Supporting Papers May 2018

Exposure Draft 64
January 2018
Comments due: June 30, 2018

Proposed International Public Sector Accounting Standard®

Leases

International Public Sector Accounting Standards Board®

This document was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective the IPSASB sets IPSAS™ and Recommended Practice Guidelines (RPGs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSAS relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSAS RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

The structures and processes that support the operations of the IPSASB are facilitated by the International Federation of Accountants® (IFAC®).

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REQUEST FOR COMMENTS

This Exposure Draft, *Leases*, was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by June 30, 2018.**

Respondents are asked to submit their comments electronically through the IPSASB website, using the "Submit a Comment" link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. This publication may be downloaded from the IPSASB website: www.ipsasb.org. The approved text is published in the English language.

Objective of the Exposure Draft

The objective of this Exposure Draft is to propose improvements to lease accounting in order to ensure that lessees and lessors provide relevant information in a manner that faithfully represents leasing transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity for accountability and decision-making purposes.

Guide for Respondents

The IPSASB would welcome comments on all of the matters discussed in this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

The Specific Matters for Comment requested for the Exposure Draft are provided below.

Specific Matter for Comment 1:

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

Specific Matter for Comment 2:

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

Specific Matter for Comment 3:

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

Specific Matter for Comment 4:

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

EXPOSURE DRAFT 64, LEASES

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Objective

1. **This [draft] Standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity for accountability and decision-making purposes.**

2. An entity shall consider the terms and conditions of contracts and all relevant facts and circumstances when applying this [draft] Standard. An entity shall apply this [draft] Standard consistently to contracts with similar characteristics and in similar circumstances.

Scope

3. An entity shall apply this [draft] Standard to all leases, including leases of right-of-use assets in a sublease, except for:

    (a) Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;

    (b) Leases of biological assets within the scope of IPSAS 27, *Agriculture*;

    (c) Service concession arrangements within the scope of IPSAS 32, *Service Concession Arrangements: Grantor*;

    (d) Licenses of intellectual property granted by a lessor within the scope of IPSAS 9, *Revenue from Exchange Transactions*; and

    (e) Rights held by a lessee under licensing agreements within the scope of IPSAS 31, *Intangible Assets* for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.

4. A lessee may, but is not required to, apply this [draft] Standard to leases of intangible assets other than those described in paragraph 3(e).

Definitions (see paragraph AG3)

5. **The following terms are used in this [draft] Standard with the meanings specified:**

    The <u>commencement date of the lease</u> (commencement date) is the date on which a lessor makes an underlying asset available for use by a lessee.

    A <u>concessionary lease</u> is a lease at below market terms.

    A <u>contract</u> is an agreement between two or more parties that creates enforceable rights and obligations.

    <u>Economic life</u> is either:

    (a) **The period over which an asset is expected to be economically usable by one or more users; or**

    (b) **The number of production or similar units expected to be obtained from an asset by one or more users.**

The effective date of the modification is the date when both parties agree to a lease modification.

Fixed payments are payments made by a lessee to a lessor for the right to use an underlying asset during the lease term, excluding variable lease payments.

The inception date of the lease (inception date) is the earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease.

Initial direct costs are incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained.

The interest rate implicit in the lease is the rate of interest that causes the present value of (a) the lease payments and (b) the unguaranteed residual value to equal the sum of (i) the fair value of the underlying asset and (ii) any initial direct costs of the lessor.

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

Lease incentives are payments made by a lessor to a lessee associated with a lease, or the reimbursement or assumption by a lessor of costs of a lessee.

Lease modification is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).

Lease payments are payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:

(a) **Fixed payments (including in-substance fixed payments), less any lease incentives;**

(b) **Variable lease payments that depend on an index or a rate;**

(c) **The exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and**

(d) **Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.**

For the lessee, lease payments also include amounts expected to be payable by the lessee under residual value guarantees. Lease payments do not include payments allocated to non-lease components of a contract, unless the lessee elects to combine non-lease components with a lease component and to account for them as a single lease component.

For the lessor, lease payments also include any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee. Lease payments do not include payments allocated to non-lease components.

The lease term is the non-cancellable period for which a lessee has the right to use an underlying asset, together with both:

(a) **Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and**

(b) **Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.**

A lessee is an entity that obtains the right to use an underlying asset for a period of time in exchange for consideration.

The lessee's incremental borrowing rate is the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

A lessor is an entity that provides the right to use an underlying asset for a period of time in exchange for consideration.

Optional lease payments are payments to be made by a lessee to a lessor for the right to use an underlying asset during periods covered by an option to extend or terminate a lease that are not included in the lease term.

Period of use is the total period of time that an asset is used to fulfil a contract with a customer (including any non-consecutive periods of time).

The residual value guarantee is a guarantee made to a lessor by a party unrelated to the lessor that the value (or part of the value) of an underlying asset at the end of a lease will be at least a specified amount.

A right-of-use asset is an asset that represents a lessee's right to use an underlying asset for the lease term.

A short-term lease is a lease that, at the commencement date, has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease.

A sublease is a transaction for which an underlying asset is re-leased by a lessee ('intermediate lessor') to a third party, and the lease ('head lease') between the head lessor and lessee remains in effect.

Underlying asset is an asset that is the subject of a lease, for which the right to use that asset has been provided by a lessor to a lessee.

Unguaranteed residual value is that portion of the residual value of the underlying asset, the realization of which by a lessor is not assured or is guaranteed solely by a party related to the lessor.

Variable lease payments are the portion of payments made by a lessee to a lessor for the right to use an underlying asset during the lease term that varies because of changes in facts or circumstances occurring after the commencement date, other than the passage of time.

Terms defined in other IPSASs are used in this [draft] Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately. The defined term useful life is used in this [draft] Standard with the meaning as in IPSAS 17, *Property, Plant, and Equipment*.

Identifying a Lease (see paragraphs AG4–AG28 and AG58–AG61)

6. **At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an**

identified asset for a period of time in exchange for consideration. Paragraphs AG4–AG26 set out guidance on the assessment of whether a contract is, or contains, a lease.

7. A period of time may be described in terms of the amount of use of an identified asset (for example, the number of production units that an item of equipment will be used to produce).

8. An entity shall reassess whether a contract is, or contains, a lease only if the terms and conditions of the contract are changed.

Separating Components of a Contract

9. For a contract that is, or contains, a lease, an entity shall account for each lease component within the contract as a lease separately from non-lease components of the contract, unless the entity applies the practical expedient in paragraph 13. Paragraphs AG27–AG28 set out guidance on separating components of a contract.

Lessor

10. For a contract that contains a lease component and one or more additional lease or non-lease components, a lessor shall allocate the consideration in the contract applying IPSAS 9.

Lessee

11. For a contract that contains a lease component and one or more additional lease or non-lease components, a lessee shall allocate the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components.

12. The relative stand-alone price of lease and non-lease components shall be determined on the basis of the price the lessor, or a similar supplier, would charge an entity for that component, or a similar component, separately. If an observable stand-alone price is not readily available, the lessee shall estimate the stand-alone price, maximizing the use of observable information.

13. As a practical expedient, a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component. A lessee shall not apply this practical expedient to embedded derivatives that meet the criteria in paragraph 12 of IPSAS 29, *Financial Instruments: Recognition and Measurement*.

14. Unless the practical expedient in paragraph 13 is applied, a lessee shall account for non-lease components applying other applicable Standards.

Assessing Whether the Lease is at Market Terms or at Below Market Terms

15. A lessor and a lessee will determine whether the lease is at market terms or at below market terms. In certain circumstances, such as when a lessor transfers the right to use an underlying asset to the lessee that is at market terms, the lease is an exchange transaction. In other circumstances, such as when a lessor transfers the right to use an underlying asset to the lessee that is at below market terms, the lease is a concessionary lease. In these cases, the lease can have exchange and non-exchange components. In determining whether a lease has identifiable exchange or non-exchange components, professional judgment is exercised. Where it is not possible to distinguish separate

exchange and non-exchange components (for example, leases for zero consideration) or the consideration is only of nominal amount, the lease is treated as a non-exchange transaction.

Lease Term (see paragraphs AG29–AG37)

16. An entity shall determine the lease term as the non-cancellable period of a lease, together with both:

    (a) Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and

    (b) Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

17. In assessing whether a lessee is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease, an entity shall consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise the option to extend the lease, or not to exercise the option to terminate the lease, as described in paragraphs AG32–AG35.

18. A lessee shall reassess whether it is reasonably certain to exercise an extension option, or not to exercise a termination option, upon the occurrence of either a significant event or a significant change in circumstances that:

    (a) Is within the control of the lessee; and

    (b) Affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term (as described in paragraph AG36).

19. An entity shall revise the lease term if there is a change in the non-cancellable period of a lease. For example, the non-cancellable period of a lease will change if:

    (a) The lessee exercises an option not previously included in the entity’s determination of the lease term;

    (b) The lessee does not exercise an option previously included in the entity’s determination of the lease term;

    (c) An event occurs that contractually obliges the lessee to exercise an option not previously included in the entity’s determination of the lease term; or

    (d) An event occurs that contractually prohibits the lessee from exercising an option previously included in the entity’s determination of the lease term.

Lessor

Lessor: Accounting for the Underlying Asset

Lessor: Recognition

20. **At the commencement date, a lessor shall not derecognize the existing underlying asset.**

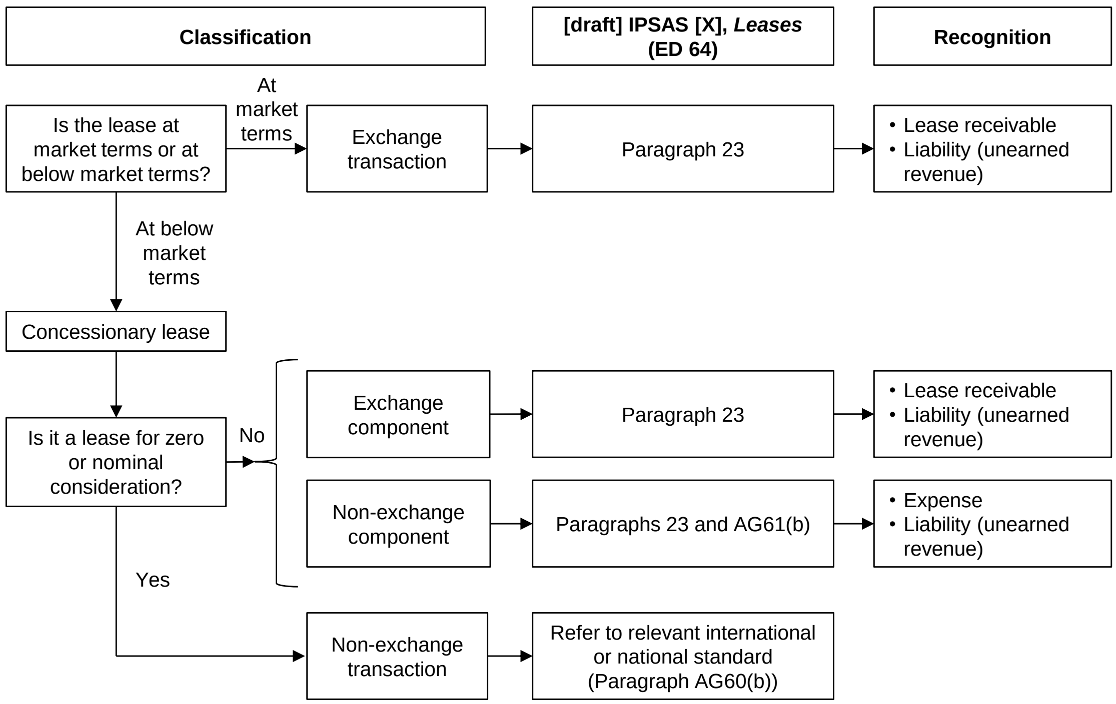
Lessor: Measurement

21. **At and after the commencement date, a lessor shall measure the underlying asset in accordance with IPSAS 16, *Investment Property*, IPSAS 17 or IPSAS 31, as appropriate.**

Lessor: Accounting for the Lease

22. Paragraph 15 of this [draft] Standard requires a lessor to determine whether the lease is at market terms or at below market terms. The flowchart below illustrates the analytic process a lessor undertakes to classify and recognize leases at market terms or at below market terms.

Illustration of Classification and Recognition of Leases at Market Terms and at Below Market Terms for Lessors[1]



Lessor: Recognition

23. **At the commencement date, a lessor shall recognize a lease receivable and a liability (unearned revenue).**

Lessor: Recognition Exemption

24. A lessor may elect not to apply the requirements in paragraphs 23 and 27–50 to short-term leases.

25. If a lessor elects not to apply the requirements in paragraphs 23 and 27–50 to short-term leases, the lessor shall recognize the lease payments associated with those leases as revenue on either a straight-line basis over the lease term or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern of the lessor's benefit.

26. If a lessor accounts for short-term leases applying paragraph 25, the lessor shall consider the lease to be a new lease for the purposes of this [draft] Standard if:

    (a) There is a lease modification; or

[1] The flowchart is illustrative only; it does not take the place of this [draft] Standard. It is provided as an aid to interpreting this [draft] Standard.

(b) There is any change in the lease term (for example, the lessee exercises an option not previously included in its determination of the lease term).

Lessor: Measurement

Lessor: Initial Measurement (see paragraphs AG58–AG61)

Lessor: Initial Measurement of the Lease Receivable

27. **At the commencement date, a lessor shall measure the lease receivable at the present value of the lease payments that are not received at that date. The lease payments shall be discounted using the interest rate implicit in the lease. In the case of a sublease, if the interest rate implicit in the sublease cannot be readily determined, an intermediate lessor may use the discount rate used for the head lease to measure the lease receivable.**

28. At the commencement date, the lease payments included in the measurement of the lease receivable comprise the following payments for the right to use the underlying asset during the lease term that are not received at the commencement date:

    (a) Fixed payments (including in-substance fixed payments as described in paragraph AG38), less any lease incentives receivable;

    (b) Variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;

    (c) Any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee;

    (d) The exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in paragraphs AG32); and

    (e) Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

29. **Where a lease receivable is recognized in relation to a concessionary lease, its cost shall be measured at its fair value as at the commencement date. The fair value of the lease receivable is measured by discounting the contractual lease payments at market interest rates.**

Lessor: Initial Measurement of the Liability (Unearned Revenue) (see paragraph AG39)

30. **At the commencement date, a lessor shall measure the liability (unearned revenue) at the initial value of the lease receivable, plus the amount of any lease payments received at or before the commencement date of the lease that relate to future periods (for example, the final month's rent).**

31. Initial direct costs are deducted from the initial measurement of the liability (unearned revenue) and reduce the amount of revenue recognized over the lease term.

32. **At the commencement date, a lessor shall measure the liability (unearned revenue) recognized through a concessionary lease at fair value. The fair value of the liability (unearned revenue) is measured by reference to the fair value of the right-of-use asset transferred to the lessee. The fair value of the right-of-use asset transferred to the lessee shall be measured by**

discounting market lease payments using a market interest rate. If applicable, the fair value of the liability (unearned revenue) shall also include initial direct costs.

Lessor: Subsequent Measurement

Lessor: Subsequent Measurement of the Lease Receivable

33. **After the commencement date, a lessor shall measure the lease receivable by:**
    (a) **Increasing the carrying amount to reflect interest on the lease receivable;**
    (b) **Reducing the carrying amount to reflect the lease payments received; and**
    (c) **Remeasuring the carrying amount to reflect any reassessment or lease modifications specified in paragraphs 38–42 and 45–47, or to reflect revised in-substance fixed lease payments (see paragraph AG38).**
34. Interest on the lease receivable in each period during the lease term shall be the amount that produces a constant periodic rate of interest on the remaining balance of the lease receivable. The periodic rate of interest is the discount rate described in paragraph 27, or if applicable the revised discount rate described in paragraph 40, paragraph 42 or paragraph 46(c).
35. The periodic rate of interest in a concessionary lease is the discount rate described in paragraph 29, or if applicable the revised discount rate at the moment of reassessment of the lease liability and lease modifications.
36. After the commencement date, a lessor shall recognize in surplus or deficit both:
    (a) Interest on the lease receivable; and
    (b) Variable lease payments not included in the measurement of the lease receivable in the period in which the event or condition that triggers those payments occurs.
37. After the commencement date, a lessor shall apply the derecognition and impairment requirements in IPSAS 29 to the lease receivable.

Lessor: Reassessment of the Lease Receivable

38. After the commencement date, a lessor shall apply paragraphs 39–42 to remeasure the lease receivable to reflect changes to the lease payments. A lessor shall recognize the amount of the remeasurement of the lease receivable as an adjustment to the liability (unearned revenue). However, if the carrying amount of the liability (unearned revenue) is reduced to zero and there is a further reduction in the measurement of the lease receivable, a lessor shall recognize any remaining amount of the remeasurement in surplus or deficit.
39. A lessor shall remeasure the lease receivable by discounting the revised lease payments using a revised discount rate, if either:
    (a) There is a change in the lease term, as described in paragraph 19. A lessor shall determine the revised lease payments on the basis of the revised lease term; or
    (b) There is a change in the assessment of an option to purchase the underlying asset, assessed considering the events and circumstances described in paragraph 19 in the context of a purchase option. A lessor shall determine the revised lease payments to reflect the change in amounts payable under the purchase option.

40. In applying paragraph 39, a lessor shall determine the revised discount rate as the interest rate implicit in the lease for the remainder of the lease term. In the case of a concessionary lease, a lessor shall apply the discount rate identified in paragraph 29.

41. A lessor shall remeasure the lease receivable by discounting the revised lease payments, if either:

    (a) There is a change in the amounts expected to be payable under a residual value guarantee. A lessor shall determine the revised lease payments to reflect the change in amounts expected to be payable under the residual value guarantee.

    (b) There is a change in future lease payments resulting from a change in an index or a rate used to determine those payments, including for example a change to reflect changes in market rental rates following a market rent review. The lessor shall remeasure the lease receivable to reflect those revised lease payments only when there is a change in the cash flows (i.e., when the adjustment to the lease payments takes effect). A lessor shall determine the revised lease payments for the remainder of the lease term based on the revised contractual payments.

42. In applying paragraph 41, a lessor shall use an unchanged discount rate, unless the change in lease payments results from a change in floating interest rates. In that case, the lessor shall use a revised discount rate that reflects changes in the interest rate.

Lessor: Subsequent Measurement of the Liability (Unearned Revenue) (see paragraph AG39)

43. **After the commencement date, a lessor shall recognize revenue according to the substance of the lease contract, and the liability (unearned revenue) is reduced as revenue is recognized in the statement of financial performance.**

44. A lessor shall adjust the liability (unearned revenue) by the same amount as the change resulting from the remeasurement of the lease receivable.

Lessor: Lease Modifications

45. A lessor shall account for a lease modification as a separate lease if both:

    (a) The modification increases the scope of the lease by adding the right to use one or more underlying assets; and

    (b) The consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.

46. For a lease modification that is not accounted for as a separate lease, at the effective date of the lease modification a lessor shall:

    (a) Allocate the consideration in the modified contract applying paragraph 10;

    (b) Determine the lease term of the modified lease applying paragraphs 16–17; and

    (c) Remeasure the lease receivable by discounting the revised lease payments using a revised discount rate. The revised discount rate is determined as the interest rate implicit in the lease for the remainder of the lease term.

47. For a lease modification that is not accounted for as a separate lease, the lessor shall account for the remeasurement of the lease receivable by:

(a) Decreasing the carrying amount of the liability (unearned revenue) to reflect the partial or full termination of the lease for lease modifications that decrease the scope of the lease. The lessor shall recognize in surplus or deficit any gain or loss relating to the partial or full termination of the lease.

(b) Making a corresponding adjustment to the liability (unearned revenue) for all other lease modifications.

Lessor: Presentation

Lessor: Display

48. A lessor shall continue to display underlying assets subject to leases in its statement of financial position according to the nature of the underlying asset, according to the relevant IPSAS.

49. A lessor shall either display in the statement of financial position, or disclose in the notes:

(a) Lease receivables separately from other assets. If the lessor does not display lease receivables separately in the statement of financial position, the lessor shall disclose which line items in the statement of financial position include those assets.

(b) Liabilities (unearned revenue) separately from other liabilities. If a lessor does not display liabilities (unearned revenue) separately from other liabilities, the lessor shall disclose which line items in the statement of financial position include those liabilities.

50. In the statement of financial performance, a lessor shall display interest revenue on the lease receivable as revenue according to paragraph 102(a) of IPSAS 1, *Presentation of Financial Statements*.

51. In the cash flow statement, a lessor shall classify:

(a) Cash receipts for the principal portion of the lease receivable within operating activities;

(b) Cash receipts for the interest portion of the lease receivable applying the requirements in IPSAS 2, *Cash Flow Statements* for interest received; and

(c) Short-term lease payments and variable lease payments not included in the measurement of the lease receivable within operating activities.

Lessor: Note Disclosure

52. **The objective of the note disclosure is for lessors to disclose information in the notes that, together with the information provided in the statement of financial position, statement of financial performance and cash flow statement, gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessor. Paragraphs 54–61 specify requirements on how to meet this objective.**

53. A lessor shall disclose information about its leases for which it is a lessor in a single note or separate section in its financial statements. However, a lessor need not duplicate information that is already presented elsewhere in the financial statements, provided that the information is incorporated by cross-reference in the single note or separate section about leases.

54. A lessor shall disclose the following amounts for the reporting period:

(a) Lease revenue, separately disclosing income relating to variable lease payments that do not depend on an index or a rate.

(b) Interest revenue on lease receivables;

(c) Revenue relating to variable lease payments not included in the measurement of the lease receivable;

(d) The revenue relating to short-term leases accounted for applying paragraph 25. This revenue need not include the revenue relating to leases with a lease term of one month or less; and

(e) Total cash inflow for leases.

55. A lessor shall provide the disclosures specified in paragraph 54 in a tabular format, unless another format is more appropriate.

56. A lessor shall disclose additional qualitative and quantitative information about its leasing activities necessary to meet the disclosure objective in paragraph 52. This additional information includes, but is not limited to, information that helps users of financial statements to assess:

(a) The nature of the lessor's leasing activities;

(b) How the lessor manages the risk associated with any rights it retains in underlying assets. In particular, a lessor shall disclose its risk management strategy for the rights it retains in underlying assets, including any means by which the lessor reduces that risk. Such means may include, for example, buy-back agreements, residual value guarantees or variable lease payments for use in excess of specified limits; and

(c) The purpose and terms of the various types of leases.

57. A lessor shall provide a qualitative and quantitative explanation of the significant changes in the carrying amount of the lease receivable.

58. A lessor shall disclose a maturity analysis of the lease payments receivable, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years.

59. For items of property, plant and equipment subject to a lease, a lessor shall apply the disclosure requirements of IPSAS 17. In applying the disclosure requirements in IPSAS 17, a lessor shall disaggregate each class of property, plant and equipment into assets subject to leases and assets not subject to leases. Accordingly, a lessor shall provide the disclosures required by IPSAS 17 for assets subject to a lease (by class of underlying asset) separately from owned assets held and used by the lessor.

60. A lessor shall apply the disclosure requirements in IPSAS 16, IPSAS 21, *Impairment of Non-Cash Generating Assets*, IPSAS 26, *Impairment of Cash Generating Assets*, IPSAS 27, and IPSAS 31 for assets subject to leases.

Lessor: Concessionary Leases

61. For concessionary leases granted, a lessor shall also disclose:

(a) The subsidy recognized as an expense at initial recognition;

(b) The subsidy recognized as liability (unearned revenue) and as lease revenue in the period;

(c) Leases repaid during the period;

(d) Impairment losses recognized related to the lease receivable;

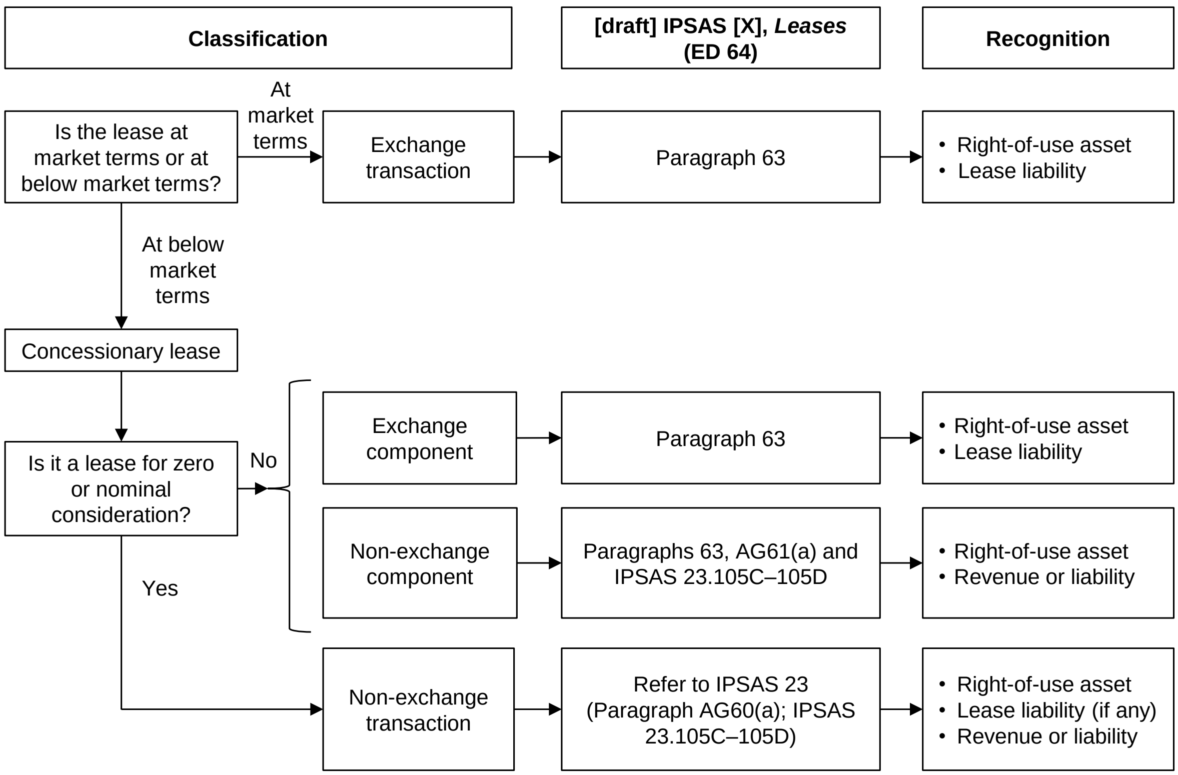
(e) Other changes; and

(f) Valuation assumptions.

