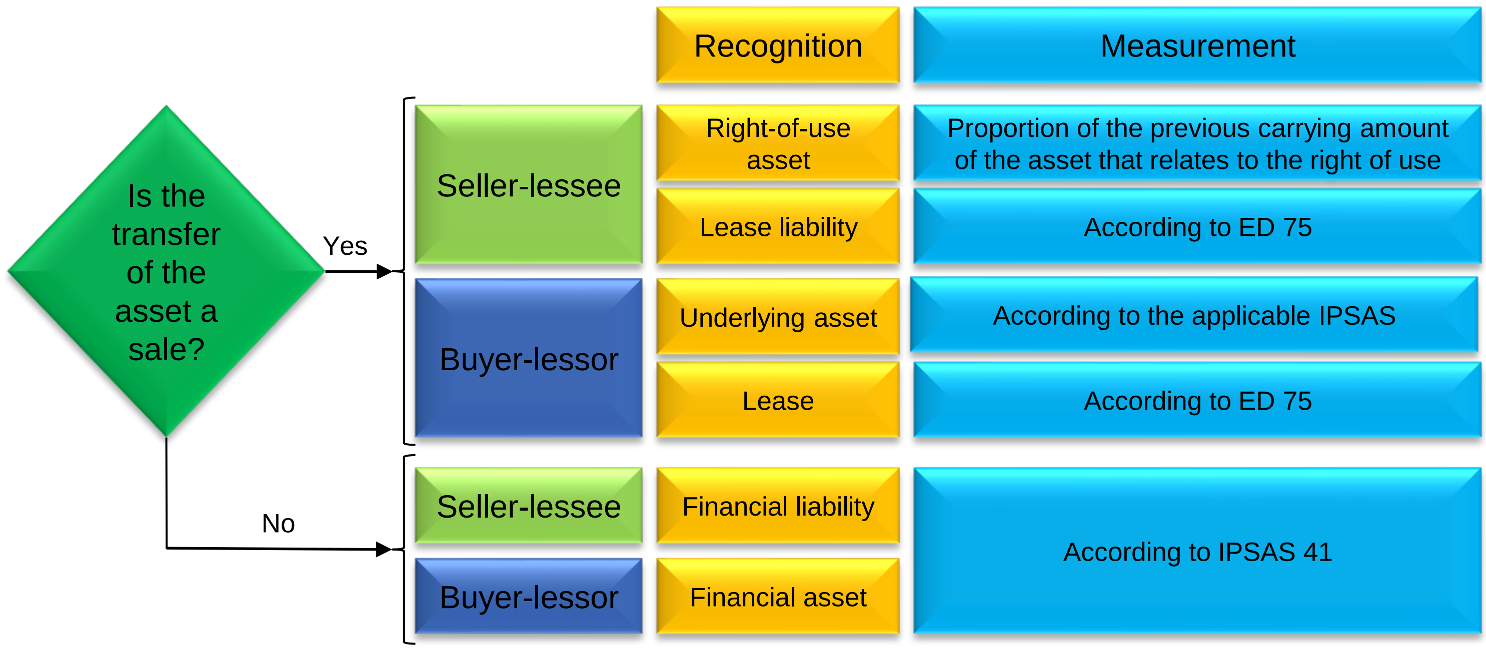
Intermediate lessor in sublease

Finance lease
- Derecognise the right-of-use asset transferred to sublessee
- Continue to recognise lease liability in headlease.
- Recognise a net investment in the sublease

Operating lease
- Continue to recognise the right-of-use asset and lease liability
- Recognise lease income

Sale and leaseback transactions

Sale and leaseback transactions



Source: IPSASB

Main changes from IPSAS 13

- The accounting in IPSAS 13 depended on whether the leaseback was classified as a finance or an operating lease.
- The determining factor in ED 75 is whether the transfer of the asset qualifies as a sale in accordance with ED 70 (equivalent of IFRS 15).
  - The assessment is made based on requirements for determining when a performance obligation is satisfied in ED 70.

Disclosures

Main changes from IPSAS 13

- ED 75 provides more extensive and enhanced disclosures to better evaluate the amount, timing and uncertainty of cash flows from a leasing activities.
- The objective of the disclosures is to provide users of AFS with a basis to assess the effect of leasing activities on the entity's financial position, performance and cash flows.
  - To achieve that objective, lessees and lessors disclose both qualitative and quantitative information.