Lessee

62. Paragraph 15 of this [draft] Standard requires a lessee to determine whether the lease is at market terms or at below market terms. The flowchart below illustrates the analytic process a lessee undertakes to classify and recognize leases at market terms or at below market terms.

Illustration of Classification and Recognition of Leases at Market Terms and at Below Market Terms for Lessees[2]



Lessee: Recognition

63. **At the commencement date, a lessee shall recognize a right-of-use asset and a lease liability.**

Lessee: Recognition Exemptions (see paragraphs AG40–AG45)

64. A lessee may elect not to apply the requirements in paragraphs 63 and 68–100 to:

(a) Short-term leases; and

(b) Leases for which the underlying asset is of low value (as described in paragraphs AG40–AG45).

[2] The flowchart is illustrative only; it does not take the place of this [draft] Standard. It is provided as an aid to interpreting this [draft] Standard.

65. If a lessee elects not to apply the requirements in paragraphs 63 and 68–100 to either short-term leases or leases for which the underlying asset is of low value, the lessee shall recognize the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis. The lessee shall apply another systematic basis if that basis is more representative of the pattern of the lessee's benefit.

66. If a lessee accounts for short-term leases applying paragraph 65, the lessee shall consider the lease to be a new lease for the purposes of this [draft] Standard if:

(a) There is a lease modification; or

(b) There is any change in the lease term (for example, the lessee exercises an option not previously included in its determination of the lease term).

67. The election for short-term leases shall be made by class of underlying asset to which the right of use relates. A class of underlying asset is a grouping of underlying assets of a similar nature and use in an entity's operations. The election for leases for which the underlying asset is of low value can be made on a lease-by-lease basis.

Lessee: Measurement

Lessee: Initial Measurement (see paragraphs AG58–AG61)

Lessee: Initial Measurement of the Right-of-Use Asset

68. **At the commencement date, a lessee shall measure the right-of-use asset at cost.**

69. The cost of the right-of-use asset shall comprise:

(a) The amount of the initial measurement of the lease liability, as described in paragraph 75;

(b) Any lease payments made at or before the commencement date, less any lease incentives received;

(c) Any initial direct costs incurred by the lessee; and

(d) An estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period.

70. A lessee shall recognize the costs described in paragraph 69(d) as part of the cost of the right-of-use asset when it incurs an obligation for those costs. A lessee applies IPSAS 12, *Inventories* to costs that are incurred during a particular period as a consequence of having used the right-of-use asset to produce inventories during that period. The obligations for such costs accounted for applying this [draft] Standard or IPSAS 12 are recognized and measured applying IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.

71. **Where a right-of-use asset is acquired through a concessionary lease, its cost shall be measured at its fair value as at the commencement date.**

72. A right-of-use asset may be acquired through a non-exchange transaction. For example, property may be leased by a public sector entity at below fair value to implement a public policy. Under these circumstances, the cost of the right-of-use asset is its fair value as at the commencement date.

73. The fair value of the right-of-use asset shall be measured at the present value of market lease payments. The market lease payments shall be discounted using the interest rates identified in paragraph 78. The fair value of the right-of-use asset shall also include the items identified in paragraphs 69(c) and 69(d).

74. Where the lessee initially recognizes the right-of-use asset at fair value, in accordance with paragraph 71, the fair value is the cost of the right-of-use asset. The lessee shall decide, subsequent to initial recognition, to adopt either the cost model (paragraphs 80–83), the fair value model (paragraph 84), or the revaluation model (paragraph 85).

Lessee: Initial Measurement of the Lease Liability

75. **At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.**

76. At the commencement date, the lease payments included in the measurement of the lease liability comprise the following payments for the right to use the underlying asset during the lease term that are not paid at the commencement date:

    (a) Fixed payments (including in-substance fixed payments as described in paragraph AG38), less any lease incentives receivable;

    (b) Variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date (as described in paragraph 77);

    (c) Amounts expected to be payable by the lessee under residual value guarantees;

    (d) The exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in paragraphs AG32–AG35); and

    (e) Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

77. Variable lease payments that depend on an index or a rate described in paragraph 76(b) include, for example, payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates.

78. **Where a lease liability is recognized through a concessionary lease, its cost shall be measured at its fair value as at the commencement date. The fair value of the lease liability is measured by discounting the contractual lease payments using the lessee's incremental borrowing rate, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use market interest rates.**

Lessee: Subsequent Measurement

Lessee: Subsequent Measurement of the Right-of-Use Asset

79. **After the commencement date, a lessee shall measure the right-of-use asset applying a cost model, unless it applies either of the measurement models described in paragraphs 84 and 85.**

Lessee: Cost Model

80. To apply a cost model, a lessee shall measure the right-of-use asset at cost:

    (a) Less any accumulated depreciation and any accumulated impairment losses; and

    (b) Adjusted for any remeasurement of the lease liability specified in paragraph 86(c).

81. A lessee shall apply the depreciation requirements in IPSAS 17 in depreciating the right-of-use asset, subject to the requirements in paragraph 82.

82. If the lease transfers ownership of the underlying asset to the lessee by the end of the lease term or if the cost of the right-of-use asset reflects that the lessee will exercise a purchase option, the lessee shall depreciate the right-of-use asset from the commencement date to the end of the useful life of the underlying asset. Otherwise, the lessee shall depreciate the right-of-use asset from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term.

83. A lessee shall apply IPSAS 21 or IPSAS 26, as appropriate, to determine whether the right-of-use asset is impaired and to account for any impairment loss identified.

Lessee: Other Measurement Models

84. If a lessee applies the fair value model in IPSAS 16 to its investment property, the lessee shall also apply that fair value model to right-of-use assets that meet the definition of investment property in IPSAS 16.

85. If right-of-use assets relate to a class of property, plant and equipment to which the lessee applies the revaluation model in IPSAS 17, a lessee may elect to apply that revaluation model to all of the right-of-use assets that relate to that class of property, plant and equipment.

Lessee: Subsequent Measurement of the Lease Liability

86. **After the commencement date, a lessee shall measure the lease liability by:**

    (a) **Increasing the carrying amount to reflect interest on the lease liability;**

    (b) **Reducing the carrying amount to reflect the lease payments made; and**

    (c) **Remeasuring the carrying amount to reflect any reassessment or lease modifications specified in paragraphs 90–97, or to reflect revised in-substance fixed lease payments (see paragraph AG38).**

87. Interest on the lease liability in each period during the lease term shall be the amount that produces a constant periodic rate of interest on the remaining balance of the lease liability. The periodic rate of interest is the discount rate described in paragraph 75, or if applicable the revised discount rate described in paragraph 92, paragraph 94 or paragraph 96(c).

88. The periodic rate of interest in a concessionary lease is the discount rate described in paragraph 78, or if applicable the revised discount rate at the moment of reassessment of the lease liability and lease modifications.

89. After the commencement date, a lessee shall recognize in surplus or deficit, unless the costs are included in the carrying amount of another asset applying other applicable Standards, both:

    (a) Interest on the lease liability; and

(b) Variable lease payments not included in the measurement of the lease liability in the period in which the event or condition that triggers those payments occurs.

Lessee: Reassessment of the Lease Liability

90. After the commencement date, a lessee shall apply paragraphs 91–94 to remeasure the lease liability to reflect changes to the lease payments. A lessee shall recognize the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset. However, if the carrying amount of the right-of-use asset is reduced to zero and there is a further reduction in the measurement of the lease liability, a lessee shall recognize any remaining amount of the remeasurement in surplus or deficit.

91. A lessee shall remeasure the lease liability by discounting the revised lease payments using a revised discount rate, if either:

(a) There is a change in the lease term, as described in paragraphs 18–19. A lessee shall determine the revised lease payments on the basis of the revised lease term; or

(b) There is a change in the assessment of an option to purchase the underlying asset, assessed considering the events and circumstances described in paragraphs 18–19 in the context of a purchase option. A lessee shall determine the revised lease payments to reflect the change in amounts payable under the purchase option.

92. In applying paragraph 91, a lessee shall determine the revised discount rate as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the date of reassessment, if the interest rate implicit in the lease cannot be readily determined. In the case of a concessionary lease, a lessee shall apply the discount rate identified in paragraph 78.

93. A lessee shall remeasure the lease liability by discounting the revised lease payments, if either:

(a) There is a change in the amounts expected to be payable under a residual value guarantee. A lessee shall determine the revised lease payments to reflect the change in amounts expected to be payable under the residual value guarantee.

(b) There is a change in future lease payments resulting from a change in an index or a rate used to determine those payments, including for example a change to reflect changes in market rental rates following a market rent review. The lessee shall remeasure the lease liability to reflect those revised lease payments only when there is a change in the cash flows (i.e., when the adjustment to the lease payments takes effect). A lessee shall determine the revised lease payments for the remainder of the lease term based on the revised contractual payments.

94. In applying paragraph 93, a lessee shall use an unchanged discount rate, unless the change in lease payments results from a change in floating interest rates. In that case, the lessee shall use a revised discount rate that reflects changes in the interest rate.

Lessee: Lease Modifications

95. A lessee shall account for a lease modification as a separate lease if both:

(a) The modification increases the scope of the lease by adding the right to use one or more underlying assets; and

(b) The consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.

96. For a lease modification that is not accounted for as a separate lease, at the effective date of the lease modification a lessee shall:

(a) Allocate the consideration in the modified contract applying paragraphs 11–14;

(b) Determine the lease term of the modified lease applying paragraphs 16–17; and

(c) Remeasure the lease liability by discounting the revised lease payments using a revised discount rate. The revised discount rate is determined as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the effective date of the modification, if the interest rate implicit in the lease cannot be readily determined.

97. For a lease modification that is not accounted for as a separate lease, the lessee shall account for the remeasurement of the lease liability by:

(a) Decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease for lease modifications that decrease the scope of the lease. The lessee shall recognize in surplus or deficit any gain or loss relating to the partial or full termination of the lease.

(b) Making a corresponding adjustment to the right-of-use asset for all other lease modifications.

Lessee: Presentation

Lessee: Display

98. A lessee shall either display in the statement of financial position, or disclose in the notes:

(a) Right-of-use assets separately from other assets. If a lessee does not display right-of-use assets separately in the statement of financial position, the lessee shall:

(i) Include right-of-use assets within the same line item as that within which the corresponding underlying assets would be presented if they were owned; and

(ii) Disclose which line items in the statement of financial position include those right-of-use assets.

(b) Lease liabilities separately from other liabilities. If the lessee does not display lease liabilities separately in the statement of financial position, the lessee shall disclose which line items in the statement of financial position include those liabilities.

99. The requirement in paragraph 98(a) does not apply to right-of-use assets that meet the definition of investment property, which shall be presented in the statement of financial position as investment property.

100. In the statement of financial performance, a lessee shall present interest expense on the lease liability separately from the depreciation charge for the right-of-use asset. Interest expense on the lease liability is a component of finance costs, which paragraph 102(b) of IPSAS 1 requires to be presented separately in the statement of financial performance.

101. In the cash flow statement, a lessee shall classify:

(a) Cash payments for the principal portion of the lease liability within financing activities;

(b) Cash payments for the interest portion of the lease liability applying the requirements in IPSAS 2, *Cash Flow Statements* for interest paid; and

(c) Short-term lease payments, payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability within operating activities.

Lessee: Note Disclosure

102. **The objective of the note disclosures is for lessees to disclose information in the notes that, together with the information provided in the statement of financial position, statement of financial performance and cash flow statement, gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessee. Paragraphs 103–112 specify requirements on how to meet this objective.**

103. A lessee shall disclose information about its leases for which it is a lessee in a single note or separate section in its financial statements. However, a lessee need not duplicate information that is already presented elsewhere in the financial statements, provided that the information is incorporated by cross-reference in the single note or separate section about leases.

104. A lessee shall disclose the following amounts for the reporting period:

(a) Depreciation charge for right-of-use assets by class of underlying asset;

(b) Interest expense on lease liabilities;

(c) The expense relating to short-term leases accounted for applying paragraph 65. This expense need not include the expense relating to leases with a lease term of one month or less;

(d) The expense relating to leases of low-value assets accounted for applying paragraph 65. This expense shall not include the expense relating to short-term leases of low-value assets included in paragraph 104(c);

(e) The expense relating to variable lease payments not included in the measurement of lease liabilities;

(f) Revenue from subleasing right-of-use assets;

(g) Total cash outflow for leases;

(h) Additions to right-of-use assets;

(i) Gains or losses arising from sale and leaseback transactions; and

(j) The carrying amount of right-of-use assets at the end of the reporting period by class of underlying asset.

105. A lessee shall provide the disclosures specified in paragraph 104 in a tabular format, unless another format is more appropriate. The amounts disclosed shall include costs that a lessee has included in the carrying amount of another asset during the reporting period.

106. A lessee shall disclose the amount of its lease commitments for short-term leases accounted for applying paragraph 65 if the portfolio of short-term leases to which it is committed at the end of the reporting period is dissimilar to the portfolio of short-term leases to which the short-term lease expense disclosed applying paragraph 104(c) relates.

107. If right-of-use assets meet the definition of investment property, a lessee shall apply the disclosure requirements in IPSAS 16. In that case, a lessee is not required to provide the disclosures in paragraph 104(a), (f), (h) or (j) for those right-of-use assets.

108. If a lessee measures right-of-use assets at revalued amounts applying IPSAS 17, the lessee shall disclose the information required by paragraph 92 of IPSAS 17 for those right-of-use assets.

109. A lessee shall disclose a maturity analysis of lease liabilities applying paragraphs 46 and AG12 of IPSAS 28, *Financial Instruments: Disclosures* separately from the maturity analyses of other financial liabilities.

110. In addition to the disclosures required in paragraphs 104–109, a lessee shall disclose additional qualitative and quantitative information about its leasing activities necessary to meet the disclosure objective in paragraph 102 (as described in paragraph AG51). This additional information may include, but is not limited to, information that helps users of financial statements to assess:

(a) The nature of the lessee’s leasing activities;

(b) Future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities. This includes exposure arising from:

(i) Variable lease payments (as described in paragraph AG52);

(ii) Extension options and termination options (as described in paragraph AG53);

(iii) Residual value guarantees (as described in paragraph AG54); and

(iv) Leases not yet commenced to which the lessee is committed.

(c) Restrictions or covenants imposed by leases;

(d) Sale and leaseback transactions (as described in paragraph AG55); and

(e) The purpose and terms of the various types of leases.

111. A lessee that accounts for short-term leases or leases of low-value assets applying paragraph 65 shall disclose that fact.

Lessee: Concessionary Leases

112. For concessionary leases received, a lessee shall also disclose:

(a) The subsidy recognized as a liability and as revenue in the period;

(b) Leases repaid during the period;

(c) Other changes; and

(d) Valuation assumptions.

Sale and Leaseback Transactions

113. If an entity (the seller-lessee[3]) transfers an asset to another entity (the buyer-lessor[4]) and leases that asset back from the buyer-lessor, both the seller-lessee and the buyer-lessor shall account for the transfer contract and the lease applying paragraphs 114–118.

Assessing Whether the Transfer of the Asset is a Sale

114. An entity shall apply the requirements of IPSAS 9 to determine whether the transfer of an asset is accounted for as a sale of that asset.

Transfer of the Asset is a Sale

115. If the transfer of an asset by the seller-lessee satisfies the requirements of IPSAS 9 to be accounted for as a sale of the asset:

    (a) The seller-lessee shall measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognize only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.

    (b) The buyer-lessor shall account for the purchase of the asset applying applicable IPSASs, and for the lease applying the lessor accounting requirements in this [draft] Standard.

116. If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or if the payments for the lease are not at market rates, an entity shall make the following adjustments to measure the sale proceeds at fair value:

    (a) Any below-market terms shall be accounted for according to the requirements in this [draft] Standard for concessionary leases and according to the relevant IPSASs for sales, as appropriate; and

    (b) Any above-market terms shall be accounted for as additional financing provided by the buyer-lessor to the seller-lessee.

117. The entity shall measure any potential adjustment required by paragraph 116 on the basis of the more readily determinable of:

    (a) The difference between the fair value of the consideration for the sale and the fair value of the asset; and

    (b) The difference between the present value of the contractual payments for the lease and the present value of payments for the lease at market rates.

Transfer of the Asset is not a Sale

118. If the transfer of an asset by the seller-lessee does not satisfy the requirements of IPSAS 9 to be accounted for as a sale of the asset:

[3] The seller-lessee is the transferor of the underlying asset and the transferee of the right-of-use asset.

[4] The buyer-lessor is the transferee of the underlying asset and the transferor of the right-of-use asset.

(a) The seller-lessee shall continue to recognize the transferred asset and shall recognize a financial liability equal to the transfer proceeds. It shall account for the financial liability applying IPSAS 29[5].

(b) The buyer-lessor shall not recognize the transferred asset and shall recognize a financial asset equal to the transfer proceeds. It shall account for the financial asset applying IPSAS 29.

Effective Date and Transition

Effective Date

119. **An entity shall apply this [draft] Standard for annual financial statements beginning on or after MM DD, YYYY. Earlier adoption is encouraged. If an entity applies this [draft] Standard for a period beginning before MM DD, YYYY, it shall disclose that fact.**

Transition

120. For the purposes of the requirements in paragraphs 119–148, the date of initial application is the beginning of the annual reporting period in which an entity first applies this [draft] Standard.

Definition of a Lease

121. As a practical expedient, an entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity is permitted:

(a) To apply this [draft] Standard to contracts that were previously identified as leases applying IPSAS 13, *Leases*. The entity shall apply the transition requirements in paragraphs 123–147 to those leases.

(b) Not to apply this [draft] Standard to contracts that were not previously identified as containing a lease applying IPSAS 13.

122. If an entity chooses the practical expedient in paragraph 121, it shall disclose that fact and apply the practical expedient to all of its contracts, including concessionary leases. As a result, the entity shall apply the requirements in paragraphs 6–8 only to contracts entered into (or changed) on or after the date of initial application.

Lessors or Lessees

123. A lessor or lessee shall apply this [draft] Standard to its leases, including concessionary leases, either:

(a) Retrospectively to each prior reporting period presented applying IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*; or

(b) Retrospectively with the cumulative effect of initially applying the [draft] Standard recognized at the date of initial application in accordance with paragraphs 125–135 and 136–144, respectively.

124. A lessor or lessee shall apply the election described in paragraph 123 consistently to all of its leases in which it is a lessor or lessee.

[5] The IPSASB has published Exposure Draft 62, *Financial Instruments* to update the IPSASB's financial instruments Standards with a new financial instruments Standard based on IFRS 9, *Financial Instruments*.

125. If a lessor or lessee elects to apply this [draft] Standard in accordance with paragraph 123(b), the lessor or lessee shall not restate comparative information. Instead, the lessor or lessee shall recognize the cumulative effect of initially applying this [draft] Standard as an adjustment to the opening balance of accumulated surpluses or deficits (or other component of net assets/equity, as appropriate) at the date of initial application.

Lessors

Leases Previously Classified as Operating Leases

126. If a lessor elects to apply this [draft] Standard in accordance with paragraph 123(b), the lessor shall:

(a) Recognize a lease receivable at the date of initial application for leases previously classified as an operating lease applying IPSAS 13. The lessor shall measure that lease receivable at the present value of the remaining lease payments, discounted using the interest rate implicit in the lease at the date of initial application.

(b) Recognize a liability (unearned revenue) at the date of initial application for leases previously classified as an operating lease applying IPSAS 13. The lessor shall choose, on a lease-by-lease basis, to measure that liability (unearned revenue) at either:

(i) Its carrying amount as if the [draft] Standard had been applied since the commencement date, but discounted using the interest rate implicit in the lease at the date of initial application; or

(ii) An amount equal to the lease receivable, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognized in the statement of financial position immediately before the date of initial application.

127. A lessor may use one or more of the following practical expedients when applying this [draft] Standard retrospectively in accordance with paragraph 123(b) to leases previously classified as operating leases applying IPSAS 13. A lessor is permitted to apply these practical expedients on a lease-by-lease basis:

(a) A lessor may apply a single discount rate to a portfolio of leases with reasonably similar characteristics (such as leases with a similar remaining lease term for a similar class of underlying asset in a similar economic environment).

(b) A lessor may elect not to apply the requirements in paragraph 126 to leases for which the lease term ends within 12 months of the date of initial application. In this case, a lessor shall:

(i) Account for those leases in the same way as short-term leases as described in paragraph 25; and

(ii) Include the revenue associated with those leases within the disclosure of short-term lease revenue in the annual reporting period that includes the date of initial application.

(c) A lessor may exclude initial direct costs from the measurement of the lease receivable at the date of initial application.

(d) A lessor may use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.

Leases Previously Classified as Finance Leases

128. If a lessor elects to apply this [draft] Standard in accordance with paragraph 123(b), for leases that were classified as finance leases applying IPSAS 13, the carrying amount of the underlying asset at the date of initial application shall be the carrying amount of the residual value of the underlying asset immediately before that date measured applying IPSAS 13. For those leases, a lessor shall account for the underlying asset applying the relevant IPSASs from the date of initial application.

129. If a lessor elects to apply this [draft] Standard in accordance with paragraph 123(b), for leases that were classified as finance leases applying IPSAS 13, the carrying amount of the lease receivable and the liability (unearned revenue) at the date of initial application shall be the present value of the remaining future lease payments immediately before that date measured applying IPSAS 13. For those leases, a lessor shall account for the lease receivable and the liability (unearned revenue) applying this [draft] Standard from the date of initial application.

Presentation: Note Disclosure

130. If a lessor elects to apply this [draft] Standard in accordance with paragraph 123(b), the lessor shall disclose information about initial application required by paragraph 33 of IPSAS 3, except for the information specified in paragraph 33(f) of IPSAS 3. Instead of the information specified in paragraph 33(f) of IPSAS 3, the lessor shall disclose:

(a) The weighted average of the interest rate implicit in the lease applied to lease receivables recognized in the statement of financial position at the date of initial application; and

(b) An explanation of any difference between:

(i) Expected lease payments disclosed applying IPSAS 13 at the end of the annual reporting period immediately preceding the date of initial application, discounted using the interest rate implicit in the lease at the date of initial application as described in paragraph 126; and

(ii) Lease receivables recognized in the statement of financial position at the date of initial application.

131. If a lessor uses one or more of the specified practical expedients in paragraph 127, it shall disclose that fact.

Concessionary Leases

Leases Previously Classified as Operating Leases

132. If a lessor elects to apply this [draft] Standard in accordance with paragraph 123(b) for concessionary leases that were classified as operating leases according to IPSAS 13, the lessor shall:

(a) Measure the lease receivable at the present value of the remaining lease payments, discounted using market interest rates at the date of initial application.

(b) Measure, on a lease-by-lease basis, the liability (unearned revenue) at its carrying amount as if the [draft] Standard had been applied since the commencement date, but discounted using market interest rates at the date of initial application.

133. A lessor may use one or more of the following practical expedients identified in paragraph 127 when applying this [draft] Standard retrospectively in accordance with paragraph 123(b) to leases previously classified as operating leases applying IPSAS 13.

Leases Previously Classified as Finance Leases

134. If a lessor elects to apply this [draft] Standard in accordance with paragraph 123(b), for concessionary leases that were classified as finance leases applying IPSAS 13, the lessor shall:

(a) Measure the lease receivable according to the requirements in paragraph 132(a); and

(b) Measure the liability (unearned revenue) according to the requirements in paragraph 132(b).

Presentation: Note Disclosure

135. If a lessor elects to apply this [draft] Standard in accordance with paragraph 123(b) for concessionary leases, the lessor shall disclose information according to paragraphs 130 and 131, as appropriate.

Lessees

Leases Previously Classified as Operating Leases

136. If a lessee elects to apply this [draft] Standard in accordance with paragraph 123(b), the lessee shall:

(a) Recognize a lease liability at the date of initial application for leases previously classified as an operating lease applying IPSAS 13. The lessee shall measure that lease liability at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application.

(b) Recognize a right-of-use asset at the date of initial application for leases previously classified as an operating lease applying IPSAS 13. The lessee shall choose, on a lease-by-lease basis, to measure that right-of-use asset at either:

(i) Its carrying amount as if the [draft] Standard had been applied since the commencement date, but discounted using the lessee's incremental borrowing rate at the date of initial application; or

(ii) An amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognized in the statement of financial position immediately before the date of initial application.

(c) Apply IPSAS 21 or IPSAS 26, as appropriate, to right-of-use assets at the date of initial application, unless the lessee applies the practical expedient in paragraph 138(b).

137. Notwithstanding the requirements in paragraph 136, for leases previously classified as operating leases applying IPSAS 13, a lessee:

(a) Is not required to make any adjustments on transition for leases for which the underlying asset is of low value (as described in paragraphs AG40–AG45) that will be accounted for applying paragraph 65. The lessee shall account for those leases applying this [draft] Standard from the date of initial application.

(b) Is not required to make any adjustments on transition for leases previously accounted for as investment property using the fair value model in IPSAS 16. The lessee shall account for the right-of-use asset and the lease liability arising from those leases applying IPSAS 16 and this [draft] Standard from the date of initial application.

(c) Shall measure the right-of-use asset at fair value at the date of initial application for leases previously accounted for as operating leases applying IPSAS 13 and that will be accounted for as investment property using the fair value model in IPSAS 16 from the date of initial application. The lessee shall account for the right-of-use asset and the lease liability arising from those leases applying IPSAS 16 and this [draft] Standard from the date of initial application.

138. A lessee may use one or more of the following practical expedients when applying this [draft] Standard retrospectively in accordance with paragraph 123(b) to leases previously classified as operating leases applying IPSAS 13. A lessee is permitted to apply these practical expedients on a lease-by-lease basis:

(a) A lessee may apply a single discount rate to a portfolio of leases with reasonably similar characteristics (such as leases with a similar remaining lease term for a similar class of underlying asset in a similar economic environment).

(b) A lessee may rely on its assessment of whether leases are onerous applying IPSAS 19 immediately before the date of initial application as an alternative to performing an impairment review. If a lessee chooses this practical expedient, the lessee shall adjust the right-of-use asset at the date of initial application by the amount of any provision for onerous leases recognized in the statement of financial position immediately before the date of initial application.

(c) A lessee may elect not to apply the requirements in paragraph 136 to leases for which the lease term ends within 12 months of the date of initial application. In this case, a lessee shall:

(i) Account for those leases in the same way as short-term leases as described in paragraph 65; and

(ii) Include the cost associated with those leases within the disclosure of short-term lease expense in the annual reporting period that includes the date of initial application.

(d) A lessee may exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application.

(e) A lessee may use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.

Leases Previously Classified as Finance Leases

139. If a lessee elects to apply this [draft] Standard in accordance with paragraph 123(b), for leases that were classified as finance leases applying IPSAS 13, the carrying amount of the right-of-use asset and the lease liability at the date of initial application shall be the carrying amount of the lease asset and lease liability immediately before that date measured applying IPSAS 13. For those leases, a lessee shall account for the right-of-use asset and the lease liability applying this [draft] Standard from the date of initial application.

Presentation: Note Disclosure

140. If a lessee elects to apply this [draft] Standard in accordance with paragraph 123(b), the lessee shall disclose information about initial application required by paragraph 33 of IPSAS 3, except for the information specified in paragraph 33(f) of IPSAS 3. Instead of the information specified in paragraph 33(f) of IPSAS 3, the lessee shall disclose:

(a) The weighted average lessee's incremental borrowing rate applied to lease liabilities recognized in the statement of financial position at the date of initial application; and

(b) An explanation of any difference between:

(i) Operating lease commitments disclosed applying IPSAS 13 at the end of the annual reporting period immediately preceding the date of initial application, discounted using the incremental borrowing rate at the date of initial application as described in paragraph 136(a); and

(ii) Lease liabilities recognized in the statement of financial position at the date of initial application.

141. If a lessee uses one or more of the specified practical expedients in paragraph 138, it shall disclose that fact.

Concessionary Leases

Leases Previously Classified as Operating Leases

142. If a lessee elects to apply this [draft] Standard in accordance with paragraph 123(b) for concessionary leases that were classified as operating leases according to IPSAS 13, the lessee shall:

(a) Measure the lease liability at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use market interest rates.

(b) Measure, on a lease-by-lease basis, the right-of-use asset at its carrying amount as if the [draft] Standard had been applied since the commencement date, but discounted using the lessee's incremental borrowing rate at the date of initial application, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use market interest rates.

(c) Apply IPSAS 21 or IPSAS 26, as appropriate, to right-of-use assets at the date of initial application, unless the lessee applies the practical expedient in paragraph 138(b).

Leases Previously Classified as Finance Leases

143. If a lessee elects to apply this [draft] Standard in accordance with paragraph 123(b) for concessionary leases that were classified as finance leases applying IPSAS 13, the lessee shall:

(a) Measure the lease liability according to the requirements in paragraph 142(a); and

(b) Measure the right-of-use asset according to the requirements in paragraph 142(b);

Presentation: Note Disclosure

144. If a lessee elects to apply this [draft] Standard in accordance with paragraph 123(b) for concessionary leases, the lessee shall disclose Information according to paragraphs 140 and 141, as appropriate.

Sale and Leaseback Transactions before the Date of Initial Application

145. An entity shall not reassess sale and leaseback transactions entered into before the date of initial application to determine whether the transfer of the underlying asset satisfies the requirements in IPSAS 9 to be accounted for as a sale.

146. If a sale and leaseback transaction was accounted for as a sale and a finance lease applying IPSAS 13, the seller-lessee shall:

(a) Account for the leaseback in the same way as it accounts for any other finance lease that exists at the date of initial application; and

(b) Continue to amortize any gain on sale over the lease term.

147. If a sale and leaseback transaction was accounted for as a sale and operating lease applying IPSAS 13, the seller-lessee shall:

(a) Account for the leaseback in the same way as it accounts for any other operating lease that exists at the date of initial application; and

(b) Adjust the leaseback right-of-use asset for any deferred gains or losses that relate to off-market terms recognized in the statement of financial position immediately before the date of initial application.

Amounts Previously Recognized in Respect of Public Sector Combinations

148. If a lessee previously recognized an asset or a liability applying IPSAS 40, *Public Sector Combinations* relating to favorable or unfavorable terms of a lease acquired as part of a business combination, the lessee shall derecognize that asset or liability and adjust the carrying amount of the right-of-use asset by a corresponding amount at the date of initial application.

Withdrawal and Replacement of IPSAS 13 (December 2001)

149. This [draft] Standard supersedes IPSAS 13, *Leases*, issued in 2001. IPSAS 13 remains applicable until this [draft] Standard is applied or becomes effective, whichever is earlier.

Appendix A

Application Guidance

This Appendix is an integral part of [draft] IPSAS [X] (ED 64).

Portfolio Application

AG1. This [draft] Standard specifies the accounting for an individual lease. However, as a practical expedient, an entity may apply this [draft] Standard to a portfolio of leases with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this [draft] Standard to the portfolio would not differ materially from applying this [draft] Standard to the individual leases within that portfolio. If accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio.

Combination of Contracts

AG2. In applying this [draft] Standard, an entity shall combine two or more contracts entered into at or near the same time with the same counterparty (or related parties of the counterparty), and account for the contracts as a single contract if one or more of the following criteria are met:

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

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

(c) 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 as described in paragraph AG27.

Definitions (see paragraph 5)

AG3. An entity considers the substance rather than the legal form of an arrangement in determining whether it is a "contract" for the purposes of this [draft] Standard. Contracts, for the purposes of this [draft] Standard, are generally evidenced by the following (although this may differ from jurisdiction to jurisdiction):

(a) Contracts involve willing parties entering into an arrangement;

(b) The terms of the contract create rights and obligations for the parties to the contract, and those rights and obligations need not result in equal performance by each party. For example, a donor funding arrangement creates an obligation for the donor to transfer resources to the recipient in terms of the agreement concluded, and establishes the right of the recipient to receive those resources. These types of arrangements may be contractual even though the recipient did not provide equal consideration in return i.e., the arrangement does not result in equal performance by the parties; and

(c) The remedy for non-performance is enforceable by law.

Identifying a Lease (see paragraphs 6–14)

AG4. To assess whether a contract conveys the right to control the use of an identified asset (see paragraphs AG8–AG15) for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:

(a) The right to obtain substantially all of the economic benefits from use of the identified asset (as described in paragraphs AG16–AG18); and

(b) The right to direct the use of the identified asset (as described in paragraphs AG19–AG25).

AG5. If the customer has the right to control the use of an identified asset for only a portion of the term of the contract, the contract contains a lease for that portion of the term.

AG6. A contract to receive goods or services may be entered into by a joint arrangement, or on behalf of a joint arrangement, as defined in IPSAS 37, *Joint Arrangements*. In this case, the joint arrangement is considered to be the customer in the contract. Accordingly, in assessing whether such a contract contains a lease, an entity shall assess whether the joint arrangement has the right to control the use of an identified asset throughout the period of use.

AG7. An entity shall assess whether a contract contains a lease for each potential separate lease component. Refer to paragraph AG27 for guidance on separate lease components.

Identified Asset

AG8. An asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer.

Substantive Substitution Rights

AG9. Even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. A supplier's right to substitute an asset is substantive only if both of the following conditions exist:

(a) The supplier has the practical ability to substitute alternative assets throughout the period of use (for example, the customer cannot prevent the supplier from substituting the asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time); and

(b) The supplier would benefit economically from the exercise of its right to substitute the asset (i.e., the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).

AG10. If the supplier has a right or an obligation to substitute the asset only on or after either a particular date or the occurrence of a specified event, the supplier's substitution right is not substantive because the supplier does not have the practical ability to substitute alternative assets throughout the period of use.

AG11. An entity's evaluation of whether a supplier's substitution right is substantive is based on facts and circumstances at inception of the contract and shall exclude consideration of future events that, at inception of the contract, are not considered likely to occur. Examples of future events that, at inception of the contract, would not be considered likely to occur and, thus, should be excluded from the evaluation include:

(a) An agreement by a future customer to pay an above market rate for use of the asset;

(b) The introduction of new technology that is not substantially developed at inception of the contract;

(c) A substantial difference between the customer's use of the asset, or the performance of the asset, and the use or performance considered likely at inception of the contract; and

(d) A substantial difference between the market price of the asset during the period of use, and the market price considered likely at inception of the contract.

AG12. If the asset is located at the customer's premises or elsewhere, the costs associated with substitution are generally higher than when located at the supplier's premises and, therefore, are more likely to exceed the benefits associated with substituting the asset.

AG13. The supplier's right or obligation to substitute the asset for repairs and maintenance, if the asset is not operating properly or if a technical upgrade becomes available does not preclude the customer from having the right to use an identified asset.

AG14. If the customer cannot readily determine whether the supplier has a substantive substitution right, the customer shall presume that any substitution right is not substantive.

Portions of Assets

AG15. A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fibre optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset.

Right to Obtain Economic Benefits from Use

AG16. To control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding or sub-leasing the asset. The economic benefits from use of an asset include its primary output and by-products (including potential cash flows derived from these items), and other economic benefits from using the asset that could be realized from a commercial transaction with a third party.

AG17. When assessing the right to obtain substantially all of the economic benefits from use of an asset, an entity shall consider the economic benefits that result from use of the asset within the defined scope of a customer's right to use the asset (see paragraph AG25). For example:

(a) If a contract limits the use of a motor vehicle to only one particular territory during the period of use, an entity shall consider only the economic benefits from use of the motor vehicle within that territory, and not beyond.

(b) If a contract specifies that a customer can drive a motor vehicle only up to a particular number of miles during the period of use, an entity shall consider only the economic benefits from use of the motor vehicle for the permitted mileage, and not beyond.

AG18. If a contract requires a customer to pay the supplier or another party a portion of the cash flows derived from use of an asset as consideration, those cash flows paid as consideration shall be considered to be part of the economic benefits that the customer obtains from use of the asset. For example, if the customer is required to pay the supplier a percentage of sales from use of retail space as consideration for that use, that requirement does not prevent the customer from having the right to obtain substantially all of the economic benefits from use of the retail space. This is because the cash flows arising from those sales are considered to be economic benefits that the customer obtains from use of the retail space, a portion of which it then pays to the supplier as consideration for the right to use that space.

Right to Direct the Use

AG19. A customer has the right to direct the use of an identified asset throughout the period of use only if either:

(a) The customer has the right to direct how and for what purpose the asset is used throughout the period of use (as described in paragraphs AG20–AG25); or

(b) The relevant decisions about how and for what purpose the asset is used are predetermined and:

(i) The customer has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use, without the supplier having the right to change those operating instructions; or

(ii) The customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

How and for What Purpose the Asset is Used

AG20. A customer has the right to direct how and for what purpose the asset is used if, within the scope of its right of use defined in the contract, it can change how and for what purpose the asset is used throughout the period of use. In making this assessment, an entity considers the decision-making rights that are most relevant to changing how and for what purpose the asset is used throughout the period of use. Decision-making rights are relevant when they affect the economic benefits to be derived from use. The decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.

AG21. Examples of decision-making rights that, depending on the circumstances, grant the right to change how and for what purpose the asset is used, within the defined scope of the customer's right of use, include:

(a) Rights to change the type of output that is produced by the asset (for example, to decide whether to use a shipping container to transport goods or for storage, or to decide upon the mix of products sold from retail space);

(b) Rights to change when the output is produced (for example, to decide when an item of machinery or a power plant will be used);

(c) Rights to change where the output is produced (for example, to decide upon the destination of a truck or a ship, or to decide where an item of equipment is used); and

(d) Rights to change whether the output is produced, and the quantity of that output (for example, to decide whether to produce energy from a power plant and how much energy to produce from that power plant).

AG22. Examples of decision-making rights that do not grant the right to change how and for what purpose the asset is used include rights that are limited to operating or maintaining the asset. Such rights can be held by the customer or the supplier. Although rights such as those to operate or maintain an asset are often essential to the efficient use of an asset, they are not rights to direct how and for what purpose the asset is used and are often dependent on the decisions about how and for what purpose the asset is used. However, rights to operate an asset may grant the customer the right to direct the use of the asset if the relevant decisions about how and for what purpose the asset is used are predetermined (see paragraph AG19(b)(ii)).

Decisions Determined during and before the Period of Use

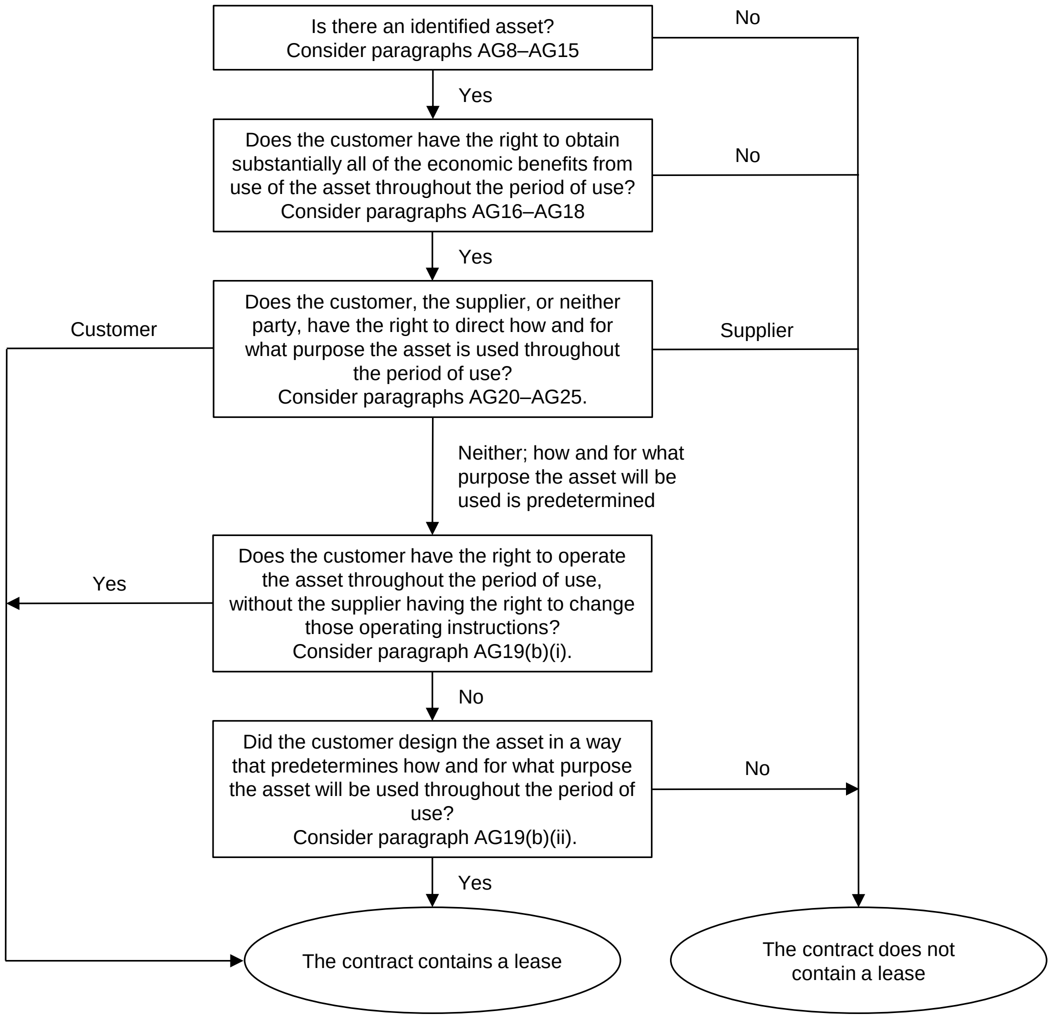
AG23. The relevant decisions about how and for what purpose the asset is used can be predetermined in a number of ways. For example, the relevant decisions can be predetermined by the design of the asset or by contractual restrictions on the use of the asset.

AG24. In assessing whether a customer has the right to direct the use of an asset, an entity shall consider only rights to make decisions about the use of the asset during the period of use, unless the customer designed the asset (or specific aspects of the asset) as described in paragraph AG19(b)(ii). Consequently, unless the conditions in paragraph AG19(b)(ii) exist, an entity shall not consider decisions that are predetermined before the period of use. For example, if a customer is able only to specify the output of an asset before the period of use, the customer does not have the right to direct the use of that asset. The ability to specify the output in a contract before the period of use, without any other decision-making rights relating to the use of the asset, gives a customer the same rights as any customer that purchases goods or services.

Protective Rights

AG25. A contract may include terms and conditions designed to protect the supplier's interest in the asset or other assets, to protect its personnel, or to ensure the supplier's compliance with laws or regulations. These are examples of protective rights. For example, a contract may (i) specify the maximum amount of use of an asset or limit where or when the customer can use the asset, (ii) require a customer to follow particular operating practices, or (iii) require a customer to inform the supplier of changes in how an asset will be used. Protective rights typically define the scope of the customer's right of use but do not, in isolation, prevent the customer from having the right to direct the use of an asset.

AG26. The following flowchart may assist entities in making the assessment of whether a contract is, or contains, a lease.



Separating Components of a Contract (see paragraphs 9–14)

AG27. The right to use an underlying asset is a separate lease component if both:

(a) The lessee can benefit from use of the underlying asset either on its own or together with other resources that are readily available to the lessee. Readily available resources are goods or services that are sold or leased separately (by the lessor or other suppliers) or resources that the lessee has already obtained (from the lessor or from other transactions or events); and

(b) The underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract. For example, the fact that a lessee could decide not to lease the underlying asset without significantly affecting its rights to use other underlying assets in the contract might indicate that the underlying asset is not highly dependent on, or highly interrelated with, those other underlying assets.

AG28. A contract may include an amount payable by the lessee for activities and costs that do not transfer a good or service to the lessee. For example, a lessor may include in the total amount payable a charge for administrative tasks, or other costs it incurs associated with the lease, that do not transfer a good or service to the lessee. Such amounts payable do not give rise to a separate component of the contract, but are considered to be part of the total consideration that is allocated to the separately identified components of the contract.

Lease Term (see paragraphs 16–19)

AG29. In determining the lease term and assessing the length of the non-cancellable period of a lease, an entity shall apply the definition of a contract and determine the period for which the contract is enforceable. A lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with no more than an insignificant penalty.

AG30. If only a lessee has the right to terminate a lease, that right is considered to be an option to terminate the lease available to the lessee that an entity considers when determining the lease term. If only a lessor has the right to terminate a lease, the non-cancellable period of the lease includes the period covered by the option to terminate the lease.

AG31. The lease term begins at the commencement date and includes any rent-free periods provided to the lessee by the lessor.

AG32. At the commencement date, an entity assesses whether the lessee is reasonably certain to exercise an option to extend the lease or to purchase the underlying asset, or not to exercise an option to terminate the lease. The entity considers all relevant facts and circumstances that create an economic incentive for the lessee to exercise, or not to exercise, the option, including any expected changes in facts and circumstances from the commencement date until the exercise date of the option. Examples of factors to consider include, but are not limited to:

(a) Contractual terms and conditions for the optional periods compared with market rates, such as:

  (i) The amount of payments for the lease in any optional period;

  (ii) The amount of any variable payments for the lease or other contingent payments, such as payments resulting from termination penalties and residual value guarantees; and

  (iii) The terms and conditions of any options that are exercisable after initial optional periods (for example, a purchase option that is exercisable at the end of an extension period at a rate that is currently below market rates).

(b) Significant leasehold improvements undertaken (or expected to be undertaken) over the term of the contract that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;

(c) Costs relating to the termination of the lease, such as negotiation costs, relocation costs, costs of identifying another underlying asset suitable for the lessee's needs, costs of integrating a new asset into the lessee's operations, or termination penalties and similar costs, including costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location;

(d) The importance of that underlying asset to the lessee's operations, considering, for example, whether the underlying asset is a specialized asset, the location of the underlying asset and the availability of suitable alternatives; and

(e) Conditionality associated with exercising the option (i.e., when the option can be exercised only if one or more conditions are met), and the likelihood that those conditions will exist.

AG33. An option to extend or terminate a lease may be combined with one or more other contractual features (for example, a residual value guarantee) such that the lessee guarantees the lessor a minimum or fixed cash return that is substantially the same regardless of whether the option is exercised. In such cases, and notwithstanding the guidance on in-substance fixed payments in paragraph AG38, an entity shall assume that the lessee is reasonably certain to exercise the option to extend the lease, or not to exercise the option to terminate the lease.

AG34. The shorter the non-cancellable period of a lease, the more likely a lessee is to exercise an option to extend the lease or not to exercise an option to terminate the lease. This is because the costs associated with obtaining a replacement asset are likely to be proportionately higher the shorter the non-cancellable period.

AG35. A lessee's past practice regarding the period over which it has typically used particular types of assets (whether leased or owned), and its economic reasons for doing so, may provide information that is helpful in assessing whether the lessee is reasonably certain to exercise, or not to exercise, an option. For example, if a lessee has typically used particular types of assets for a particular period of time or if the lessee has a practice of frequently exercising options on leases of particular types of underlying assets, the lessee shall consider the economic reasons for that past practice in assessing whether it is reasonably certain to exercise an option on leases of those assets.

AG36. Paragraph 18 specifies that, after the commencement date, a lessee reassesses the lease term upon the occurrence of a significant event or a significant change in circumstances that is within the control of the lessee and affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term. Examples of significant events or changes in circumstances include:

(a) Significant leasehold improvements not anticipated at the commencement date that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;

(b) A significant modification to, or customization of, the underlying asset that was not anticipated at the commencement date;

(c) The inception of a sublease of the underlying asset for a period beyond the end of the previously determined lease term; and

(d) A business decision of the lessee that is directly relevant to exercising, or not exercising, an option (for example, a decision to extend the lease of a complementary asset, to dispose of an alternative asset or to dispose of an operation within which the right-of-use asset is employed).

AG37. A cancellation clause related to availability of funding (e.g., a clause that allows public sector lessees to cancel a lease agreement if the government does not appropriate funds for the lease payments) should be considered in determining the lease term only when it is reasonably certain that the clause will be exercised (i.e., funds will not be appropriated).

In-substance Fixed Lease Payments (see paragraphs 28(a), 76(a), 86(c))

AG38. Lease payments include any in-substance fixed lease payments. In-substance fixed lease payments are payments that may, in form, contain variability but that, in substance, are unavoidable. In-substance fixed lease payments exist, for example, if:

(a) Payments are structured as variable lease payments, but there is no genuine variability in those payments. Those payments contain variable clauses that do not have real economic substance. Examples of those types of payments include:

(i) Payments that must be made only if an asset is proven to be capable of operating during the lease, or only if an event occurs that has no genuine possibility of not occurring; or

(ii) Payments that are initially structured as variable lease payments linked to the use of the underlying asset but for which the variability will be resolved at some point after the commencement date so that the payments become fixed for the remainder of the lease term. Those payments become in-substance fixed payments when the variability is resolved.

(b) There is more than one set of payments that a lessee could make, but only one of those sets of payments is realistic. In this case, an entity shall consider the realistic set of payments to be lease payments.

(c) There is more than one realistic set of payments that a lessee could make, but it must make at least one of those sets of payments. In this case, an entity shall consider the set of payments that aggregates to the lowest amount (on a discounted basis) to be lease payments.

Lessor (see paragraphs 30–32 and 43–44)

Recognition and Measurement of the Liability (Unearned Revenue)

AG39. When the lessor fulfills its obligation to make the underlying asset available for use by the lessee, the lessee is granted the right to earn revenue over the lease term because it controls the right-of-use asset. Likewise, the lessor earns the benefit associated with the lease receivable in exchange for the right to use the underlying asset granted to the lessee over the lease term. Accordingly, the revenue is not recognized immediately. Instead, a liability (unearned revenue) is recognized for the revenue that is not yet earned in accordance with paragraph 23. Revenue is recognized and the liability reduced in accordance with paragraph 43 based on the economic substance of the lease contract, usually as access to the underlying asset is provided to the lessee over the lease term.

Lessee: Recognition Exemption of Leases for which the Underlying Asset is of Low Value (see paragraphs 64–67)

AG40. Except as specified in paragraph AG44, this [draft] Standard permits a lessee to apply paragraph 65 to account for leases for which the underlying asset is of low value. A lessee shall assess the value of an underlying asset based on the value of the asset when it is new, regardless of the age of the asset being leased.

AG41. The assessment of whether an underlying asset is of low value is performed on an absolute basis, considering the materiality of leasing transactions in relation to the lessee's financial statements.

AG42. An underlying asset can be of low value only if:

(a) The lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee; and

(b) The underlying asset is not highly dependent on, or highly interrelated with, other assets.

AG43. A lease of an underlying asset does not qualify as a lease of a low-value asset if the nature of the asset is such that, when new, the asset is typically not of low value. For example, leases of cars would not qualify as leases of low-value assets because a new car would typically not be of low value.

AG44. If a lessee subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset.

AG45. Examples of low-value underlying assets can include tablet and personal computers, small items of office furniture and telephones.

Lessee Involvement with the Underlying Asset before the Commencement Date

Costs of the Lessee Relating to the Construction or Design of the Underlying Asset

AG46. An entity may negotiate a lease before the underlying asset is available for use by the lessee. For some leases, the underlying asset may need to be constructed or redesigned for use by the lessee. Depending on the terms and conditions of the contract, a lessee may be required to make payments relating to the construction or design of the asset.

AG47. If a lessee incurs costs relating to the construction or design of an underlying asset, the lessee shall account for those costs applying other applicable Standards, such as IPSAS 17. Costs relating to the construction or design of an underlying asset do not include payments made by the lessee for the right to use the underlying asset. Payments for the right to use an underlying asset are payments for a lease, regardless of the timing of those payments.

Legal Title to the Underlying Asset

AG48. A lessee may obtain legal title to an underlying asset before that legal title is transferred to the lessor and the asset is leased to the lessee. Obtaining legal title does not in itself determine how to account for the transaction.

AG49. If the lessee controls (or obtains control of) the underlying asset before that asset is transferred to the lessor, the transaction is a sale and leaseback transaction that is accounted for applying paragraphs 113–118.

AG50. However, if the lessee does not obtain control of the underlying asset before the asset is transferred to the lessor, the transaction is not a sale and leaseback transaction.

Lessee: Note Disclosure (see paragraph 102)

AG51. In determining whether additional information about leasing activities is necessary to meet the disclosure objective in paragraph 102, a lessee shall consider:

(a) Whether that information is relevant to users of financial statements. A lessee shall provide additional information specified in paragraph 110 only if that information is expected to be relevant to users of financial statements. In this context, this is likely to be the case if it helps those users to understand:

(i) The flexibility provided by leases. Leases may provide flexibility if, for example, a lessee can reduce its exposure by exercising termination options or renewing leases with favorable terms and conditions.