Stakeholders’ feedback

Feedback from stakeholders

Stakeholders feedback on the specific matters for comment and/or general comments is requested for the roundtable discussions to be held in April/May.

Specific matters for comment

Specific matters for comment

Specific Matter for Comment 1:

The IPSASB decided to propose an IFRS 16-aligned Standard in ED 75 (see paragraphs BC21 - BC36).

Do you agree with how the IPSASB has modified IFRS 16 for the public sector (see paragraphs BC37 - BC60)? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

Specific matters for comment

Specific Matter for Comment 2:

The IPSASB decided to propose the retention of the fair value definition from IFRS 16 and IPSAS 13, Leases, which differs from the definition proposed in ED 77, Measurement[1] (see paragraphs BC43 - BC45).

Do you agree with the IPSASB's decision? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

Specific matters for comment

Specific Matter for Comment 3:

The IPSASB decided to propose to refer to both “economic benefits” and “service potential”, where appropriate, in the application guidance section of ED 75 on identifying a lease (see paragraphs BC46 - BC48).

Do you agree with the IPSASB’s decision? If not, please explain your reasons. If you agree, please provide any additional reasons not already discussed in the Basis for Conclusions.

PART B

Request for information (RFI)

Approach to the leases project

Phase One

- Deal with lease accounting model(s) for both lessees and lessors
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Outline

- Objective of the RFI
- Request for information

Objective of RFI

- Gather information on concessionary leases and other common arrangements similar to leases.
- Information required includes the nature/characteristics of the arrangements and if and how they are accounted for.

Objective of RFI

- Information will be used to determine the next steps in Phase Two.
- The IPSASB requests comment by **17 May**.

Request for information

- These arrangements are identified in the RFI on which feedback is requested:
    1. Concessionary leases
    2. Leases for zero or nominal consideration
    3. Access rights (or rights of access to property/land)
    4. Arrangements allowing right-of-use
    5. Social housing rental arrangements
    6. Shared properties with/without a lease arrangement in place

1. Concessionary leases

- A lease at below market terms implies the existence of a concession/subsidy in-kind in the lease.
- Concession/subsidy → difference between the market value of the right to use an asset and the consideration stipulated in the lease contract.

1. Concessionary leases

- Value of the right to use the assets comprises:
  - consideration stipulated in the lease contract;
  - Implicit value of the concession/subsidy.
- Example: *lease of office buildings to international aid organisations requiring presence in a specific location.*

2. Leases for zero or nominal consideration

- Similar to concessionary leases, however these arrangements are at zero or nominal consideration (e.g. R1).
- Difference with concessionary leases is that there is a zero or insignificant consideration.
- Thus the implicit value of the concession is almost 100% of the market value of the right to use asset.

2. Leases for zero or nominal consideration

- For example: *provision of office accommodation for free.*

3. Access rights

- These arrangements transfer access rights, rather than full rights to use an asset, in exchange for consideration.
- The lessee does not have control (as per ED 75) of the use of an identified asset, as it does not:
  - obtain substantially all of the economic benefits from use of the asset; and
  - direct the use of the asset throughout the period of use.
- For example: *access rights to land (i.e. servitudes)*.

4. Arrangements allowing right-of-use

- These types of arrangement allow a public sector entity to deliver services using properties by third parties (e.g. trust and non-government entities).
- Depending on the arrangement, the properties can/cannot be substituted for during period of use.
- Usually no specific written agreement for the arrangement.

5. Social housing rental arrangements

- Under such arrangements, the lessor usually has limited powers to terminate the rental. Other arrangements have no end term which means that there is no obligation to vacate the rented premises.
- It is not clear whether such arrangements meet the definition of a lease.
- For example: *accommodation for low income households, student accommodation and staff quarters.*

6. Shared properties with/without a lease arrangement

- These arrangements include sharing of property by entities to provide services (co-location).

- It is common for these arrangements not to be documented in a lease contract or for consideration not to be payable in the arrangement.

Responding to the RFI

- The IPSASB seeks feedback on these arrangements and other types of arrangements prevalent in our environment.
- Information should focus on:
  1. Nature and characteristics of the arrangements
  2. Accounting treatment and basis for the treatment for both parties in the arrangements

Stakeholders' feedback

Feedback from stakeholders

Stakeholders feedback on their experience with such arrangements is requested:

(a) Which arrangements are you aware of?

(b) Are there other arrangements or issues in practice?

(c) What accounting issues did you encounter with these arrangements?

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