(ii) Restrictions imposed by leases. Leases may impose restrictions, for example, by requiring the lessee to maintain particular financial ratios.

(iii) Sensitivity of reported information to key variables. Reported information may be sensitive to, for example, future variable lease payments.

(iv) Exposure to other risks arising from leases.

(v) Deviations from industry practice. Such deviations may include, for example, unusual or unique lease terms and conditions that affect a lessee's lease portfolio.

(b) Whether that information is apparent from information either presented in the primary financial statements or disclosed in the notes. A lessee need not duplicate information that is already presented elsewhere in the financial statements.

AG52. Additional information relating to variable lease payments that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 102 could include information that helps users of financial statements to assess, for example:

(a) The lessee's reasons for using variable lease payments and the prevalence of those payments;

(b) The relative magnitude of variable lease payments to fixed payments;

(c) Key variables upon which variable lease payments depend and how payments are expected to vary in response to changes in those key variables; and

(d) Other operational and financial effects of variable lease payments.

AG53. Additional information relating to extension options or termination options that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 102 could include information that helps users of financial statements to assess, for example:

(a) The lessee's reasons for using extension options or termination options and the prevalence of those options;

(b) The relative magnitude of *optional lease payments* to lease payments;

(c) The prevalence of the exercise of options that were not included in the measurement of lease liabilities; and

(d) Other operational and financial effects of those options.

AG54. Additional information relating to residual value guarantees that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 102 could include information that helps users of financial statements to assess, for example:

(a) The lessee's reasons for providing residual value guarantees and the prevalence of those guarantees;

(b) The magnitude of a lessee's exposure to residual value risk;

(c) The nature of underlying assets for which those guarantees are provided; and

(d) Other operational and financial effects of those guarantees.

AG55. Additional information relating to sale and leaseback transactions that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 102 could include information that helps users of financial statements to assess, for example:

(a) The lessee's reasons for sale and leaseback transactions and the prevalence of those transactions;

(b) Key terms and conditions of individual sale and leaseback transactions;

(c) Payments not included in the measurement of lease liabilities; and

(d) The cash flow effect of sale and leaseback transactions in the reporting period.

Sublease

AG56. A sublease involves three parties: the head lessor, the intermediate lessor (who is the lessee in the head lease), and a third party (the new lessee). The head lessor should continue to apply the lessor accounting requirements in this [draft] Standard. The intermediate lessor should account for the head lease and the sublease as two separate transactions, as a lessee and as a lessor, respectively. Those separate transactions should not be offset against one another. The new lessee should apply the lessee accounting requirements in this [draft] Standard.

AG57. The intermediate lessor should disclose the sublease arrangements separately from its lessee transactions related to the head lease.

Concessionary Leases (see paragraphs 15, 22, 29, 32, 35, 40, 62, 71–74, 78, 88, and 92)

AG58. Concessionary leases are granted to or received by an entity at below market terms. Examples of concessionary leases include leases to international organizations or to other public sector entities with public policy objectives.

AG59. As concessionary leases are granted or received at below market terms, the discounted contractual lease payments (consideration) on initial recognition of the lease will be lower than the discounted market lease payments. At initial recognition, an entity therefore analyzes the substance of the lease granted or received into its component parts, and accounts for those components using the principles in paragraphs AG60 and AG61 below.

AG60. An entity firstly assesses whether the substance of the concessionary lease is in fact a financing transaction, a grant or a combination thereof, by applying the principles in this [draft] Standard and paragraphs 42–58 of IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. If an entity has determined that, in substance, the concessionary lease is a grant (for example, leases for zero or nominal consideration), it accounts for the concessionary lease as follows:

(a) Where the concessionary lease (grant) is received by an entity, it is accounted for in accordance with IPSAS 23.

(b) Where the concessionary lease (grant) is granted by an entity, it is accounted for according to the relevant international or national accounting standard.

AG61. If an entity has determined that the transaction is a combination of a financing transaction and a grant, any difference between the discounted market lease payments and the discounted contractual lease payments is treated as follows:

(a) Where the concessionary lease is received by an entity, the difference is accounted for in accordance with IPSAS 23.

(b) Where the concessionary lease is granted by an entity, the difference is treated as an expense in surplus or deficit at initial recognition, except where the lease is a transaction with owners, in their capacity as owners. For example, where a controlling entity provides a concessionary lease to a controlled entity, the difference may represent a capital contribution, i.e., an investment in an entity, rather than an expense.

Illustrative examples are provided in paragraphs IG55 and IG56 of IPSAS 23 as well as in paragraphs IE11 and IE12 accompanying this [draft] Standard.

Appendix B

Amendments to Other IPSASs

Amendments to IPSAS 2, *Cash Flow Statements*

Paragraphs 26 and 55 are amended. Paragraph 63E is added. New text is underlined and deleted text is struck through.

Presentation of a Cash Flow Statement

…

Financing Activities

26. The separate disclosure of cash flows arising from financing activities is important, because it is useful in predicting claims on future cash flows by providers of capital to the entity. Examples of cash flows arising from financing activities are:

    (a) Cash proceeds from issuing debentures, loans, notes, bonds, mortgages, and other short or long-term borrowings;

    (b) Cash repayments of amounts borrowed; and

    (c) Cash payments by a lessee for the reduction of the outstanding liability relating to a ~~finance~~ lease.

…

Noncash Transactions

…

55. Many investing and financing activities do not have a direct impact on current cash flows, although they do affect the capital and asset structure of an entity. The exclusion of noncash transactions from the cash flow statement is consistent with the objective of a cash flow statement, as these items do not involve cash flows in the current period. Examples of noncash transactions are:

    (a) The acquisition of assets through the exchange of assets, the assumption of directly related liabilities, or by means of a ~~finance~~ lease; ~~and~~

    (b) The conversion of debt to equity; <u>and</u>

    (c) <u>The initial recognition of the lease receivable and the liability (unearned revenue) by a lessor.</u>

…

Effective date

<u>63E.</u> <u>**Paragraphs 26 and 55 were amended by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply these amendments for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendment for a period beginning before MM DD, YYYY, it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.**</u>

Amendments to IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*

Paragraph 17 is amended. Paragraph 71C is added. New text is underlined and deleted text is struck through.

Definitions

…

Monetary Items

17. The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: social policy obligations and other employee benefits to be paid in cash; provisions that are to be settled in cash; lease liabilities; and cash dividends or similar distributions that are recognized as a liability. Conversely, the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: amounts prepaid for goods and services ~~(e.g., prepaid rent)~~; goodwill; intangible assets; inventories; property, plant, and equipment; right-of-use assets; and provisions that are to be settled by the delivery of a non-monetary asset.

…

Effective Date

…

71C. **Paragraphs 17 was amended by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply this amendment for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendments for a period beginning before MM DD, YYYY it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.**

Amendments to IPSAS 5, *Borrowing Costs*

Paragraph 6 is amended. Paragraph 42C is added. New text is underlined and deleted text is struck through.

Definitions

Borrowing Costs

…

6. Borrowing costs may include:

   (a) Interest on bank overdrafts and short-term and long-term borrowings;

   (b) Amortization of discounts or premiums relating to borrowings;

   (c) Amortization of ancillary costs incurred in connection with the arrangement of borrowings;

   (d) ~~Finance charges~~ Interest in respect of ~~finance~~ lease~~s~~ liabilities and service concession arrangements; and

   (e) Exchange differences arising from foreign currency borrowings, to the extent that they are regarded as an adjustment to interest costs.

…

Effective Date

…

42C. **Paragraphs 6 was amended by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply this amendment for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendments for a period beginning before MM DD, YYYY it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.**

Amendments to IPSAS 9, *Revenue from Exchange Transactions*

Paragraph 10 is amended. Paragraph 41C is added. New text is underlined and deleted text is struck through.

Scope

...

10. This Standard does not deal with revenues arising from:

    (a) Lease agreements (see ~~IPSAS 13~~ [draft] IPSAS [X] (ED 64), *Leases*);

    …

Effective date

41C. **Paragraph 10 was amended by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply this amendment for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendment for a period beginning before MM DD, YYYY, it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.**

Amendments to IPSAS 12, *Inventories*

Paragraph 20 is amended. Paragraph 51C is added. New text is underlined and deleted text is struck through.

Measurement of Inventories

…

Cost of Inventories

…

Costs of Conversion

20. The costs of converting work-in-progress inventories into finished goods inventories are incurred primarily in a manufacturing environment. The costs of conversion of inventories include costs directly related to the units of production, such as direct labor. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods.

Fixed production overheads are those indirect costs of production that remain relatively constant regardless of (a) the volume of production, such as depreciation and maintenance of factory buildings, ~~and~~ equipment and right-of-use assets used in the production process, and (b) the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labor.

Effective date

51C. Paragraph 20 was amended by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply this amendment for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendment for a period beginning before MM DD, YYYY it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.

Amendments to IPSAS 16, *Investment Property*

Paragraphs 7, 10, 12, 13, 14, 20, 26, 27, 39, 49, 50, 59, 62, 62A, 63, 65, 66, 69, 71, 72, 73, 78, 80, 85, 86, 88, 89 and 97 were amended. Paragraphs 25A, 38A, 41A, 41B, 41C, 49A, 100A and its related heading and paragraph 101F were added. Paragraphs 5, 8 and its related heading, 34, 35 and 43 were deleted.

Scope

…

5. [Deleted] ~~This Standard applies to accounting for investment property, including (a) the measurement in a lessee's financial statements of investment property interests held under a lease accounted for as a finance lease, and to (b) the measurement in a lessor's financial statements of investment property provided to a lessee under an operating lease. This Standard does not deal with matters covered in IPSAS 13, *Leases*, including:~~

   ~~(a) Classification of leases as finance leases or operating leases;~~

   ~~(b) Recognition of lease revenue from investment property (see also IPSAS 9, Revenue from Exchange Transactions);~~

   ~~(c) Measurement in a lessee's financial statements of property interests held under a lease accounted for as an operating lease;~~

   ~~(d) Measurement in a lessor's financial statements of its net investment in a finance lease;~~

   ~~(e) Accounting for sale and leaseback transactions; and~~

   ~~(f) Disclosure about finance leases and operating leases.~~

…

Definitions

7. **The following terms are used in this Standard with the meanings specified:**

   …

Investment property is property (land or a building – or part of a building – or both) held (by the owner or by the lessee as a right-of-use asset) to earn rentals or for capital appreciation, or both, rather than for:

(a) **Use in the production or supply of goods or services, or for administrative purposes; or**

(b) **Sale in the ordinary course of operations.**

Owner-occupied property is property held (by the owner or by the lessee ~~under a finance lease~~ as a right-of-use asset) for use in the production or supply of goods or services, or for administrative purposes.

…

Property Interest Held by a Lessee under an Operating Lease

8. [Deleted] ~~**A property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property if, and only if, (a) the property would otherwise meet the definition of an investment property, and (b) the lessee uses the fair value model set out in paragraphs 42–64 for the asset recognized. This classification alternative is available on a property-by-property basis. However, once this classification alternative is selected for one such property interest held under an operating lease, all property classified as investment property shall be accounted for using the fair value model. When this classification alternative is selected, any interest so classified is included in the disclosures required by paragraphs 85–89.**~~

Investment Property

…

10. Investment property is held to earn rentals or for capital appreciation, or both. Therefore, investment property generates cash flows largely independently of the other assets held by an entity. This distinguishes investment property from other land or buildings controlled by public sector entities, including owner-occupied property. The production or supply of goods or services (or the use of property for administrative purposes) can also generate cash flows. For example, public sector entities may use a building to provide goods and services to recipients in return for full or partial cost recovery. However, the building is held to facilitate the production of goods and services, and the cash flows are attributable not only to the building, but also to other assets used in the production or supply process. IPSAS 17, *Property, Plant, and Equipment*, applies to owned owner-occupied property and [draft] IPSAS [X] (ED 64), *Leases* applies to owner-occupied property by a lessee as a right-of-use asset.

…

12. The following are examples of investment property:

(a) Land held for long-term capital appreciation rather than for short-term sale in the ordinary course of operations. For example, land held by a hospital for capital appreciation that may be sold at a beneficial time in the future.

(b) Land held for a currently undetermined future use. (If an entity has not determined that it will use the land as owner-occupied property, including occupation to provide services such as those provided by national parks to current and future generations, or for short-term sale in the ordinary course of operations, the land is regarded as held for capital appreciation).

(c) A building owned by the entity (or a right-of-use asset relating to a building held by the entity ~~under a finance lease~~) and leased out under one or more ~~operating~~ leases on a commercial basis. For example, a university may own a building that it leases on a commercial basis to external parties.

(d) A building that is vacant but is held to be leased out under one or more ~~operating~~ leases on a commercial basis to external parties.

(e) Property that is being constructed or developed for future use as investment property.

13. The following are examples of items that are not investment property and are therefore outside the scope of this Standard:

(a) Property held for sale in the ordinary course of operations or in the process of construction or development for such sale (see IPSAS 12, *Inventories*). For example, a municipal government may routinely supplement rate income by buying and selling property, in which case property held exclusively with a view to subsequent disposal in the near future or for development for resale is classified as inventory. A housing department may routinely sell part of its housing stock in the ordinary course of its operations as a result of changing demographics, in which case any housing stock held for sale is classified as inventory.

(b) Property being constructed or developed on behalf of third parties. For example, a property and service department may enter into construction contracts with entities external to its government (see IPSAS 11, *Construction Contracts*).

(c) Owner-occupied property (see IPSAS 17 and [draft] IPSAS [X] (ED 64)), including (among other things) property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees such as housing for military personnel (whether or not the employees pay rent at market rates) and owner-occupied property awaiting disposal.

(d) [Deleted]

(e) [Deleted] ~~Property that is leased to another entity under a finance lease.~~

(f) Property held to provide a social service and which also generates cash inflows. For example, a housing department may hold a large housing stock used to provide housing to low income families at below market rental. In this situation, the property is held to provide housing services rather than for rentals or capital appreciation and rental revenue generated is incidental to the purposes for which the property is held. Such property is not considered an “investment property” and would be accounted for in accordance with IPSAS 17.

(g) Property held for strategic purposes which would be accounted for in accordance with IPSAS 17.

14. In many jurisdictions, public sector entities will hold property to meet service delivery objectives rather than to earn rental or for capital appreciation. In such situations, the property will not meet the definition of investment property. However, where a public sector entity does hold property to earn rental or for capital appreciation, this Standard is applicable. In some cases, public sector entities hold some property that comprises (a) a portion that is held to earn rentals or for capital appreciation rather than to provide services, and (b) another portion that is held for use in the production or supply

of goods or services or for administrative purposes. For example, a hospital or a university may own a building, part of which is used for administrative purposes, and part of which is leased out as apartments on a commercial basis. If these portions could be sold separately ~~(or leased out separately under a finance lease~~), an entity accounts for the portions separately. If the portions could not be sold separately, the property is investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.

…

Recognition

20. **An owned ~~I~~investment property shall be recognized as an asset when, and only when:**

    (a) **It is probable that the future economic benefits or service potential that are associated with the investment property will flow to the entity; and**

    (b) **The cost or fair value of the investment property can be measured reliably.**

…

25A. An investment property held by a lessee as a right-of-use asset shall be recognized in accordance with [draft] IPSAS [X] (ED 64).

Measurement at Recognition

26. **An owned ~~I~~investment property shall be measured initially at its cost (transaction costs shall be included in this initial measurement).**

27. **Where an owned investment property is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the date of acquisition.**

…

34. [Deleted] ~~**The initial cost of a property interest held under a lease and classified as an investment property shall be as prescribed for a finance lease by paragraph 28 of IPSAS 13, i.e., the asset shall be recognized at the lower of the fair value of the property and the present value of the minimum lease payments. An equivalent amount shall be recognized as a liability in accordance with that same paragraph.**~~

35. [Deleted] ~~Any premium paid for a lease is treated as part of the minimum lease payments for this purpose, and is therefore included in the cost of the asset, but is excluded from the liability. If a property interest held under a lease is classified as investment property, the item accounted for at fair value is that interest and not the underlying property. Guidance on determining the fair value of a property interest is set out for the fair value model in paragraphs 42–61. That guidance is also relevant to the determination of fair value when that value is used as cost for initial recognition purposes.~~

…

38A. An investment property held by a lessee as a right-of-use asset shall be measured initially in accordance with [draft] IPSAS [X] (ED 64).

Measurement after Recognition

Accounting Policy

39. **With the exception noted in paragraph 41A ~~43~~ , an entity shall choose as its accounting policy either the fair value model in paragraphs 42–64 or the cost model in paragraph 65, and shall apply that policy to all of its investment property.**

…

41A. **An entity may:**

(a) **Choose either the fair value model or the cost model for all investment property backing liabilities that pay a return linked directly to the fair value of, or returns from, specified assets including that investment property; and**

(b) **Choose either the fair value model or the cost model for all other investment property, regardless of the choice made in (a).**

41B. Some insurers and other entities operate an internal property fund that issues notional units, with some units held by investors in linked contracts and others held by the entity. Paragraph 41A does not permit an entity to measure the property held by the fund partly at cost and partly at fair value.

41C. If an entity chooses different models for the two categories described in paragraph 41A, sales of investment property between pools of assets measured using different models shall be recognized at fair value and the cumulative change in fair value shall be recognized in surplus or deficit. Accordingly, if an investment property is sold from a pool in which the fair value model is used into a pool in which the cost model is used, the property's fair value at the date of the sale becomes its deemed cost.

Fair Value Model

…

43. [Deleted] ~~**When a property interest held by a lessee under an operating lease is classified as an investment property under paragraph 8, paragraph 39 is not elective; the fair value model shall be applied.**~~

…

49. The fair value of investment property reflects, among other things, rental revenue from current leases and reasonable and supportable assumptions that represent what knowledgeable, willing parties would assume about rental revenue from future leases in the light of current conditions. It also reflects, on a similar basis, any cash outflows (including rental payments and other outflows) that could be expected in respect of the property. ~~Some of those outflows are reflected in the liability whereas others relate to outflows that are not recognized in the financial statements until a later date (e.g. periodic payments such as contingent rents).~~

49A. When a lessee uses the fair value model to measure an investment property that is held as a right-of-use asset, it shall measure the right-of-use asset, and not the underlying asset, at fair value.

50. ~~Paragraph 34~~ [Draft] IPSAS [X] (ED 64) specifies the basis for initial recognition of the cost of ~~an interest in a leased property~~ an investment property held by a lessee as a right-of-use asset. Paragraph 42 requires ~~the interest in the leased property~~ investment property held by a lessee as a right-of-use asset to be remeasured, if necessary, to fair value if the entity chooses the fair value

model. ~~In a lease negotiated~~ When lease payments are at market rates, the fair value of ~~an interest in a leased property~~ an investment property held by a lessee as a right-of-use asset at acquisition, net of all expected lease payments (including those relating to recognized lease liabilities), should be zero. ~~This fair value does not change regardless of whether, for accounting purposes, a leased asset and liability are recognized at fair value or at the present value of minimum lease payments, in accordance with paragraph 28 of IPSAS 13.~~ Thus, remeasuring a ~~leased~~ right-of-use asset from cost in accordance with ~~paragraph 34~~ [draft] IPSAS [X] (ED 64) to fair value in accordance with paragraph 42 (taking into account the requirements in paragraph 59) should not give rise to any initial gain or loss, unless fair value is measured at different times. This could occur when an election to apply the fair value model is made after initial recognition.

…

59. In determining the carrying amount of investment property under the fair value model, an entity does not double-count assets or liabilities that are recognized as separate assets or liabilities. For example:

(a) Equipment such as elevators or air-conditioning is often an integral part of a building and is generally included in the fair value of the investment property, rather than recognized separately as property, plant, and equipment.

(b) If an office is leased on a furnished basis, the fair value of the office generally includes the fair value of the furniture, because the rental revenue relates to the furnished office. When furniture is included in the fair value of investment property, an entity does not recognize that furniture as a separate asset.

(c) The fair value of investment property excludes prepaid or accrued ~~operating~~ lease revenue, because the entity recognizes it as a separate liability or asset.

(d) The fair value of investment property held by a lessee as a right-of-use asset ~~under a lease~~ reflects expected cash flows (including ~~contingent rent that is~~ variable lease payments that are expected to become payable). Accordingly, if a valuation obtained for a property is net of all payments expected to be made, it will be necessary to add back any recognized lease liability, to arrive at the carrying amount of the investment property using the fair value model.

…

Inability to Determine Fair Value Reliably

62. **There is a rebuttable presumption that an entity can reliably determine the fair value of an investment property on a continuing basis. However, in exceptional cases, there is clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property after a change in use) that the fair value of the investment property is not reliably determinable on a continuing basis. This arises when, and only when, comparable market transactions are infrequent and alternative reliable estimates of fair value (for example, based on discounted cash flow projections) are not available. If an entity determines that the fair value of an investment property under construction is not reliably determinable but expects the fair value of the property to be reliably determinable when construction is complete, it shall measure that investment property under construction at cost until either its fair value becomes reliably determinable or construction is completed (whichever is earlier). If an entity determines that the fair value of an investment property (other than an investment property under construction) is not reliably determinable on a**

continuing basis, the entity shall measure that investment property using the cost model in IPSAS 17 <u>for owned investment property or in accordance with [draft] IPSAS [X] (ED 64) for investment property held by a lessee as a right-of-use asset</u>. The residual value of the investment property shall be assumed to be zero. The entity shall <u>continue to</u> apply IPSAS 17 <u>or [draft] IPSAS [X] (ED 64)</u> until disposal of the investment property.

62A. Once an entity becomes able to measure reliably the fair value of an investment property under construction that has previously been measured at cost, it shall measure that property at its fair value. Once construction of that property is complete, it is presumed that fair value can be measured reliably. If this is not the case, in accordance with paragraph 62, the property shall be accounted for using the cost model in accordance with IPSAS 17 <u>for owned assets or [draft] IPSAS [X] (ED 64) for investment property held by a lessee as a right-of-use asset</u>.

…

63. In the exceptional cases when an entity is compelled, for the reason given in paragraph 62, to measure an investment property using the cost model in accordance with IPSAS 17 <u>or [draft] IPSAS [X] (ED 64)</u>, it measures at fair value all its other investment property, including investment property under construction. In these cases, although an entity may use the cost model for one investment property, the entity shall continue to account for each of the remaining properties using the fair value model.

…

Cost Model

65. **~~After initial recognition, an entity that chooses the cost model shall measure all of its investment property in accordance with IPSAS 17's requirements for that model, i.e., at cost less any accumulated depreciation and any accumulated impairment losses.~~**

<u>After initial recognition, an entity that chooses the cost model shall measure investment property:</u>

<u>(a)</u> **<u>In accordance with [draft] IPSAS [X] (ED 64) if it is held by a lessee as a right-of-use asset; and</u>**

<u>(b)</u> **<u>In accordance with the requirements in IPSAS 17 for the cost model if it is held by an owner as an owned investment property.</u>**

Transfers

66. **Transfers to or from investment property shall be made when, and only when, there is a change in use, evidenced by:**

(a) **Commencement of owner-occupation, for a transfer from investment property to owner-occupied property;**

(b) **Commencement of development with a view to sale, for a transfer from investment property to inventories;**

(c) **End of owner-occupation, for a transfer from owner-occupied property to investment property; or**

(d) **Commencement of a~~n~~ ~~operating~~ lease (on a commercial basis) to another party, for a transfer from inventories to investment property.**

(e) [Deleted]

…

69. A government property department may regularly review its buildings to determine whether they are meeting its requirements, and as part of that process may identify, and hold, certain buildings for sale. In this situation, the building may be considered inventory. However, if the government decided to hold the building for its ability to generate rent revenue and its capital appreciation potential, it would be reclassified as an investment property on commencement of any subsequent ~~operating~~ lease.

…

71. **For a transfer from investment property carried at fair value to owner-occupied property or inventories, the property's cost for subsequent accounting in accordance with IPSAS 17, [draft] IPSAS [X] (ED 64) or IPSAS 12, shall be its fair value at the date of change in use.**

72. **If an owner-occupied property becomes an investment property that will be carried at fair value, an entity shall apply IPSAS 17 for owned property and [draft] IPSAS [X] (ED 64) for property held by a lessee as a right-of-use asset up to the date of change in use. The entity shall treat any difference at that date between the carrying amount of the property in accordance with IPSAS 17 or [draft] IPSAS [X] (ED 64), and its fair value in the same way as a revaluation in accordance with IPSAS 17.**

73. Up to the date when an owner-occupied property becomes an investment property carried at fair value, an entity depreciates the property (or right-of-use asset) and recognizes any impairment losses that have occurred. The entity treats any difference at that date between the carrying amount of the property in accordance with IPSAS 17 or [draft] IPSAS [X] (ED 64), and its fair value in the same way as a revaluation in accordance with IPSAS 17. In other words:

(a) Any resulting decrease in the carrying amount of the property is recognized in surplus or deficit. However, to the extent that an amount is included in revaluation surplus for that property, the decrease is charged against that revaluation surplus.

(b) Any resulting increase in the carrying amount is treated as follows:

(i) To the extent that the increase reverses a previous impairment loss for that property, the increase is recognized in surplus or deficit. The amount recognized in surplus or deficit does not exceed the amount needed to restore the carrying amount to the carrying amount that would have been determined (net of depreciation) if no impairment loss had been recognized.

(ii) Any remaining part of the increase is credited directly to net assets/equity in revaluation surplus. On subsequent disposal of the investment property, the revaluation surplus included in net assets/equity may be transferred to accumulated surpluses or deficits. The transfer from revaluation surplus to accumulated surpluses or deficits is not made through surplus or deficit.

…

Disposals

…

78. The disposal of an investment property ~~may be~~ is achieved by sale ~~or by entering into a finance lease~~. In determining the date of disposal for investment property that is sold, an entity applies the criteria in IPSAS 9 for recognizing revenue from the sale of goods and considers the related guidance in the Implementation Guidance to IPSAS 9. ~~IPSAS 13~~ [draft] IPSAS [X] (ED 64) applies to a disposal effected by entering into a ~~finance lease and to a~~ sale and leaseback.

…

80. **Gains or losses arising from the retirement or disposal of investment property shall be determined as the difference between the net disposal proceeds and the carrying amount of the asset, and shall be recognized in surplus or deficit (unless ~~IPSAS 13~~ [draft] IPSAS [X] (ED 64) requires otherwise on a sale and leaseback) in the period of the retirement or disposal.**

…

Disclosure

Fair Value Model and Cost Model

85. The disclosures below apply in addition to those in ~~IPSAS 13~~ [draft] IPSAS [X] (ED 64). In accordance with ~~IPSAS 13~~ [draft] IPSAS [X] (ED 64), the owner of an investment property provides lessors' disclosures about leases into which it has entered. ~~An entity~~ A lessee that holds an investment property ~~under a finance lease or operating lease~~ as a right-of-use asset provides lessees' disclosures ~~for finance leases~~ as required by [draft] IPSAS [X] (ED 64) and lessors' disclosures as required by [draft] IPSAS [X] (ED 64) for any ~~operating~~ leases into which it has entered.

86. **An entity shall disclose:**

    (a) **Whether it applies the fair value or the cost model;**

    (b) [Deleted] **~~If it applies the fair value model, whether, and in what circumstances, property interests held under operating leases are classified and accounted for as investment property~~**;

    (c) **When classification is difficult (see paragraph 18), the criteria it uses to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of operations;**

    (d) **The methods and significant assumptions applied in determining the fair value of investment property, including a statement whether the determination of fair value was supported by market evidence, or was more heavily based on other factors (which the entity shall disclose) because of the nature of the property and lack of comparable market data;**

    (e) **The extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognized and relevant professional qualification and has recent experience in the location and category of the investment property being valued. If there has been no such valuation, that fact shall be disclosed;**

(f) **The amounts recognized in surplus or deficit for:**

(i) **Rental revenue from investment property;**

(ii) **Direct operating expenses (including repairs and maintenance) arising from investment property that generated rental revenue during the period; and**

(iii) **Direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental revenue during the period.**

(g) **The existence and amounts of restrictions on the realizability of investment property or the remittance of revenue and proceeds of disposal; and**

(h) **Contractual obligations to purchase, construct, or develop investment property or for repairs, maintenance, or enhancements.**

Fair Value Model

…

88. **When a valuation obtained for investment property is adjusted significantly for the purpose of the financial statements, for example to avoid double-counting of assets or liabilities that are recognized as separate assets and liabilities as described in paragraph 59, the entity shall disclose a reconciliation between the valuation obtained and the adjusted valuation included in the financial statements, showing separately the aggregate amount of any recognized lease ~~obligations~~ liabilities that have been added back, and any other significant adjustments.**

89. **In the exceptional cases referred to in paragraph 62, when an entity measures investment property using the cost model in IPSAS 17 or in accordance with [draft] IPSAS [X] (ED 64), the reconciliation required by paragraph 87 shall disclose amounts relating to that investment property separately from amounts relating to other investment property. In addition, an entity shall disclose:**

(a) **A description of the investment property;**

(b) **An explanation of why fair value cannot be determined reliably;**

(c) **If possible, the range of estimates within which fair value is highly likely to lie; and**

(d) **On disposal of investment property not carried at fair value:**

(i) **The fact that the entity has disposed of investment property not carried at fair value;**

(ii) **The carrying amount of that investment property at the time of sale; and**

(iii) **The amount of gain or loss recognized.**

Transitional Provisions

…

Fair Value Model

…

97. An entity that (a) has previously applied IPSAS 16 (2001), and (b) elects for the first time to classify and account for some or all eligible property interests held under ~~operating~~ leases as investment property, shall recognize the effect of that election as an adjustment to the opening balance of accumulated surpluses or deficits for the period in which the election is first made. In addition, if the entity has previously disclosed publicly (in financial statements or otherwise) the fair value of those property interests in earlier periods, paragraph 94(a) applies. If the entity has not previously disclosed publicly the information related to those property interests described in paragraph 94(a), paragraph 94(b) applies.

…

[draft] IPSAS [X] (ED 64)

100A. **An entity applying [draft] IPSAS [X] (ED 64), and its related amendments to this Standard, for the first time shall apply the transition requirements in [draft] IPSAS [X] (ED 64) to its investment property.**

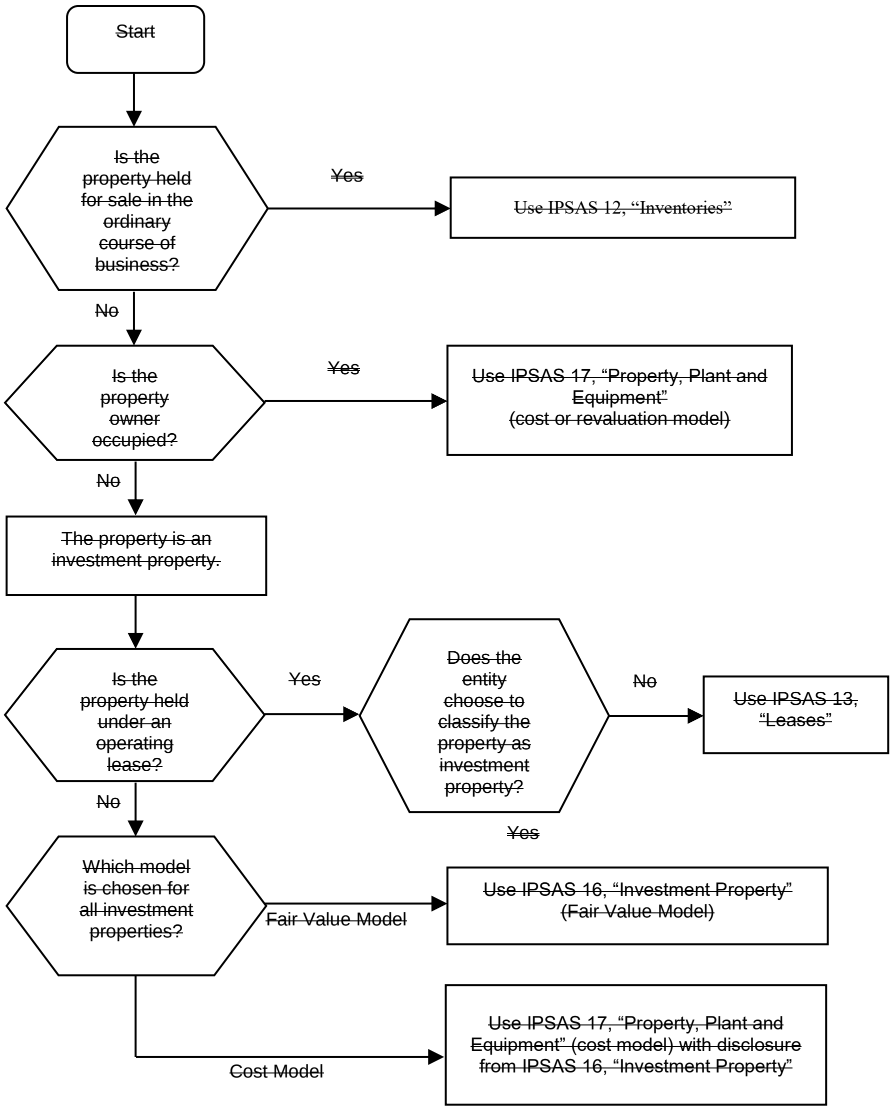
Effective Date

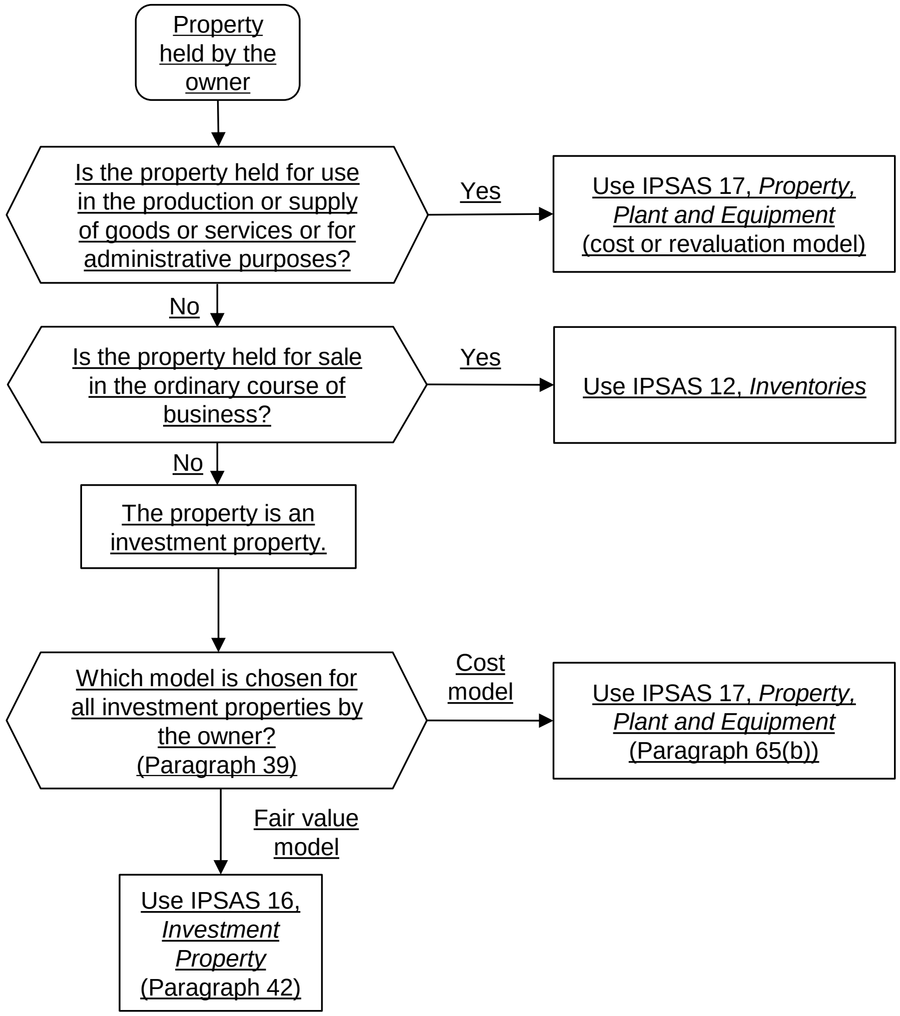
…

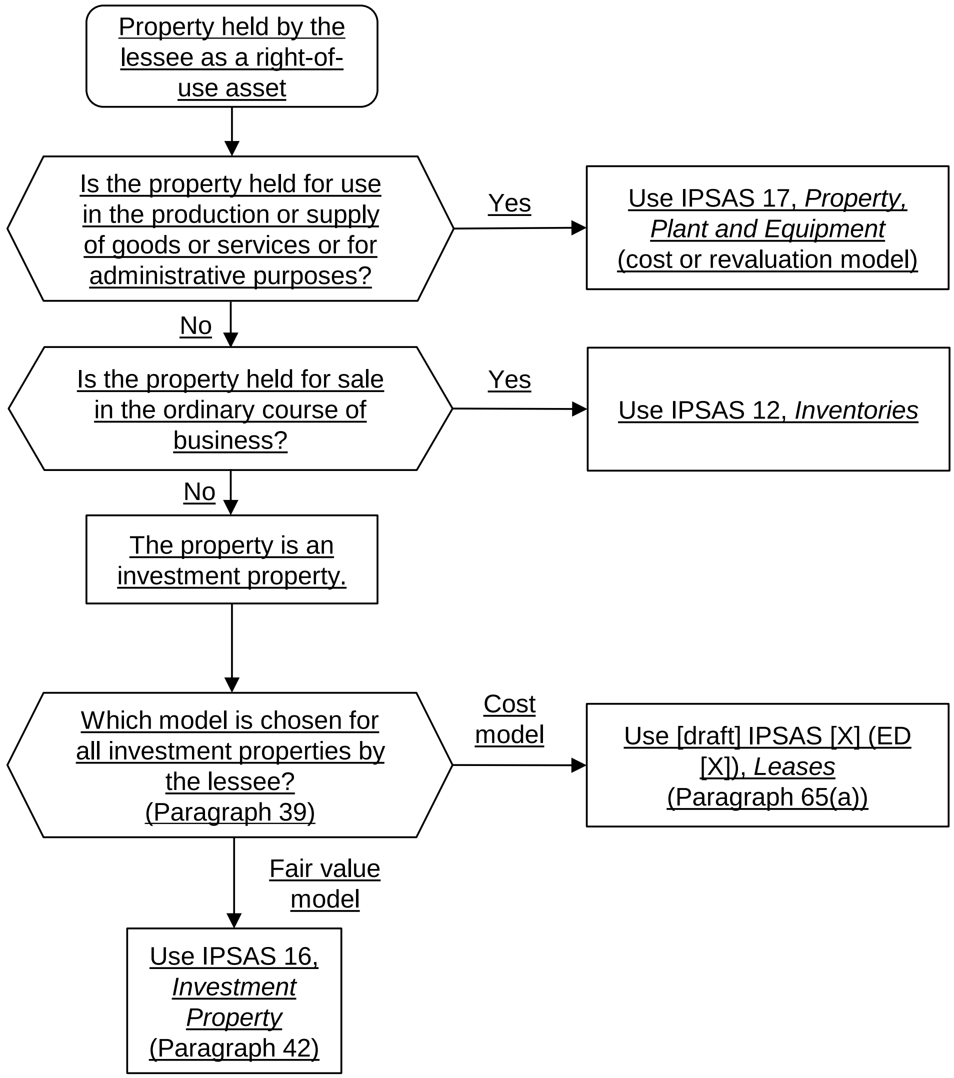
101F. **[draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY, amended the scope of IPSAS 16 by defining investment property to include both owned investment property and property held by a lessee as a right-of-use asset. Paragraphs 7, 10, 12, 13, 14, 20, 26, 27, 39, 49, 50, 59, 62, 62A, 63, 65, 66, 69, 71, 72, 73, 78, 80, 85, 86, 88, 89 and 97 were amended, paragraphs 25A, 38A, 41A, 41B, 41C, 49A and 100A and its related heading were added, and paragraphs 5, 8 and its related heading, 34, 35 and 43 were deleted by [draft] IPSAS [X] (ED 64). An entity shall apply these amendments for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendments for a period beginning before MM DD, YYYY it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.**

Illustrative Decision Trees

~~This~~ These decision trees accompani~~es~~y, but ~~is~~ are not part of, IPSAS 16.




Property held by the owner
Is the property held for use in the production or supply of goods or services or for administrative purposes?
Yes
Use IPSAS 17, *Property, Plant and Equipment* (cost or revaluation model)
No
Is the property held for sale in the ordinary course of business?
Yes
Use IPSAS 12, *Inventories*
No
The property is an investment property.
Which model is chosen for all investment properties by the owner? (Paragraph 39)
Cost model
Use IPSAS 17, *Property, Plant and Equipment* (Paragraph 65(b))
Fair value model
Use IPSAS 16, *Investment Property* (Paragraph 42)



Amendments to IPSAS 17, *Property, Plant, and Equipment*

Paragraphs 8, 19, 60, 83, 84 are amended. Paragraph 108O is added. Paragraphs 7 and 41 are deleted. New text is underlined and deleted text is struck through.

Scope

…

7. <u>[Deleted]</u> ~~Other IPSASs may require recognition of an item of property, plant, and equipment based on an approach different from that in this Standard. For example, IPSAS 13, *Leases*, requires an entity to evaluate its recognition of an item of leased property, plant, and equipment on the basis of the transfer of risks and rewards. IPSAS 32 requires an entity to evaluate the recognition of an item of property, plant, and equipment used in a service concession arrangement on the basis of control of the asset. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.~~

8. An entity using the cost model for investment property in accordance with IPSAS 16, *Investment Property* shall use the cost model in this Standard for owned investment property.

Recognition

…

19. An entity evaluates under this recognition principle all its property, plant, and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant, and equipment and costs incurred subsequently to add to, replace part of, or service it. The cost of an item of property, plant and equipment may include costs incurred relating to leases of assets that are used to construct, add to, replace part of or service an item of property, plant and equipment, such as depreciation of right-of-use assets.

Measurement at Recognition

…

Measurement of Cost

…

41. [Deleted] ~~The cost of an item of property, plant, and equipment held by a lessee under a finance lease is determined in accordance with IPSAS 13.~~

Measurement after Recognition

…

Depreciation

…

60. An entity allocates the amount initially recognized in respect of an item of property, plant, and equipment to its significant parts and depreciates separately each such part. For example, in most cases, it would be required to depreciate separately the pavements, formation, curbs and channels, footpaths, bridges, and lighting within a road system. Similarly, it may be appropriate to depreciate separately the airframe and engines of an aircraft~~, whether owned or subject to a finance lease~~. Similarly, if an entity acquires property, plant and equipment subject to a~~n~~ ~~operating~~ lease in which it is the lessor, it may be appropriate to depreciate separately amounts reflected in the cost of that item that are attributable to favorable or unfavorable lease terms relative to market terms.

…

Derecognition

83. The gain or loss arising from the derecognition of an item of property, plant, and equipment shall be included in surplus or deficit when the item is derecognized (unless ~~IPSAS 13~~ [draft] IPSAS [X] (ED 64) requires otherwise on a sale and leaseback).

…

84. The disposal of an item of property, plant and equipment may occur in a variety ways (e.g., by sale~~, by entering into a finance lease~~ or by donation). In determining the date of disposal of an item, an

entity applies the criteria in IPSAS 9 for recognizing revenue from the sale of goods. ~~IPSAS 13~~ [draft] IPSAS [X] (ED 64) applies to disposal by a sale and leaseback.

…

Effective Date

…

108O. **Paragraphs 8, 19, 60, 83, 84 were amended and paragraphs 7 and 41 were deleted by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply these amendments for annual financial statements covering periods beginning on or after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendments for a period beginning before MM DD, YYYY, it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.**

Amendments to IPSAS 18, *Segment Reporting*

Paragraphs 33 and 35 are amended. Paragraph 76C is added. New text is underlined and deleted text is struck through.

Definitions of Segment Revenue, Expense, Assets, Liabilities, and Accounting Policies

…

Segment Assets, Liabilities, Revenue, and Expense, and Accounting Policies

33. Examples of segment assets include current assets that are used in the operating activities of the segment: property, plant, and equipment; right-of-use assets ~~that are the subject of finance leases~~; and intangible assets. If a particular item of depreciation or amortization is included in segment expense, the related asset is also included in segment assets. Segment assets do not include assets used for general entity or head office purposes. For example:

    (a) The office of the central administration and policy development unit of a department of education is not included in segments reflecting the delivery of primary, secondary and tertiary educational services; or

    (b) The parliamentary or other general assembly building is not included in segments reflecting major functional activities such as education, health, and defense when reporting at the whole-of-government level.

    Segment assets include operating assets shared by two or more segments if a reasonable basis for allocation exists.

…

35. Examples of segment liabilities include trade and other payables, accrued liabilities, advances from members of the community for the provision of partially subsidized goods and services in the future, product warranty provisions arising from any commercial activities of the entity, and other claims relating to the provision of goods and services. Segment liabilities do not include borrowings, liabilities related to right-of-use assets ~~that are the subject of finance leases~~, and other liabilities that are incurred for financing rather than operating purposes. If interest expense is included in segment expense, the related interest-bearing liability is included in segment liabilities.

Effective Date

…

76C. **Paragraphs 33 and 35 were amended by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply these amendments for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendments for a period beginning before MM DD, YYYY it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.**

Amendments to IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*

Paragraph 13 is amended. Paragraph 111D is added. New text is underlined and deleted text is struck through.

Scope

13. Where another IPSAS deals with a specific type of provision, contingent liability, or contingent asset, an entity applies that standard instead of this Standard. For example, certain types of provisions are also addressed in Standards on:

    (a) Construction contracts (see IPSAS 11, *Construction Contracts*); and

    (b) Leases (see ~~IPSAS 13~~ [draft] IPSAS [X] (ED 64), *Leases*). However, ~~as IPSAS 13 contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases~~ this Standard applies to leases at market terms that becomes onerous before the commencement date of the lease as defined in [draft] IPSAS [X] (ED 64). This Standard also applies to short-term leases and leases for which the underlying asset is of low value accounted for in accordance with paragraph 65 of [draft] IPSAS [X] (ED 64) and that have become onerous.

Effective Date

…

111D. **Paragraph 13 was amended by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply this amendment for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendments for a period beginning before MM DD, YYYY it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.**

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 19.

…

An Onerous Contract

IG13. [Deleted] ~~A hospital laundry operates from a building that the hospital (the reporting entity) has leased under an operating lease. During December 2004, the laundry relocates to a new building. The lease on the old building continues for the next four years; it cannot be canceled. The hospital has no alternative use for the building and the building cannot be re-let to another user.~~

~~**Analysis**~~

~~Present obligation as a result of a past obligating event – The obligating event is the signing of the lease contract, which gives rise to a legal obligation.~~

~~An outflow of resources embodying economic benefits or service potential in settlement – When the lease becomes onerous, an outflow of resources embodying economic benefits is probable. (Until the lease becomes onerous, the hospital accounts for the lease under IPSAS 13, Leases).~~

~~**Conclusion**~~

~~A provision is recognized for the best estimate of the unavoidable lease payments (see paragraphs 13(b), 22 and 76).~~

Amendments to IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*

Paragraph 43 is amended. Paragraphs 43A, 105C, 105D, 123A and 124F are added. The heading above paragraph 105C is added. New text is underlined.

Measurement of Assets on Initial Recognition

…

43. Consistent with IPSAS 12, *Inventories*, IPSAS 16, *Investment Property*, ~~and~~ IPSAS 17, <u>and [draft] IPSAS [X] (ED 64), *Leases* for right-of-use assets held by a lessee</u>~~,~~ assets acquired through non-exchange transactions are measured at their fair value as at the date of acquisition.

<u>43A. The fair value of right-of-use assets held by a lessee is measured in accordance with [draft] IPSAS [X] (ED 64)).</u>

<u>Concessionary Leases</u>

<u>105C. Concessionary leases (including concessionary leasebacks) are granted to or received by an entity at below market terms, including leases for zero or nominal consideration. The portion of the lease that is payable, if any, along with any interest payments, is an exchange transaction and is accounted for in accordance with [draft] IPSAS [X] (ED 64), *Leases*. An entity considers whether any difference between the consideration (lease payments) and the fair value of the lease on initial recognition (see [draft] IPSAS [X] (ED 64)) is non-exchange revenue that should be accounted for in accordance with this Standard.</u>

<u>105D. Where an entity determines that the difference between the consideration (lease payments) and the fair value of the lease on initial recognition is non-exchange revenue, an entity recognizes the difference as revenue, except if a present obligation exists, e.g., where specific conditions imposed on the transferred asset (the right-of-use asset) by the recipient result in a present obligation. Where a present obligation exists, it is recognized as a liability. As the entity satisfies the present obligation, the liability is reduced and an equal amount of revenue is recognized.</u>

Transitional Provisions

…

<u>123A. The transitional provisions in [draft] IPSAS [X] (ED 64) are also applicable to the measurement of the right-of-use assets held by a lessee of concessionary leases of zero or nominal amount.</u>

Effective Date

…

124F. **Paragraph 43 was amended and paragraphs 43A, 105C, 105D, and 123A were added by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply these amendments for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendments for a period beginning before MM DD, YYYY it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.**

…

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 23.

Measurement, Recognition, and Disclosures of Revenue from Non-Exchange Transactions

…

Concessionary leases (paragraphs 105C and 105D)

Concessionary Lease (Lessee)–Subsidy Results from 30% Lower Contract Lease Payments than Market Value of Lease Payments.

IG55. A public sector not-for profit organization (Lessee) enters into a lease with a municipality (Lessor) to use a building over a period of 5 years with the condition to use it for providing medical services to the population in general. The annual market lease payment is CU5,312,420 with a market interest rate at 5% and the lessee pays only 70% of the annual market lease payment.

- The agreement stipulates that the lease should be paid over the 5 year period as follows:

  Year 1: CU3,718,694

  Year 2: CU3,718,694

  Year 3: CU3,718,694

  Year 4: CU3,718,694

  Year 5: CU3,718,694

- The lease includes conditions. To the extent the conditions are not met, the lease is cancelled and the right to use the underlying asset returns to the lessor. The conditions are met on a straight-line basis.

Analysis

As it is a concessionary lease, the fair value of the right-of-use asset is assessed separately from the fair value of the contractual lease payments. The public sector not-for profit organization (Lessee) has effectively received a subsidy of CU6,900,000 (which is the difference between the fair value of the right-of-use asset (measured at the present value of the market lease payments) and the present value of the contractual lease payments. (Note: An entity would consider whether the substance of the CU6,900,000 is a contribution from owners or revenue; assume for purposes of this example that the CU6,900,000 is revenue).

The grant of CU6,900,000 is accounted for in accordance with this Standard and, the lease with its related contractual interest and capital payments, in accordance with [draft] IPSAS [X] (ED 64).

The journal entries to account for the concessionary lease are as follows:

1. On initial recognition, the entity will recognize the following:

Dr		Right-of-use asset	CU23,000,000	
	Cr	Lease liability		CU16,100,000
	Cr	Liability		CU6,900,000

2. Year 1: the entity will recognize the following:

Dr		Liability	CU1,380,000	
	Cr	Non-exchange revenue		CU1,380,000

(1/5 of the conditions met X CU6.900.000)

(Note: The journal entries for the repayment of interest and capital and interest accruals, have not been reflected in this example as it is intended to illustrate the recognition of revenue arising from concessionary leases. Comprehensive examples are included in the Illustrative Examples to [draft] IPSAS [X] (ED 64).

3. Year 2: the entity will recognize the following (the entity subsequently measures the concessionary lease at amortized cost):

Dr		Liability	CU1,380,000	
	Cr	Non-exchange revenue		CU1,380,000

(1/5 of the conditions met X CU6,900,000)

4. Year 3: the entity will recognize the following:

Dr		Liability	CU1,380,000	
	Cr	Non-exchange revenue		CU1,380,000

(1/5 of the conditions met X CU6,900,000)

5. Year 4: the entity will recognize the following:

Dr		Liability	CU1,380,000	
	Cr	Non-exchange revenue		CU1,380,000

(1/5 of the conditions met X CU6,900,000)

6. Year 5: the entity will recognize the following:

Dr		Liability	CU1,380,000	
	Cr	Non-exchange revenue		CU1,380,000

(1/5 of the conditions met X CU6,900,000)

If the concessionary lease was granted with no conditions, the entity would recognize the following on initial recognition:

Dr		Right-of-use asset	CU23,000,000	
	Cr	Lease liability		CU16,100,000
	Cr	Non-exchange revenue		CU6,900,000

Sale and Leaseback Transaction at Below Market Terms (Concessionary Leaseback)

IG56. An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) at fair value for cash of CU1,800,000. Immediately before the transaction, the building is carried at a cost of CU1,000,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 18 years, with annual payments of CU103,553 at the end of each year. The terms and conditions of the transaction are such that the:

(a) Transfer of the building by Seller-lessee satisfies the requirements of IPSAS 9, Revenue from Exchange Transactions;

(b) Non-exchange component included in the concessionary leaseback is recognized by Seller-lessee as a liability (unearned revenue) on initial recognition, according to this Standard;

(c) The credit entry for the non-exchange component included in the concessionary leaseback is recognized by Buyer-lessor as a liability (unearned revenue), according to [draft] IPSAS [X] (ED64); and

(d) The debit entry for the non-exchange component included in the concessionary leaseback is recognized by Buyer-lessor as a non-exchange expense, according to [draft] IPSAS [X] (ED64).

Accordingly, Seller-lessee and Buyer-lessor account for the transaction as a sale and concessionary leaseback. This example ignores any initial direct costs.

The annual market lease payment is CU120,000. The market interest rate is 4.5 per cent per annum.

The present value of the annual market lease payments amounts to CU1,459,200 (18 payments of CU120,000, discounted at 4.5 per cent per annum). The present value of the agreed annual lease payments (18 payments of CU103,553, discounted at 4.5 per cent per annum), amounts to CU1,259,200.

Because the consideration for the annual payments is below fair value, Buyer-lessor gives a subsidy to Seller-lessee of CU200,000 (CU1,459,200 – CU1,259,200).

Seller-lessee

At the commencement date, Seller-lessee measures the right-of-use asset arising from the leaseback of the building at the proportion of the previous carrying amount of the building that relates to the right of use retained by Seller-lessee, which is CU810,667. This is calculated as: CU1,000,000 (the carrying amount of the building) ÷ CU1,800,000 (the fair value of the building) × CU1,459,200 (the discounted lease payments for the 18-year right-of-use asset at fair value).

Seller-lessee recognizes only the amount of the gain that relates to the rights transferred to Buyer-lessor of CU151,467 calculated as follows. The gain on sale of building amounts to CU800,000 (CU1,800,000 – CU1,000,000), of which:

(a) CU648,533 (CU800,000 ÷ CU1,800,000 × CU1,459,200) relates to the right to use the building retained by Seller-lessee; and

(b) CU151,467 (CU800,000 ÷ CU1,800,000 × (CU1,800,000 – CU1,459,200)) relates to the rights transferred to Buyer-lessor.

At the commencement date, Seller-lessee accounts for the transaction as follows.

Cash	CU1,800,000	
Right-of-use asset	CU810,667	
Building		CU1,000,000
Lease liability		CU1,259,200
Liability or non-exchange		

revenue (concessionary element) CU200,000

Gain on rights transferred CU151,467

From Year 1 to year 18 the Seller-lessee recognizes as revenue 1/18 of the liability (unearned revenue) as follows:

Liability (unearned revenue) CU11,111

Non-exchange revenue CU11,111

If the concessionary leaseback was granted with no conditions, the entity would recognize the CU200,000 as non-exchange revenue on initial recognition.

Amendments to IPSAS 27, *Agriculture*

Paragraph 3 is amended. Paragraph 56G is added. New text is underlined and deleted text is struck through.

Scope

3. This Standard does not apply to:

   (e) Land related to agricultural activity (see IPSAS 16, *Investment Property* and IPSAS 17, *Property, Plant, and Equipment*);

   (f) Intangible assets related to agricultural activity (see IPSAS 31, *Intangible Assets*); and

   (g) Biological assets held for the provision or supply of services.

   (h) Right-of-use assets arising from a lease of land related to agricultural activity (see [draft] IPSAS [X] (ED 64)).

Effective Date

…

56G. **Paragraph 3 is amended by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply this amendment for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendments for a period beginning before MM DD, YYYY it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.**

Amendments to IPSAS 28, *Financial Instruments: Presentation*

Paragraphs AG16 and AG17 are amended. Paragraph 60D is added. New text is underlined and deleted text is struck through.

Definitions (paragraphs 9 and 10)

Designation as at Fair Value through Surplus or Deficit

…

AG16. ~~Under IPSAS 13, *Leases*, a finance lease is regarded as primarily~~ A lease typically creates an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. The lessor accounts for its investment in the amount receivable under the lease contract ~~rather than the leased asset itself~~ as a lease receivable and continues to recognize the leased asset. Accordingly, a lessor regards the lease receivable as a financial instrument. ~~An operating lease, on the other hand, is regarded as primarily an uncompleted contract committing the lessor to provide the use of an asset in future periods in exchange for consideration similar to a fee for a service. The lessor continues to account for the leased asset itself rather than any amount receivable in the future under the contract. Accordingly, a finance lease is regarded as a financial instrument and an operating lease is not regarded as a financial instrument (except as regards individual payments currently due and payable).~~

AG17. Physical assets (such as inventories, property, plant and equipment), ~~leased~~ right-of-use assets and intangible assets (such as patents and trademarks) are not financial assets. Control of such physical assets, right-of-use assets and intangible assets creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset.

Effective Date

…

60D. **Paragraphs AG16 and AG17 were amended by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply these amendments for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendments for a period beginning before MM DD, YYYY it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.**

Amendments to IPSAS 29, *Financial Instruments: Recognition and Measurement*

Paragraphs 2 and AG46 are amended. Paragraph 125H is added. New text is underlined and deleted text is struck through.

Scope

2. This Standard shall be applied by all entities to all types of financial instruments, except:

   (a) Those interests in controlled entities, associates and joint ventures that are accounted for in accordance with IPSAS 34*, Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements,* IPSAS 36, *Investments in Associates and Joint Ventures*. However, in some cases, IPSAS 34, IPSAS 35 or IPSAS 36 require or permit an entity to account for an interest in a controlled entity, associate, or joint venture in accordance with some or all of the requirements of this Standard. Entities shall also apply this Standard to derivatives on an interest in a controlled entity, associate, or joint venture unless the derivative meets the definition of an equity instrument of the entity in IPSAS 28.

   (b) Rights and obligations under leases to which ~~IPSAS 13~~ [draft] IPSAS [X] (ED 64), *Leases* applies. However:

      (i) Lease receivables recognized by a lessor are subject to the derecognition and impairment provisions of this Standard (see paragraphs 17–39, 67, 68, 72, and Appendix A paragraphs AG51–AG67 and AG117–AG126);

(ii) ~~Finance~~ ~~l~~Lease ~~payables~~ liabilities recognized by a lessee are subject to the derecognition provisions in paragraph 41 of this Standard ~~(see paragraphs 41–44 and Appendix A paragraphs AG72–AG80)~~; and

(iii) Derivatives that are embedded in leases are subject to the embedded derivatives provisions of this Standard (see paragraphs 11–15 and Appendix A paragraphs AG40–AG46).

(c) Employers' rights and obligations under employee benefit plans, to which IPSAS ~~25~~ 39, *Employee Benefits* applies.

(d) Financial instruments issued by the entity that meet the definition of an equity instrument in IPSAS 28 (including options and warrants) or that are required to be classified as an equity instrument in accordance with paragraphs 15 and 16 or 17 and 18 of IPSAS 28. However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a) above.

(e) Rights and obligations arising under:

(i) An insurance contract, other than an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract in paragraph 10; or

(ii) A contract that is within the scope of the relevant international or national accounting standard dealing with insurance contracts because it contains a discretionary participation feature.

This Standard applies to a derivative that is embedded in an insurance contract if the derivative is not itself an insurance contract (see paragraphs 11–15 and Appendix A paragraphs AG40–AG46 of this Standard). An entity applies this Standard to financial guarantee contracts, but shall apply the relevant international or national accounting standard dealing with insurance contracts if the issuer elects to apply that standard in recognizing and measuring them. Notwithstanding (i) above, an entity may apply this Standard to other insurance contracts which involve the transfer of financial risk.

(f) Any forward contracts between an acquirer and seller to buy or sell an acquired operation that will result in a public sector combination at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction.

(g) Loan commitments other than those loan commitments described in paragraph 4. An issuer of loan commitments shall apply IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* to loan commitments that are not within the scope of this Standard. However, all loan commitments are subject to the derecognition provisions of this Standard (see paragraphs 17–44 and Appendix A paragraphs AG51–AG80).

(h) Financial instruments, contracts and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share based payment applies, except for contracts within the scope of paragraphs 4–6 of this Standard, to which this Standard applies.

(i) Rights to payments to reimburse the entity for expenditure it is required to make to settle a liability that it recognizes as a provision in accordance with IPSAS 19, or for which, in an earlier period, it recognized a provision in accordance with IPSAS 19.

(j) The initial recognition and initial measurement of rights and obligations arising from non-exchange revenue transactions, to which IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* applies.

(k) Rights and obligations under service concession arrangements to which IPSAS 32, *Service Concession Assets: Grantor* applies. However, financial liabilities recognized by a grantor under the financial liability model are subject to the derecognition provisions of this Standard (see paragraphs 41–44 and Appendix A paragraphs AG72–AG80).

Effective Date

…

125H. **<u>Paragraphs 2 and AG46 were amended by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply these amendments for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendments for a period beginning before MM DD, YYYY it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.</u>**

Embedded Derivatives (paragraphs 11–13)

AG46. The economic characteristics and risks of an embedded derivative are closely related to the economic characteristics and risks of the host contract in the following examples. In these examples, an entity does not account for the embedded derivative separately from the host contract.

(a) …

(f) An embedded derivative in a host lease contract is closely related to the host contract if the embedded derivative is (i) an inflation-related index such as an index of lease payments to a consumer price index (provided that the lease is not leveraged and the index relates to inflation in the entity's own economic environment), (ii) ~~contingent rentals~~ <u>variable lease payments</u> based on related sales, or (iii) ~~contingent rentals~~ <u>variable lease payments</u> based on variable interest rates.

(g) …

Amendments to IPSAS 30, *Financial Instruments: Disclosures*

Paragraphs 35 and AG16 are amended. Paragraph 52C is added. New text is underlined and deleted text is struck through.

Significance of Financial Instruments for Financial Position and Financial Performance

…

Other Disclosures

…

Fair Value

…

35. Disclosures of fair value are not required:

(a) When the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables;

(b) For an investment in equity instruments that do not have a quoted market price in an active market, or derivatives linked to such equity instruments, that is measured at cost in accordance with IPSAS 29 because its fair value cannot be measured reliably; ~~and~~

(c) For a contract containing a discretionary participation feature if the fair value of that feature cannot be measured reliably~~.~~; or

(d) For lease liabilities, other than unearned revenue.

…

Effective Date and Transition

…

52C. **Paragraphs 35 and AG16 were amended by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply these amendments for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendments for a period beginning before MM DD, YYYY it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.**

Appendix A

Application Guidance

…

Nature and Extent of Risks Arising from Financial Instruments (paragraphs 38–49)

…

Quantitative Liquidity Risk Disclosures (paragraphs 41(a), and 46(a) and (b))

…

AG16. The contractual amounts disclosed in the maturity analyses as required by paragraph 46(a) and (b) are the contractual undiscounted cash flows, for example:

(a) Gross ~~finance~~ lease ~~obligations~~ liabilities (before deducting finance charges);

(b) Prices specified in forward agreements to purchase financial assets for cash;

(c) Net amounts for pay-floating/receive-fixed interest rate swaps for which net cash flows are exchanged;

(d) Contractual amounts to be exchanged in a derivative financial instrument (e.g., a currency swap) for which gross cash flows are exchanged; and

(e) Gross loan commitments.

Such undiscounted cash flows differ from the amount included in the statement of financial position because the amount in that statement is based on discounted cash flows. When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. For example, when the amount payable varies with changes in an index, the amount disclosed may be based on the level of the index at the end of the period.

Amendments to IPSAS 31, *Intangible Assets*

Paragraphs 6, 9, 112, 113 and AG6 are amended. Paragraph 132J is added. New text is underlined and deleted text is struck through.

Scope

…

6. If another IPSAS prescribes the accounting for a specific type of intangible asset, an entity applies that IPSAS instead of this Standard. For example, this Standard does not apply to:

   (a) Intangible assets held by an entity for sale in the ordinary course of operations (see IPSAS 11, *Construction Contracts*, and IPSAS 12, *Inventories*);

   (b) Leases ~~that are within the scope of IPSAS 13~~ of intangible assets accounted for in accordance with [draft] IPSAS [X] (ED 64), *Leases*;

   (c) Assets arising from employee benefits (see IPSAS 25, *Employee Benefits*);

   (d) Financial assets as defined in IPSAS 28. The recognition and measurement of some financial assets are covered by IPSAS 34, *Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements* and IPSAS 36, *Investments in Associates and Joint Ventures*; and

   (e) Recognition and initial measurement of service concession assets that are within the scope of IPSAS 32, *Service Concession Assets: Grantor*. However, this Standard applies to the subsequent measurement and disclosure of such assets.

9. ~~In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee accounts for an intangible asset held under a finance lease in accordance with this Standard.~~ Rights held by a lessee under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents, and copyrights ~~are excluded from the scope of IPSAS 13 and~~ are within the scope of this Standard and are excluded from the scope of [draft] IPSAS [X] (ED 64).

…

Retirements and Disposals

…

112. **The gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be recognized in surplus or deficit when the asset is derecognized (unless ~~IPSAS 13~~ [draft] IPSAS [X] (ED 64) requires otherwise on a sale and leaseback).**

113. The disposal of an intangible asset may occur in a variety of ways (e.g., by sale~~, by entering into a finance lease,~~ or through a non-exchange transaction). In determining the date of disposal of such an asset, an entity applies the criteria in IPSAS 9, *Revenue from Exchange Transactions* for

recognizing revenue from the sale of goods. ~~IPSAS 13~~ [draft] IPSAS [X] (ED 64) applies to disposal by a sale and leaseback.

Effective Date

…

132J. **Paragraphs 6, 9, 112, 113 and AG6 were amended by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply these amendments for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendments for a period beginning before MM DD, YYYY it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.**

Appendix A

Application Guidance

Website costs

…

AG6. IPSAS 31 does not apply to intangible assets held by an entity for sale in the ordinary course of operations (see IPSAS 11 and IPSAS 12) or leases ~~that fall within the scope of IPSAS 13~~ of intangible assets accounted for in accordance with [draft] IPSAS [X] (ED 64). Accordingly, this Application Guidance does not apply to expenditure on the development or operation of a website (or website software) for sale to another entity or that is accounted for in accordance with [draft] IPSAS [X] (ED 64). ~~When a website is leased under an operating lease, the lessor applies this Application Guidance. When a website is leased under a finance lease, the lessee applies this Application Guidance after initial recognition of the leased asset.~~

Amendments to IPSAS 32, *Service Concession Arrangements: Grantor*

Paragraphs AG13 and AG17 are amended. Paragraph 36D is added. New text is underlined and deleted text is struck through.

Effective Date

…

36D. **Paragraphs AG13 and AG17 were amended by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply these amendments for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendments for a period beginning before MM DD, YYYY it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.**

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 32

…

AG13. The operator may have a right to use the separable asset described in paragraph AG12(a), or the facilities used to provide ancillary unregulated services described in paragraph AG12(b). In either case, there may in substance be a lease from the grantor to the operator; if so, it is accounted for in accordance with ~~IPSAS 13~~ [draft] IPSAS [X] (ED 64).

…

AG17. If the asset no longer meets the conditions for recognition in paragraph 9 (or paragraph 10 for a whole-of-life asset), the grantor follows the derecognition principles in IPSAS 17 or IPSAS 31, as appropriate. For example, if the asset is transferred to the operator on a permanent basis, it is derecognized. If the asset is transferred on a temporary basis, the grantor considers the substance of this term of the service concession arrangement in determining whether the asset should be derecognized. In such cases, the grantor also considers whether the arrangement is a ~~lease transaction or a~~ sale and leaseback transaction that should be accounted for in accordance with ~~IPSAS 13~~ [draft] IPSAS [X] (ED 64).

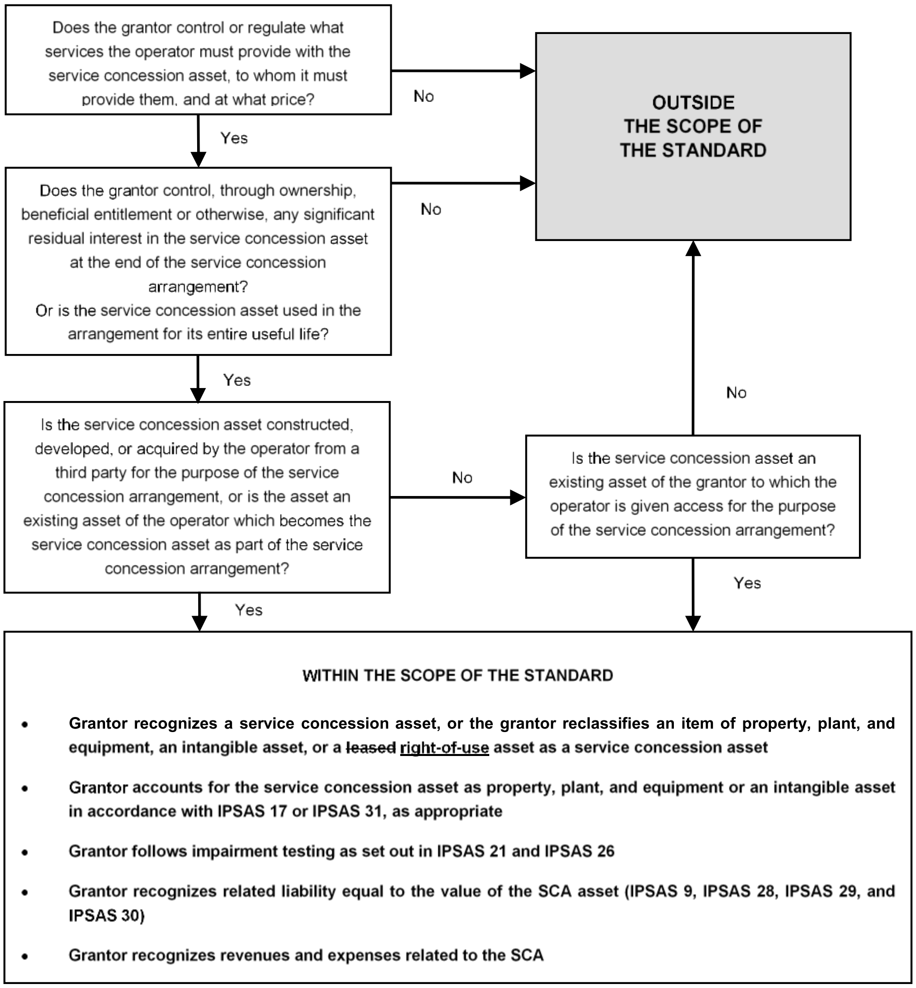
Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 32.

(…)

Accounting Framework for Service Concession Arrangements

IG2. The diagram below summarizes the accounting for service concession arrangements established by IPSAS 32.



References to IPSASs that Apply to Typical Types of Arrangements Involving an Asset Combined with Provision of a Service

(…)

IG4. Shaded text shows arrangements within the scope of IPSAS 32.

Category	Lessee	Service provider			Owner	
Typical arrangement types	Lease (e.g., operator leases asset from grantor)	Service and/or maintenance contract (specific tasks e.g., debt collection, facility management)	Rehabilitate-operate-transfer	Build-operate-transfer	Build-own-operate	100% Divestment/ Privatization/ Corporation
Asset ownership	Grantor				Operator	
Capital investment	Grantor		Operator			
Demand risk	Shared	Grantor	Grantor and/or Operator		Operator	

Typical duration	8–20 years	1–5 years	25–30 years		Indefinite (or may be limited by binding arrangement or license)
Residual interest	Grantor			Operator	
Relevant IPSASs	~~IPSAS 13~~ [draft] IPSAS [X] (ED 64)	IPSAS 1	This IPSAS/IPSAS 17/ IPSAS 31	IPSAS 17/IPSAS 31 (derecognition) IPSAS 9 (revenue recognition)	

Amendments to IPSAS 33, *First-Time Adoption of Accrual Basis IPSASs*

Paragraphs 36, 46, 47, 64, 95, and 148 are amended. Paragraphs 96A, 96B, 96C, 96D, 96E, 96F, 96G, 96H and 154A are added. Paragraph 96 is deleted. The headings above paragraphs 46 and 95 are amended. New text is underlined and deleted text is struck through.

Exemptions that Affect Fair Presentation and Compliance with Accrual Basis IPSASs during the Period of Transition

…

Three Year Transitional Relief Period for the Recognition and/or Measurement of Assets and/or Liabilities

Recognition and/or Measurement of Assets and/or Liabilities

36. Where a first-time adopter has not recognized assets and/or liabilities under its previous basis of accounting, it is not required to recognize and/or measure the following assets and/or liabilities for reporting periods beginning on a date within three years following the date of adoption of IPSASs:

(a) Inventories (see IPSAS 12, *Inventories*);

(b) Investment property (see IPSAS 16, *Investment Property*);

(c) Property, plant and equipment (see IPSAS 17, *Property, Plant and Equipment*);

(d) Defined benefit plans and other long-term employee benefits (see IPSAS 25, *Employee Benefits*);

(e) Biological assets and agricultural produce (see IPSAS 27, *Agriculture*);

(f) Intangible assets (see IPSAS 31, *Intangible Assets*);

(ff) Right-of-use assets (see [draft] IPSAS [X] (ED 64), *Leases*);

(fff) Liability (unearned revenue) (see [draft] IPSAS [X] (ED 64), *Leases*);

(g) Service concession assets and the related liabilities, either under the financial liability model or the grant of a right to the operator model (see IPSAS 32, *Service Concession Arrangements: Grantor*); and

(h) Financial instruments (see IPSAS 29, *Financial Instruments; Recognition and Measurement*).

Other Exemptions

…

~~IPSAS 13, Leases~~ [draft] IPSAS [X] (ED 64)

46. Where a first-time adopter takes advantage of the exemption in paragraph 36 which allows a three year transitional relief period to not recognize assets, it is not required to apply the requirements related to ~~finance~~ leases until the exemption that provided the relief has expired, and/or when the relevant assets are recognized in accordance with the applicable IPSASs (whichever is earlier).

47. This IPSAS allows a first-time adopter a period of up to three years from the date of adoption of IPSASs to not recognize assets in accordance with IPSASs 16, 17, 27, 31 and 32. During this period, a first-time adopter may need to consider the recognition requirements of those IPSASs at the same time as considering the recognition of ~~finance~~ leases in this IPSAS. Where a first-time adopter takes advantage of the exemption in accordance with IPSASs 16, 17, 27, 31 and 32 it is not required to recognize ~~finance~~ lease assets and/or liabilities until the exemptions that provided the relief have expired, and/or when the relevant assets are recognized in accordance with the applicable IPSASs (whichever is earlier).

Exemptions that Do Not Affect Fair Presentation and Compliance with Accrual Basis IPSASs During the Period of Adoption

…

Using Deemed Cost to Measure Assets and/or Liabilities

64. A first-time adopter may elect to measure the following assets and/or liabilities at their fair value when reliable cost information about the assets and liabilities is not available, and use that fair value as the deemed cost for:

    (a) Inventory (see IPSAS 12);

    (b) Investment property, if the first-time adopter elects to use the cost model in IPSAS 16;

    (bb) Right-of-use assets (see [draft] IPSAS [X] (ED 64));

    (bbb) Liability (unearned revenue) (see [draft] IPSAS [X] (ED 64), *Leases*);

    (c) Property, plant and equipment (see IPSAS 17);

    (d) Intangible assets, other than internally generated intangible assets (see IPSAS 31) that meets:

        (i) The recognition criteria in IPSAS 31 (excluding the reliable measurement criterion); and

        (ii) The criteria in IPSAS 31 for revaluation (including the existence of an active market);

    (e) Financial Instruments (see IPSAS 29); or

    (f) Service concession assets (see IPSAS 32).

…

~~IPSAS 13~~ [draft] IPSAS [X] (ED 64), *Leases*

95. ~~A first-time adopter shall on the date of adoption of IPSAS, classify all existing leases as operating or finance leases on the basis of circumstances existing at the inception of the lease, to the extent~~

~~that these are known on the date of adoption of IPSASs.~~ A first-time adopter may assess whether a contract existing at the date of transition to IPSASs contains a lease by applying paragraphs 6–8 of [draft] IPSAS [X] (ED 64) to those contracts on the basis of facts and circumstances existing at that date.

96. [Deleted] ~~If, however, the lessee and the lessor have agreed to change the provisions of the lease between the date of inception of the lease and the date of adoption of accrual basis IPSASs in a manner that would have resulted in a different classification of the lease identification of a lease at the date of adoption, the revised agreement contract shall be regarded as a new agreement contract. A first-time adopter shall consider the provisions of the new agreement contract at the date of adoption of accrual basis IPSASs in classifying the lease as an operating or finance lease identifying a lease~~.

96A. When a fist-time adopter that is a lessee recognizes lease liabilities and right-of-use assets, it may apply the following approach to all of its leases, except concessionary leases, (subject to the practical expedients described in paragraph 96C):

(a) Measure a lease liability at the date of transition to IPSASs. A lessee following this approach shall measure that lease liability at the present value of the remaining lease payments (see paragraph 96H), discounted using the lessee's incremental borrowing rate (see paragraph 96H) at the date of transition to IPSASs.

(b) Measure a right-of-use asset at the date to transition to IPSASs. The lessee shall choose, on a lease-by-lease basis, to measure that right-of-use asset at either:

(i) Its carrying amount as if [draft] IPSAS [X] (ED 64) had been applied since the commencement date of the lease (see paragraph 96H), but discounted using the lessee's incremental borrowing rate at the date of transition to IPSASs; or

(ii) An amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognized in the statement of financial position immediately before the date of transition to IPSASs;

(c) Apply IPSAS 21 and IPSAS 26 to right-of-use assets at the date of transition to IPSASs.

96B. Notwithstanding the requirements in paragraph 96A, a first-time adopter that is a lessee shall measure the right-of-use asset at fair value at the date of transition to IPSASs for leases, including concessionary leases, that meet the definition of investment property in IPSAS 16 and are measured using the fair value model in IPSAS 16 from the date of transition to IPSASs.

96C. A first-time adopter that is a lessee may do one or more of the following at the date of transition to IPSASs, applied on a lease-by-lease basis:

(a) Apply a single discount rate to a portfolio of leases with reasonably similar characteristics (for example, a similar remaining lease term for a similar class of underlying asset in a similar economic environment).

(b) Elect not to apply the requirements in paragraph 96A to leases for which the lease term (see paragraph 96H) ends within 12 months of the date of transition to IPSASs. Instead, the entity shall account for (including disclosure of information about) these leases as if they were short-term leases accounted for in accordance with paragraph 65 of [draft] IPSAS [X] (ED 64).

(c) Elect not to apply the requirements in paragraph 96A to leases for which the underlying asset is of low value (as described in paragraphs AG40–AG45 of [draft] IPSAS [X] (ED 64)). Instead, the entity shall account for (including disclosure of information about) these leases in accordance with paragraph 65 of [draft] IPSAS [X] (ED 64).

(d) Exclude initial direct costs (see paragraph 96H) from the measurement of the right-of-use asset at the date of transition to IPSASs.

(e) Use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.

96D. When a fist-time adopter that is a lessee recognizes lease liabilities and right-of-use assets, it may apply the following approach to all of its concessionary leases, (subject to the practical expedients described in paragraph 96C):

(a) Measure a lease liability at the date of transition to IPSASs. A lessee following this approach shall measure that lease liability at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of transition to IPSASs, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use market interest rates.

(b) Measure a right-of-use asset at the date to transition to IPSASs. The lessee shall measure, on a lease-by-lease basis, that right-of-use asset at its carrying amount as if [draft] IPSAS [X] (ED 64) had been applied since the commencement date of the lease, but discounted using the lessee's incremental borrowing rate at the date of transition to IPSASs, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use market interest rates.

(c) Apply IPSAS 21 and IPSAS 26 to right-of-use assets at the date of transition to IPSASs.

96E. When a fist-time adopter that is a lessor recognizes lease receivables, liabilities (unearned revenue), and underlying assets, it may apply the following approach to all of its leases, except concessionary leases, (subject to the practical expedients described in paragraph 96G):

(a) Measure a lease receivable at the date of transition to IPSASs. A lessor following this approach shall measure that lease receivable at the present value of the remaining lease payments, discounted using the interest rate implicit in the lease at the date of transition to IPSASs.

(b) Measure a liability (unearned revenue) at the date of transition to IPSASs. The lessor shall choose, on a lease-by-lease basis, to measure that liability (unearned revenue) at either:

   (i) Its carrying amount as if [draft] IPSAS [X] (ED 64) had been applied since the commencement date of the lease, but discounted using the lessee's incremental borrowing rate at the date of transition to IPSASs; or

   (ii) An amount equal to the lease asset, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognized in the statement of financial position immediately before the date of transition to IPSASs;

(c) Measure the underlying asset at the date of transition to IPSASs. A lessor following this approach shall measure that underlying asset at the carrying amount less the residual value of the underlying asset at the date of transition to IPSASs.

96F. When a first-time adopter that is a lessor recognizes lease receivables and liabilities (unearned revenue), it may apply the following approach to all of its concessionary leases (subject to the practical expedients described in paragraph 96G):

(a) Measure a lease receivable at the date of transition to IPSASs. A lessor following this approach shall measure that lease receivable at the present value of the remaining lease payments, discounted using the market interest rates at the date of transition to IPSASs.

(b) Measure a liability (unearned revenue) at the date to transition to IPSASs. The lessor shall measure, on a lease-by-lease basis, that liability (unearned revenue) at its carrying amount as if [draft] IPSAS [X] (ED 64) had been applied since the commencement date of the lease, but discounted using market interest rates at the date of transition to IPSASs.

(c) Measure the underlying asset at the date of transition to IPSASs. A lessor following this approach shall measure that underlying asset at the carrying amount less the residual value of the underlying asset at the date of transition to IPSASs.

96G. A first-time adopter that is a lessor may do one or more of the following at the date of transition to IPSASs, applied on a lease-by-lease basis:

(a) Apply a single discount rate to a portfolio of leases with reasonably similar characteristics (for example, a similar remaining lease term for a similar class of underlying asset in a similar economic environment).

(b) Elect not to apply the requirements in paragraph 96E to leases for which the lease term ends within 12 months of the date of transition to IPSASs. Instead, the entity shall account for (including disclosure of information about) these leases as if they were short-term leases accounted for in accordance with paragraph 25 of [draft] IPSAS [X] (ED 64).

(c) Exclude initial direct costs from the measurement of the lease receivable at the date of transition to IPSASs.

(d) Use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.

96H. Lease payments, lessor, lessee, lessee's incremental borrowing rate, commencement date of the lease, initial direct costs and lease term are defined terms in [draft] IPSAS [X] (ED 64) and are used in this Standard with the same meaning.

Disclosures

…

Disclosures where Deemed Cost is Used for Inventory, Investment Property, Property, Plant and Equipment, Intangible Assets, Right-of-Use Assets, Financial Instruments or Service Concession Assets

148. If a first-time adopter uses fair value, or the alternative in paragraphs 64, 67 or 70, as deemed cost for inventory, investment property, property, plant and equipment, intangible assets, right-of-use assets, financial instruments, or service concession assets, its financial statements shall disclose:

(a) The aggregate of those fair values or other measurement alternatives that were considered in determining deemed cost;

(b) The aggregate adjustment to the carrying amounts recognized under the previous basis of accounting; and

(c) Whether the deemed cost was determined on the date of adoption of IPSASs or during the period of transition.

Effective Date

…

154A. **Paragraphs 36, 46, 47, 64, 95, and 148, and the headings above paragraphs 46 and 95 were amended, paragraph 96 was deleted, and paragraphs 96A, 96B, 96C, 96D, 96E, 96F, 96G, and 96H were added by [draft] IPSAS [X] (ED 64),** ***Leases*** **issued in Month YYYY. An entity shall apply these amendments for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendments for a period beginning before MM DD, YYYY it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.**

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 33.

…

Transitional Exemptions that Provide Three Year Relief for the Recognition and/or Measurement of Assets and/or Liabilities

…

Accounting for ~~Finance~~ Leases ~~Assets and Finance Lease Liabilities~~

IG20. Where a first-time adopter that is a lessee takes advantage of the exemption that provides a three year transitional relief period to not recognize its ~~finance lease~~ right-of-use assets, it will also not be able to comply with the recognition requirements relating to the ~~finance~~ lease liabilities, until the transitional exemptions related to the ~~finance leased~~ right-of-use assets have expired~~, or the finance leased assets have been recognized in accordance with IPSAS 13~~.

IG21. For example, assume that a first-time adopter that is a lessee has a ~~motor vehicle~~ right-of-use asset ~~that is subject to a finance~~ as a result of a lease ~~agreement~~ contract on the date of adoption of accrual basis IPSASs on January 1, 20X1. The first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize the ~~motor vehicle~~ right-of-use asset. The ~~motor vehicle~~ right-of-use asset is recognized on December 31, 20X3 when the exemption expires. IPSAS 33 requires the first-time adopter to only recognize the corresponding ~~finance~~ lease liability for the ~~motor vehicle~~ right-of-use asset on December 31, 20X3, i.e. on the date that the ~~finance lease asset (the motor vehicle)~~ right-of-use asset is recognized.

IG21A. Where a first-time adopter that is a lessor takes advantage of the exemption that provides a three year transitional relief period to not recognize its liability (unearned revenue), it will also not be able to comply with the recognition requirements relating to the lease receivables, until the transitional exemptions related to the liability (unearned revenue) have expired.

IG21B. For example, assume that a first-time adopter that is a lessor has a liability (unearned revenue) as a result of a lease contract on the date of adoption of accrual basis IPSASs on January 1, 20X1. The first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize the liability (unearned revenue). The liability (unearned revenue) is recognized on

December 31, 20X3 when the exemption expires. IPSAS 33 requires the first-time adopter to only recognize the corresponding lease receivable for the liability (unearned revenue) on December 31, 20X3, i.e. on the date that the liability (unearned revenue) is recognized.

…

IG51. Paragraphs 23–26 of the IPSAS 33 do not override requirements in other IPSASs that base classifications or measurements on circumstances existing at a particular date. Examples include:

(a) The ~~distinction between finance leases and operating leases~~ identification of a lease (see ~~IPSAS 13, *Leases*~~ [draft] IPSAS [X] (ED 64), *Leases*; and

(b) The distinction between financial liabilities and equity instruments (see IPSAS 28, *Financial Instruments: Presentation*).

~~IPSAS 13, *Leases*~~ [draft] IPSAS [X] (ED 64)

IG52. In accordance with paragraph 95 of IPSAS 33 and paragraph ~~18 of IPSAS 13~~ 6 of [draft] IPSAS [X] (ED 64), a lessee or lessor ~~classifies leases as operating leases or finance leases~~ identifies a lease on the basis of circumstances existing at the inception of the lease, on the date of adoption of accrual basis IPSASs. In some cases, the lessee and the lessor may agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different ~~classification~~ identification in accordance with ~~IPSAS 13~~ [draft] IPSAS [X] (ED 64) had the changed terms been in effect at the inception of the lease. If so, the revised agreement is considered as a new ~~agreement~~ contract over its term from the date of adoption of accrual basis IPSASs. ~~However, changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased property) or changes in circumstances (for example, default by the lessee) do not give rise to a new classification of a lease.~~

Summary of Transitional Exemptions and Provisions Included in IPSAS 33, *First-time Adoption of Accrual Basis IPSASs*

IG91.

IPSAS	**Transitional exemption provided**							
	NO	**YES**						
		Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other
~~IPSAS 13, *Leases*~~ [draft] IPSAS [X] (ED 64)			√ Leased assets and/or liabilities not recognized under previous basis of accounting	√ Leased assets and/or liabilities recognized under previous basis of accounting				

Appendix

Differentiation between transitional exemptions and provisions that a first-time adopter is required to apply and/or can elect to apply on adoption of accrual basis IPSASs

This Appendix summarises how the transitional exemptions and provisions that a first-time adopter is required to apply in terms of this IPSAS, and those that a first-time adopter may elect to apply on adoption of accrual basis IPSASs.

As the transitional exemptions and provisions that may be elected can also affect the fair presentation and the first-time adopter's ability to assert compliance with accrual basis IPSASs as explained in paragraphs 27 to 32 of IPSAS 33, the Appendix makes a distinction between those transitional exemptions and provisions that affect fair presentation and the ability to assert compliance with accrual basis IPSASs, and those that do not.

Transitional exemption or provision	**Transitional exemptions or provisions that have to be applied**	**Transitional exemptions or provisions that may be applied or elected**	
	Do not affect fair presentation and compliance with accrual basis IPSAS	Do not affect fair presentation and compliance with accrual basis IPSAS	Affect fair presentation and compliance with accrual basis IPSAS
~~IPSAS 13~~ [draft] IPSAS [X] (ED 64) • Where a first-time adopter is a lessee~~, N~~no recognition and/or measurement of ~~finance~~ lease liability and ~~finance lease~~ right-of-use asset if relief period for recognition and/or measurement of assets is adopted • Where a first-time adopter is a lessor, no recognition and/or measurement of lease receivable and liability (unearned revenue) if relief period for recognition and/or measurement of assets is adopted • ~~Classification~~ Identification of a lease based on circumstances at adoption of accrual basis IPSAS	√		√

Amendments to IPSAS 40, *Public Sector Combinations*

Paragraphs 68, 71, 120, AG76, and AG89 are amended. Paragraphs AG72–AG74 are deleted. Paragraphs 82A, 82B, 82C, 82D, and 126A are added. The headings before paragraphs 82A and 82C are added. The heading before paragraph AG89 is amended. New text is underlined and deleted text is struck through.

The acquisition method of accounting

…

Recognizing and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired operation

Recognition principle

…

Recognition conditions

…

68. Paragraphs ~~AG72–AG84~~ AG75–AG84 provide guidance on recognizing ~~operating leases and~~ intangible assets. Paragraphs 76–82D specify the types of identifiable assets and liabilities that include items for which this Standard provides limited exceptions to the recognition principle and conditions.

…

Classifying or designating identifiable assets acquired and liabilities assumed in an acquisition

…

71. This Standard provides two exceptions to the principle in paragraph 69:

    (a) ~~Classification of a lease arrangement as either an operating lease or a finance lease in accordance with IPSAS 13, *Leases*~~ Identification of a lease contract in accordance with [draft] IPSAS [X] (ED 64), *Leases*; and

    (b) Classification of a contract as an insurance contract in accordance with the relevant international or national accounting standard dealing with insurance contracts.

Exceptions to the recognition or measurement principles

…

Exceptions to both the recognition and measurement principles

…

Leases in which the acquiree is the lessee

82A. The acquirer shall recognize right-of-use assets and lease liabilities for leases identified in accordance with [draft] IPSAS [X] (ED 64) in which the acquiree is the lessee. The acquirer is not required to recognize right-of-use assets and lease liabilities for:

(a) Leases for which the lease term (as defined in [draft] IPSAS [X] (ED 64)) ends within 12 months of the acquisition date; or

(b) Leases for which the underlying asset is of low value (as described in paragraphs AG40–AG45 of [draft] IPSAS [X] (ED 64)).

82B. The acquirer shall measure the lease liability at the present value of the remaining lease payments (as defined in [draft] IPSAS [X] (ED 64)) as if the acquired lease were a new lease at the acquisition date. The acquirer shall measure the right-of-use asset at the same amount as the lease liability, adjusted to reflect favorable or unfavorable terms of the lease when compared with market terms.

Leases in which the acquiree is the lessor

82C. The acquirer shall recognize lease receivables and liabilities (unearned revenue) for leases identified in accordance with [draft] IPSAS [X] (ED 64) in which the acquiree is the lessor. The acquirer is not required to recognize lease receivables and liabilities (unearned revenue) for:

(a) Leases for which the lease term (as defined in [draft] IPSAS [X] (ED 64)) ends within 12 months of the acquisition date; or

(b) Leases for which the underlying asset is of low value (as described in paragraphs AG40–AG45 of [draft] IPSAS [X] (ED 64)).

82D. The acquirer shall measure the lease receivable at the present value of the remaining lease payments (as defined in [draft] IPSAS [X] (ED 64)) as if the acquired lease were a new lease at the acquisition date. The acquirer shall measure the liabilities (unearned revenue) at the same amount as the lease receivable, adjusted to reflect favorable or unfavorable terms of the lease when compared with market terms.

Disclosures

…

120. To meet the objective in paragraph 119, the acquirer shall disclose the following information for each acquisition that occurs during the reporting period:

(a) The name and a description of the acquired operation.

(b) The acquisition date.

(c) The percentage of voting equity interests or equivalent acquired.

(d) The primary reasons for the acquisition and a description of how the acquirer obtained control of the acquired operation including, where applicable, the legal basis for the acquisition.

(e) A qualitative description of the factors that make up the goodwill recognized, such as expected synergies from combining the operations of the acquired operation and the acquirer, intangible assets that do not qualify for separate recognition or other factors.

(f) The acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:

(i) Cash;

(ii) Other tangible or intangible assets, including an operation or controlled entity of the acquirer;

(iii) Liabilities incurred, for example, a liability for contingent consideration; and

(iv) Equity interests of the acquirer, including the number of instruments or interests issued or issuable and the method of measuring the fair value of those instruments or interests.

(g) For contingent consideration arrangements and indemnification assets:

(i) The amount recognized as of the acquisition date;

(ii) A description of the arrangement and the basis for determining the amount of the payment; and

(iii) An estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.

(h) For acquired receivables:

(i) The fair value of the receivables;

(ii) The gross amounts receivable in accordance with a binding arrangement; and

(iii) The best estimate at the acquisition date of the cash flows in accordance with a binding arrangement not expected to be collected.

The disclosures shall be provided by major class of receivable, such as loans, ~~direct finance~~ leases and any other class of receivables.

(i) (…)

Effective date and transition

Effective date

…

126A. **<u>Paragraphs 68, 71, 120, AG76 and AG89 were amended, paragraphs AG72–AG74 were deleted and paragraphs 82A, 82B, 82C and 82D and the related headings were added by [draft] IPSAS [X] (ED 64), *Leases* issued in Month YYYY. An entity shall apply these amendments for annual financial statements covering periods beginning on or at after MM DD, YYYY. Earlier application is encouraged. If an entity applies the amendments for a period beginning before MM DD, YYYY it shall disclose that fact and apply [draft] IPSAS [X] (ED 64) at the same time.</u>**

Recognizing particular assets acquired and liabilities assumed in an acquisition (see paragraphs 64–68)

~~Operating leases~~

AG72. <u>[Deleted]</u> ~~The acquirer shall recognize no assets or liabilities related to an operating lease in which the acquired operation is the lessee except as required by paragraphs AG73–AG74.~~

AG73. <u>[Deleted]</u> ~~The acquirer shall determine whether the terms of each operating lease in which the acquired operation is the lessee are favorable or unfavorable. The acquirer shall recognize an intangible asset if the terms of an operating lease are favorable relative to market terms and a liability if the terms are unfavorable relative to market terms. Paragraph AG89 provides guidance~~

~~on measuring the acquisition-date fair value of assets subject to operating leases in which the acquired operation is the lessor.~~

AG74. [Deleted] ~~An identifiable intangible asset may be associated with an operating lease, which may be evidenced by market participants' willingness to pay a price for the lease even if it is at market terms. For example, a lease of gates at an airport or of retail space in a prime shopping area might provide entry into a market or other future economic benefits or service potential that qualify as identifiable intangible assets, for example, as a relationship with users of a service. In that situation, the acquirer shall recognize the associated identifiable intangible asset(s) in accordance with paragraph AG75.~~

Intangible assets

AG76. An intangible asset that meets the binding arrangement criterion is identifiable even if the asset is not transferable or separable from the acquired operation or from other rights and obligations. For example:

(a) [Deleted] ~~An acquired operation leases a facility under an operating lease that has terms that are favorable relative to market terms. The lease terms explicitly prohibit transfer of the lease (through either sale or sublease). The amount by which the lease terms are favorable compared with the terms of current market transactions for the same or similar items is an intangible asset that meets the binding arrangement criterion for recognition separately from goodwill, even though the acquirer cannot sell or otherwise transfer the lease arrangement.~~

(b) An acquired operation owns and operates a nuclear power plant. The license to operate that power plant is an intangible asset that meets the binding arrangement criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. An acquirer may recognize the fair value of the operating license and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.

(c) An acquired operation owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future foreign revenue in exchange. Both the technology patent and the related license agreement meet the binding arrangement criterion for recognition separately from goodwill even if selling or exchanging the patent and the related license agreement separately from one another would not be practical.

Assets subject to ~~operating~~ leases in which the acquired operation is the lessor

AG89. In measuring the acquisition-date fair value of an asset such as a building that is subject to an operating lease in which the acquired operation is the lessor, the acquirer shall take into account the terms of the lease. ~~In other words, t~~The acquirer does not recognize a separate asset or liability if the terms of a~~n~~ ~~operating~~ lease are either favorable or unfavorable when compared with market terms ~~as paragraph AG73 requires for leases in which the acquired operation is the lessee~~.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 40

…

Identifiable intangible assets in an acquisition

…

Binding arrangement-based intangible assets

IE224. Binding arrangement-based intangible assets represent the value of rights that arise from binding arrangements. Binding arrangements with customers are one type of binding arrangement-based intangible asset. If the terms of a binding arrangement give rise to a liability (for example, if the terms of a~~n~~ ~~operating lease or~~ binding arrangement with a customer are unfavorable relative to market terms), the acquirer recognizes it as a liability assumed in the acquisition. Examples of binding arrangement-based intangible assets are:

Class	**Basis**
Licensing, royalty and standstill agreements	Binding arrangement
Advertising, construction, management, service or supply binding arrangements	Binding arrangement
Lease agreements (whether the acquired operation is the lessee or the lessor)	Binding arrangement
Construction permits	Binding arrangement
Franchise agreements	Binding arrangement
Operating and broadcast rights	Binding arrangement
Servicing binding arrangements, such as mortgage servicing binding arrangements	Binding arrangement
Binding arrangements for employment	Binding arrangement
Use rights, such as drilling, water, air, timber cutting and route authorities	Binding arrangement

Amendments to IPSAS, *Financial Reporting Under the Cash Basis of Accounting*

Paragraph 2.1.35 is amended. New text is underlined and deleted text is struck through.

2.1 Encouraged Additional Disclosures

…

Disclosure of Assets, Liabilities and Comparison with Budgets

…

2.1.35 Entities that make such disclosures are encouraged to identify assets and liabilities by type, for example, by classifying:

(a) Assets as receivables, investments or property plant and equipment; and

(b) Liabilities as payables, borrowings by type or source and other liabilities.

While such disclosures may not be comprehensive in the first instance, entities are encouraged to progressively develop and build on them. In order to comply with the requirements of paragraphs 1.3.5 and 1.3.37 of Part 1 of this Standard, these disclosures will need to comply with qualitative characteristics of financial information and should be clearly described and readily understood. Accrual basis IPSASs including ~~IPSAS 13, "Leases,"~~ [draft] IPSAS [X] (ED 64), IPSAS 17, "Property, Plant and Equipment" and IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets" can provide useful guidance to entities disclosing additional information about assets and liabilities.

Appendix 3

Presentation of the Statement of Cash Receipts and Payments in the Format Required by IPSAS 2, Statement of Cash Flows

…

Financing Activities

12. The separate disclosure of cash flows arising from financing activities is useful in predicting claims on future cash flows by providers of capital to the entity. Examples of cash flows arising from financing activities are:

    (a) Cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short or long-term borrowings;

    (b) Cash repayments of amounts borrowed;

    (c) Cash payments by a lessee for the reduction of the outstanding lease liability ~~relating to a finance lease~~; and

    (d) Cash receipts and payments relating to the issue of and redemption of currency.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, [draft] IPSAS [X] (ED 64).

Introduction

BC1. IPSAS 13, *Leases*, was drawn primarily from International Accounting Standard (IAS) 17, *Leases*, issued by the International Accounting Standards Board (IASB). In January 2016, the IASB issued International Financial Reporting Standard (IFRS) 16, *Leases*. IFRS 16 replaces IAS 17 and a number of related interpretations[6].

BC2. Following the publication of IFRS 16, the IPSASB approved a project to develop revised leasing requirements. In developing IPSAS 13, the IPSASB had concluded that the economics of a lease transaction were the same in both the public sector and the private sector. Consequently, the IPSASB initiated a project to converge its leasing requirements with IFRS 16.

BC3. The IPSASB's policy document, *Process for Reviewing and Modifying IASB Documents*, sets out the process the IPSASB follows when developing a converged Standard. The first step of the process is to consider whether there are any public sector issues that warrant departure from the IFRS Standard.

BC4. In determining whether public sector issues warrant a departure from an IASB document, the IPSASB considers the following:

(a) Whether applying the requirements of the IASB document would mean that the objectives of public sector financial reporting would not be adequately met;

(b) Whether applying the requirements of the IASB document would mean that the qualitative characteristics of public sector financial reporting would not be adequately met; and

(c) Whether applying the requirements of the IASB document would require undue cost or effort.

BC5. The process requires the IPSASB to take its decisions in the context of the following:

(a) Consistency with the IPSASB's *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the *Conceptual Framework*);

(b) Internal consistency with existing IPSASs; and

(c) Consistency with the statistical bases of accounting.

Review of IFRS 16, Leases

Right-of-Use Model for Lessee Accounting in IFRS 16

BC6. IFRS 16, *Leases* introduces a new lease accounting model for lessees—the right-of-use model. The right-of-use model is based on the foundational principle that leases are financings of the right to use an underlying asset, and results in the following accounting[7]:

(a) The lessee recognizes a 'right-of-use asset'; and

---

[6] International Financial Reporting Interpretations Committee Interpretation IFRIC-4, *Determining whether an Arrangement contains a Lease* and Standing Interpretations Committee Interpretations SIC-15, *Operating Leases—Incentives* and SIC-27, *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

[7] Except for short-term leases and leases for which the underlying asset is of low value, as described in IFRS 16.5–8.

(b) The lessee recognizes lease liabilities related to the future lease payments.

BC7. The IPSASB considered whether there were any public sector issues that warranted a departure from the right-of-use model for lessee accounting in IFRS 16. In so doing, the IPSASB came to the following conclusions:

(a) The right-of-use asset satisfies the definition of, and recognition criteria for, an asset in the IPSASB's *Conceptual Framework*.

(b) The right-of-use asset is recognized when the lessee controls the asset, which is consistent with the *Conceptual Framework*. The IPSASB noted that the 'risks and rewards incidental to ownership' model in IPSAS 13 is not based on control, and is therefore not consistent with the *Conceptual Framework*.

(c) The information reported under the single lessee accounting model specified in IFRS 16 would provide the most useful information to the broadest range of users of financial statements.

(d) The right-of-use model prevents arbitrage, gaming and information asymmetry, and improves comparability between public sector entities that lease assets and public sector entities that purchase assets.

(e) The IPSASB acknowledged that there would be costs associated with adopting the right-of-use model in the public sector. However, the IPSASB did not consider that these would outweigh the benefits of so doing, particularly if the IPSASB also adopted the exemptions in IFRS 16.

BC8. Consequently, the IPSASB agreed that there were no public sector issues that warranted a departure from the right-of-use model for lessee accounting in IFRS 16. The IPSASB therefore agreed to develop revised lessee accounting requirements that were converged with the requirements in IFRS 16.

Lessor Accounting in IFRS 16

BC9. The IPSASB noted that for lessor accounting IFRS 16 retained the 'risks and rewards incidental to ownership' model previously applied in IAS 17 (and IPSAS 13). The IPSASB considered whether there were any public sector issues that warranted a departure from the lessor accounting approach in IFRS 16. In so doing, the IPSASB came to the following conclusions:

(a) As mentioned in paragraph BC7, the 'risks and rewards incidental to ownership' model is not based on control, and is therefore not consistent with the *Conceptual Framework*.

(b) The 'risks and rewards incidental to ownership' model does not distinguish between the right-of-use asset and the underlying asset. The IPSASB considered these to be different economic phenomena that should be accounted for separately.

(c) Under the 'risks and rewards incidental to ownership' model, a lessor that classified a lease:

(i) As an operating lease would not recognize a lease receivable. The IPSASB considered that leases are, in substance, financing transactions, and that the lease receivable meets the definition of a financial asset in IPSAS 28, *Financial Instruments: Presentation*.

(ii) As a finance lease would derecognize the underlying asset. The IPSASB is of the view that a lease conveys the right to use an underlying asset for a period of time and does not transfer control of the underlying asset to an entity—transactions that do transfer control are sales or purchases within the scope of other Standards (for example, IPSAS 9, *Revenue from Exchange Transactions* or IPSAS 17, *Property, Plant, and Equipment*). Therefore, the IPSASB considered that the lessor should not derecognize the underlying asset in a lease transaction.

(d) The 'risks and rewards incidental to ownership' model does not satisfy the objectives of public sector financial reporting in the *Conceptual Framework*. The lessor would not be providing complete information about the entity's management of the resources entrusted to it for the delivery of services to constituents and others, as the financial statements would omit either the underlying asset or the lease receivable.

(e) Applying a 'risk and rewards' model to lessor accounting, while applying a control model to lessee accounting, would be inconsistent with the IPSASB's existing literature. For example, IPSAS 32, *Service Concession Arrangements: Grantor*, which deals with transactions that have some similarities with leases, adopts a control-based model for the grantor. IFRIC 12, *Service Concession Arrangements*, which deals with the accounting by the operator (the other party to the transaction), also adopts a control-based model.

BC10. The IPSASB also noted that applying a 'risk and rewards' model to lessor accounting while applying a control model to lessee accounting would give rise to inconsistent accounting by the two parties to a lease. This could give rise to a number of practical issues in the public sector:

(a) Consolidation issues where the lessor and the lessee are part of the same economic entity. If the lessor classifies the lease as a finance lease, the underlying asset is not recognized by either party, and separate records will need to be maintained to report the underlying asset in the consolidated financial statements. On the other hand, if the lessor classifies the lease as an operating lease, the lessor will not recognize a lease receivable even though the lessee will recognize a lease liability. Again, additional records will be required.

(b) The use of different accounting models may make leasing transactions less understandable to some users of the financial statements. It may also be difficult for users to distinguish between a lease and the sale of an asset in a lessor's financial statements.

(c) Asymmetrical information in the public sector—Different recognition criteria for the same transaction distorts the analysis of the financial position of public sector entities.

BC11. The IPSASB noted that these factors are not unique to the public sector; they will apply equally in the private sector. However, they may be more prevalent in the public sector. In many jurisdictions, a centralized entity will undertake most or all of the property management for a government. The entity will own all the government's property assets, and lease them to other government entities. As a consequence, the prevalence of consolidation issues may be greater in the public sector than in the private sector.

BC12. Taking into consideration the issues discussed above, the IPSASB concluded that the retention of the IFRS 16 lessor accounting model is not appropriate for public sector financial reporting.

BC13. As a consequence, the IPSASB decided to develop a single right-of-use model for lessor accounting specifically designed for public sector financial reporting (see paragraphs BC34–BC39).

Concessionary Leases

BC14. IFRS 16 deals with leases that are exchange transactions. However, quite often in the public sector leases are granted to or received by an entity at below market terms (concessionary leases). In this case, the IFRS 16 cost measurement basis does not reflect the full economic value created by the concessionary lease.

BC15. Therefore, the IPSASB decided to provide additional guidance on how to account for concessionary leases for lessees in this [draft] Standard (see paragraphs BC104–BC109 and BC112–BC114) and amend IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

BC16. As the IPSASB had developed a specific lessor accounting model for public sector financial reporting that mirrors lessee accounting, including concessionary leases, the IPSASB decided also to provide additional guidance on how to account for concessionary leases for lessors (see paragraphs BC77–BC96).

Requirements of Government Finance Statistics Reporting Guidelines

BC17. The IPSASB also considered the requirements of Government Finance Statistics (GFS) reporting guidelines on leases.

BC18. GFS classifies leases based on the distinction between legal and economic ownership, and accounts for leases based on economic ownership, determined by the distribution of risks and associated benefits between the parties. The IPSASB noted that although GFS has a different lease accounting model from IPSAS 13 and IAS 17, generally GFS applies the same principles as in IPSAS 13 and IAS 17 for recognition and measurement.

BC19. As IPSAS 13 is aligned with IAS 17, rather than with GFS, and IFRS 16 was published after the most recent GFS manuals, the IPSASB decided to converge with IFRS 16, instead of aligning with GFS.

Definitions (see paragraphs 5 and AG3)

Definition of a Lease

Concessionary Leases

BC20. Concessionary leases are granted to or received by an entity at below market terms. The IPSASB considered the economic substance of several types of concessionary leases. The IPSASB is of the view that leases with consideration above nominal amount still meet the IFRS 16 definition of a lease. As a consequence of this view, the IPSASB decided to retain in this [draft] Standard the wording “in exchange for consideration” in the IFRS 16 definition of a lease.

BC21. The IPSASB is of the view that leases for zero or nominal consideration are in substance a grant in kind and, therefore, outside of the scope of this [draft] Standard.

BC22. This [draft] Standard amended IPSAS 23 to provide guidance on accounting for the non-exchange component of concessionary leases from the lessee side, including leases for zero or nominal consideration.

BC23. The IPSASB has underway a project on Revenue and Non-Exchange Expenses and has already issued a Consultation Paper. Until an IPSAS on Non-Exchange Expenses is published, preparers can apply the relevant international or national accounting standard to leases for zero or nominal consideration in the lessor’s financial statements.

Contractual Arrangements

BC24. The IPSASB noted that, in certain jurisdictions, public sector entities are precluded from entering into formal contracts, but do enter into arrangements that have the substance of contracts. These arrangements may be known by another term, e.g., a "government order." To assist entities in identifying contracts, which either have the substance or legal form of a contract, the IPSASB considered it appropriate to issue additional Application Guidance explaining the factors an entity should consider in assessing whether an arrangement is contractual or non-contractual.

BC25. Consideration was given to whether the term "binding arrangement" should be used to describe the arrangements highlighted in paragraph BC24. The term "binding arrangement" is defined as contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract. For example, an arrangement between two government departments that do not have the power to contract may be a binding arrangement. The IPSASB concluded that the term "binding arrangements," as used in IPSASs, embraces a wider set of arrangements than those identified in paragraph BC24 and therefore concluded that it should not be used in this [draft] Standard.

Fair Value

BC26. The IPSASB noted that IFRS 16 uses the term "fair value" and *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the *Conceptual Framework*) uses the term "market value". Consistent with previous IPSASB decisions, the IPSASB decided to retain the term "fair value" in this [draft] Standard. The IPSASB has an ongoing project on Measurement that will assess the measurement bases in all IPSASs according to the *Conceptual Framework*.

IFRS 16 Definitions on Lessor Accounting

BC27. The IPSASB decided not to include the IFRS 16 requirements on lessor accounting (see paragraphs BC9–BC13) in this [draft] Standard. Therefore, this [draft] Standard does not include the definitions related to IFRS 16 lessor accounting. The IFRS 16 definition of 'initial direct costs' has also been amended to remove the reference to a manufacturer or dealer lessor (see paragraph BC76). The remaining definitions in this [draft] Standard are also applicable to lessor accounting.

Identifying a Lease (see paragraphs 6–8 and AG4–AG28)

BC28. IFRS 16 provides guidance on identifying a lease, and distinguishing a lease from a service. The IPSASB considered that this guidance was relevant to the public sector, but that it needed to be extended to include service concession arrangements. IFRS 16 does not need to address service concession arrangements, as IFRIC 12 provides guidance for the operator only, whereas IPSAS 32 specifies the requirements for the grantor.

BC29. The IPSASB is of the view that the guidance in paragraphs AG4–AG26 of this [draft] Standard complements the flowchart in the Implementation Guidance section of IPSAS 32 in distinguishing a lease from a service concession arrangement and helps public sector entities apply this [draft] Standard.

BC30. The IPSASB also decided to include flowcharts in the Implementation Guidance section to [draft] IPSAS [X] (ED 64) in order to:

(a) Distinguish leases from other types of transactions covered by other IPSAS; and

(b) Clarify that assets accounted for according to IPSAS 16, *Investment Property*, IPSAS 17, and IPSAS 31, *Intangible Assets*, can only be derecognized if they meet the derecognition criteria in those IPSASs.

Lease Term (see paragraphs 16–19 and AG37)

BC31. The IPSASB considered the requirements regarding the lease term in IFRS 16. The IPSASB did not identify a public sector specific reason that would warrant different requirements in this [draft] Standard.

BC32. The IPSASB acknowledged that many times in the public sector lease contracts have cancellation clauses related to availability of funding. These clauses allow public sector lessees to terminate a lease agreement, typically on an annual basis, if the government does not appropriate funds for the lease payments.

BC33. The IPSASB concluded that these types of clauses should be assessed in the same way as other termination options because there is not a public sector specific reason that warrants a departure from the principles in IFRS 16. However, the IPSASB decided to include in the Application Guidance section of this [draft] Standard specific guidance on these types of clauses by applying the same principles as for other termination options.

Lessor Accounting (see paragraphs 20–61)

Right-of-Use Model for Lessors for Public Sector Financial Reporting

BC34. As stated in paragraph BC13, the IPSASB decided to develop a single right-of-use model for lessor accounting specifically designed for public sector financial reporting.

BC35. The right-of-use model for lease accounting is based on the foundational principle that leases are the financing of the right to use an underlying asset. Based on this principle, the IPSASB considered two mutually exclusive approaches to the right-of-use model for lessor accounting. These approaches reflected different views of the relationship between the underlying asset and the right-of-use asset, as follows:

(a) In Approach 1, the right-of-use asset is considered to be a separate economic phenomenon to the underlying asset. Under this approach, the lessor would:

(i) Continue to recognize the underlying asset in its entirety in the statement of financial position;

(ii) Recognize a lease receivable (representing the present value of future lease payments by the lessee) in the statement of financial position; and

(iii) Recognize a credit entry in the statement of financial position that will be reduced subsequently over the lease term as revenue is recognized in the statement of financial performance.

(b) In Approach 2, the right-of-use asset is considered to be a component of the underlying asset. Under this approach, the lessor would:

(i) Derecognize the component of the underlying asset that is transferred to the lessee from the statement of financial position;

(ii) Recognize a residual asset in the statement of financial position (representing the rights retained in the underlying asset, or the right to receive back the underlying asset);

(iii) Recognize a lease receivable in the statement of financial position;

(iv) Recognize immediately the credit entry (representing the present value of future lease payments by the lessee) in the statement of financial performance; and

(v) Recognize immediately the lease expense (representing the cost of the portion of the underlying asset that is derecognized at the commencement of the lease) in the statement of financial performance.

BC36. The IPSASB concluded that Approach 1 provides the most consistent accounting treatment with IPSASB's literature, as follows:

(a) It is consistent with the *Conceptual Framework* derecognition criteria, which refer to the removal of an item, not portions of an item;

(b) It does not conflict with the principles in IPSAS 16, IPSAS 17, and IPSAS 32 that underlying assets are recognized and derecognized in their entirety because assets are not recognized and derecognized as portions ("slices") of individually controlled rights;

(c) It is consistent with a control-based approach to the recognition of assets because a lease does not transfer control of the underlying asset (see paragraph BC9); and

(d) It is consistent with the 'grant of a right to the operator model' in IPSAS 32, where a liability (unearned revenue) is initially recognized in the statement of financial position and revenue is recognized over time in the statement of financial performance.

BC37. The IPSASB also concluded that Approach 1:

(a) Is consistent with lessee accounting, as the lessee controls the right-of-use asset, and the lessor controls the underlying asset;

(b) Is a less complex and costly lessor accounting model than Approach 2 because the lessor does not need to:

(i) Determine the amount of the asset to derecognize in the cases of multiple leases of one asset (for example, floors of a building with different tenants and different lease terms that start and end at different times with different options);

(ii) Derecognize and measure the individual rights transferred to the lessee;

(iii) Identify, recognize and measure the individual rights retained in the underlying asset during the lease term, and the rights it will have in the underlying asset after the lease term[8];

(iv) Reassess the residual asset as a result of reassessment of the lease term; and

(v) Recognize and measure gains or losses at the end of leases for differences between the recorded residual values and actual values; and

[8] The asset that represents both of these rights is called the residual asset.

(c) Best meets the public interest as it provides the most understandable approach to lessor accounting because the unique economic substance of a physical asset will always be reflected in the lessor's financial statements.

BC38. In contrast, Approach 2 is not consistent with IPSASB's literature because:

(a) It conflicts with the principles elsewhere that the underlying asset is recognized or derecognized in its entirety.

(b) It is a more complex and costly lessor accounting model than Approach 1, as described in paragraph BC37(b).

(c) It is inconsistent with a control-based approach to asset recognition and derecognition. For example, where a lease is classified as a finance lease, the lessor would derecognize the underlying asset despite continuing to control the asset. Similarly, under an operating lease the lessor would not recognize the lease receivable despite controlling the financial instrument.

(d) It does not recognize the liability (unearned revenue) and revenue in a manner consistent with IPSAS 32.

BC39. Therefore, the IPSASB decided to adopt Approach 1 in this [draft] Standard.

BC40. As stated in paragraph BC35(a), under Approach 1 the right-of-use asset is a separate economic phenomenon from the underlying asset. In this context, the IPSASB noted that when a lease contract is signed, it creates a new resource (the right-of-use asset) separate from the underlying asset. As the creation of the new resource occurs at the same time as its transfer to the lessee, the lessor never recognizes the right-of-use asset in its statement of financial position. In other words, a lease under the right-of-use model is in substance a sale of an unrecognized right-of-use asset. This is consistent with the 'grant of a right to the operator model' in IPSAS 32, where the grantor transfers the right to access to operate the service concession asset to the operator of an existing asset, while retaining control of the service concession asset.

Recognition of the Lease Receivable

BC41. The lessor has fulfilled its obligation to transfer the right-of-use asset to the lessee when it makes the underlying asset available for use by the lessee. At this moment, the lessee controls the right-of-use asset. Therefore, the lessor has an unconditional right to receive lease payments (the lease receivable).

BC42. The IPSASB concluded that the lease receivable meets the definition of an asset because:

(a) It is a resource—an item with service potential or the ability to generate economic benefits (typically cash from the lessee to the lessor);

(b) It is presently controlled by the entity—for example, it can decide to sell or securitize the lease receivable; and

(c) It arises from a past event—the commitment to the lease contract and the underlying asset being made available for use by the lessee.

BC43. Therefore, the IPSASB concluded that this [draft] Standard should require a lessor to recognize a lease receivable.

Recognition of the Liability (Unearned Revenue)

BC44. As noted in paragraph BC35 above, the lessor recognizes a credit entry in the statement of financial position that will be reduced subsequently over the lease term as revenue is recognized in the statement of financial performance. The IPSASB debated the nature of the credit entry.

BC45. The IPSASB considered whether the credit entry in lessor accounting meets the definition of net assets/equity in IPSAS 1, *Presentation of Financial Statements*. IPSAS 1 defines net assets/equity as the residual interest in the assets of the entity after deducting all its liabilities. IPSAS 1 envisages four components of net assets/equity:

(a) Contributed capital, being the cumulative total at the reporting date of contributions from owners, less distributions to owners;

(b) Accumulated surpluses or deficits;

(c) Reserves; and

(d) Non-controlling interests.

BC46. The IPSASB concluded that the credit entry did not represent a direct increase in the lessor's net assets/equity because the credit entry is not one of the components of net assets/equity identified in paragraph BC45 for the reasons noted below:

(a) Contributions from owners are defined as "future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity…" The credit entry related to the recognition of a lease receivable does not meet this definition because the lessee has not made a contribution to the lessor that results in a financial interest in the entity by the lessee as envisaged by IPSAS 1.

(b) Accumulated surplus/deficit is an accumulation of an entity's surpluses and deficits. The credit entry related to recognition of a lease receivable represents an individual transaction and not an accumulation.

(c) Reserves generally arise from items recognized directly in net assets/equity as a result of specific requirements in IPSASs. These are generally unrealized gains and losses on revaluation of assets (e.g., property, plant, and equipment, investments). Reserves may also arise where an entity earmarks portions of its accumulated surplus or deficit. The credit entry related to the recognition of a lease receivable arises from an exchange transaction, and represents neither an unrecognized gain or loss from a revaluation, nor an earmarking of accumulated surplus or deficit.

(d) A non-controlling interest is defined as "that portion of the surplus or deficit and net assets/equity of a controlled entity attributable to net assets/equity interests that are not owned, directly or indirectly, through controlled entities, by the controlling entity." The credit entry related to the recognition of a lease receivable does not meet this definition because it does not give the lessee such a financial interest in the lessor.

BC47. The IPSASB considered whether the credit entry met the definition of revenue in the *Conceptual Framework*. The *Conceptual Framework* defines revenue as "increases in the net financial position of the entity, other than increases arising from ownership contributions." The IPSASB noted that the credit entry represents an increase in the net financial position of the entity. The IPSASB had already concluded (see paragraph BC46(a)) that the credit entry does not meet the definition of an ownership contribution. Consequently, the IPSASB decided that the credit entry represents revenue.

BC48. As a lease is usually an exchange transaction, the IPSASB referred to IPSAS 9 when considering the nature of the revenue and the timing of the recognition of that revenue. In accordance with IPSAS 9, when goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction that generates revenue as it results in an increase in the net assets of the lessor. In this situation, the lessor has received a lease receivable in exchange for granting a right (a right-of-use asset) to the lessee. The lease receivable recognized by the lessor and the right-of-use asset recognized by the lessee are dissimilar. However, until the criteria for the recognition of revenue have been satisfied, the credit entry is recognized by the lessor as a liability.

BC49. The IPSASB noted that, in this situation, there is no cash inflow to equal the revenue recognized. This result is consistent with IPSAS 9 in which an entity provides goods or services in exchange for another dissimilar asset that is subsequently used to generate cash revenues.

BC50. IPSAS 9 identifies three types of transactions that give rise to revenue: the rendering of services, the sale of goods (or other assets) and revenue arising from the use by others of the entity's assets, yielding interest, royalties, and dividends. In considering the nature of the revenue, the IPSASB considered these types of transactions separately.

BC51. While none of those scenarios fully matched the circumstances of the right-of-use lessor model, the IPSASB noted that the timing of revenue recognition under each of them is over the term of the arrangement, rather than immediately. The IPSASB determined that, by analogy, such a pattern of revenue recognition was also appropriate for recognizing the revenue arising from the liability related to the right-of-use lessor model. As a result, until the criteria for recognition of revenue have been satisfied, the credit entry is recognized as a liability.

BC52. The IPSASB also noted that this approach is consistent with the 'grant of a right to the operator model' in IPSAS 32.

BC53. The IPSASB noted that recognizing the credit entry as a liability until the revenue recognition criteria are met may not be consistent with the *Conceptual Framework* definition of a liability. However, the IPSASB also noted that recognizing revenue directly in the statement of financial position, while consistent with the *Conceptual Framework*, would not be consistent with the current requirements in IPSAS. The IPSASB therefore decided these inconsistencies should be addressed in a future IPSASB project to revise existing IPSASs for consistency with the *Conceptual Framework*.

Recognition Exemptions

BC54. IFRS 16 provides recognition exemptions for lessees. That Standard did not consider whether such exemptions were appropriate for lessors, as it did not adopt the right-of-use model for lessor accounting. The IPSASB therefore considered the IFRS 16 recognition exemptions for lessee accounting in the context of the right-of-use model for lessor accounting included in this [draft] Standard.

BC55. The IPSASB decided to propose the same recognition exemption for short-term leases in lessor accounting in order to provide the same cost relief for lessors as for lessees.

BC56. However, the IPSASB decided not to propose a recognition exemption for lessors for leases for which the underlying asset is of low value for the following reasons:

(a) IPSAS 13 does not provide recognition exemptions in lessor accounting;

(b) IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* already provides sufficient guidance on materiality in applying IPSASs to specific transactions; and

(c) It is consistent with a head lease not qualifying as a lease of a low-value asset if the lessee subleases an asset, or expects to sublease an asset.

Measurement of the Lease Receivable

BC57. The IPSASB considered the measurement requirements of the lessee's lease liability in this [draft] Standard for the lessor's lease receivable. The IPSASB decided to adopt the same measurement requirements for the lessor's lease receivable for consistency with the lessee's lease liability, where appropriate.

BC58. Additionally, the IPSASB also decided to require entities to apply the derecognition and impairment requirements in IPSAS 29, *Financial Instruments: Recognition and Measurement* to the lease receivable. The lease receivable meets the definition of a financial asset, and such treatment will ensure consistent treatment with other financial assets.

Measurement of the Liability (Unearned Revenue)

BC59. At initial recognition, the revenue that an entity will recognize over the term of the lease is represented by the lease receivable and any prepayments received. The IPSASB therefore considered it appropriate to initially measure the liability (unearned revenue) at the initial value of the lease receivable, adjusted for prepayments received.

BC60. Revenue is earned in accordance with the substance of the lease contract. As the entity recognizes revenue, it reduces the liability (unearned revenue). The IPSASB noted that this approach to subsequent measurement is consistent with the approach to measuring the liability for unearned revenue in IPSAS 32.

BC61. For concessionary leases, the IPSASB decided to measure the liability (unearned revenue) at the present value of market lease payments because this represents the full economic value created by the lease (see paragraphs BC77–BC96).

BC62. Similarly to leases at market terms, as the entity recognizes revenue, it reduces the liability (unearned revenue). The IPSASB noted that this approach to subsequent measurement is consistent with the approach to measuring interest revenue at fair value in IPSAS 29 for concessionary loans, where the interest revenue recognized is higher than the contractual interest received.

Measurement of the Underlying Asset

Double-Counting

BC63. As discussed in paragraphs BC34–BC39, the IPSASB has agreed to adopt an approach to lessor accounting where the lessor continues to recognize the underlying asset in its entirety. The IPSASB considered whether continuing to recognize the underlying asset in its entirety and recognizing the lease receivable would give rise to double-counting at both initial recognition and, for assets on fair value model, subsequent measurement.

BC64. Double-counting in accounting is an error where a single transaction or event (economic phenomenon) is recognized or counted more than once.

BC65. The IPSASB's literature[9] already addresses the principle of avoiding double-counting by requiring that assets and liabilities recognized in the financial statements should not be repeated or used for recognition and measurement of other assets.

BC66. The IPSASB concluded that there is no double-counting for the following reasons:

(a) Measurement at cost at initial recognition and subsequently—Historical cost is not a cash-flow-based measure because it results from a contractual price. A prospective purchaser is likely to assess future cash flows in determining whether to purchase an asset with the intention to lease it, but this does not make cost a cash-flow-based measure.

(b) Subsequent measurement at fair value—There is a possibility of double-counting in special situations. This is acknowledged in IPSAS 16.59. The IPSASB considered whether to repeat the substance of IPSAS 16.59 in this [draft] Standard, but concluded that it was unnecessary as this [draft] Standard does not provide the primary requirements and guidance on the measurement of investment property.

BC67. The IPSASB therefore concluded that no additional requirements relating to double-counting are required. This [draft] Standard requires a lessor to apply the requirements of IPSAS 16, IPSAS 17 and IPSAS 31 when measuring the underlying asset without the need for any additional guidance.

Grossing up and offsetting

BC68. The IPSASB also considered whether offsetting of the lease receivable and/or the underlying asset with the liability (unearned revenue) should be required in lessor accounting.

BC69. According to paragraph 48 of IPSAS 1, "assets and liabilities, and revenue and expenses, shall not be offset unless required or permitted by an IPSAS." This is because "Offsetting in the statement of financial performance or the statement of financial position, except when offsetting reflects the substance of the transaction or other event, detracts from the ability of users both (a) to understand the transactions, other events and conditions that have occurred, and (b) to assess the entity's future cash flows."[10]

BC70. The IPSASB concluded that there should not be any offsetting because the underlying asset has a different economic nature compared to the liability (unearned revenue), and arises as a result of two different transactions, as follows:

(a) Different confirmatory values—the value of the underlying asset confirms the cost incurred to purchase it, and the value of the liability (unearned revenue) confirms the present value of future lease payments that the lessor will receive for granting the right to use the underlying asset.

(b) Different predictive values—the value of the underlying asset helps to predict an "entity's ability to respond to changing circumstances and anticipated future service delivery needs", and the value of the liability (unearned revenue) helps to predict the amount of future lease

[9] For example, paragraph 59 of IPSAS 16, *Investment Property* and paragraph 56 of IPSAS 26, *Impairment of Cash-Generating Assets*.

[10] IPSAS 1.49

payments (in present value terms) that the lessor will receive for granting the right to use the underlying asset.

(c) The historical cost of the underlying asset can provide information on the amount that may be used as effective security for borrowings even when assets are being leased out, which is relevant to an assessment of financial capacity.

BC71. Furthermore, on initial recognition the part of the earnings potential of the leased asset that is leased out to the lessee over the lease term is balanced by the liability (unearned revenue) and, therefore, there is no impact on net financial position.

BC72. The IPSASB also concluded that the credit entry should not be offset against the underlying asset because the purchase of the underlying asset and the lease are two separate transactions.

Presentation (Display and Disclosure)

BC73. The IPSASB is of the view that presentation by the lessor should be consistent, to the extent possible, with presentation by the lessee. Therefore, the IPSASB decided to develop presentation requirements for lessors consistent with those for lessees.

BC74. The IPSASB also decided to adopt in this [draft] Standard the *Conceptual Framework* approach on presentation by distinguishing information selected for display or disclosure. As a consequence, the presentation section has two sub-sections, on display and note disclosure.

BC75. Additionally, the IPSASB retains in this [draft] Standard the IFRS 16 disclosure objectives and requirements that are still applicable to the proposed right-of-use model in lessor accounting and includes disclosures for concessionary leases similar to disclosures for concessionary loans in IPSAS 30, *Financial Instruments: Disclosures*.

Manufacturer or Dealer Lessors

BC76. IFRS 16 includes specific requirements relating to a manufacturer or dealer lessors. The IPSASB considered these requirements, and concluded it was not necessary to include them in this [draft] Standard, for the following reasons:

(a) The lessor model adopted in this [draft] Standard is not based on the risks and rewards model adopted in IFRS 16; and

(b) Manufacturer or dealer lessors are expected to be very rare in the public sector (commonly found in the private sector in the auto industry).

Non-Exchange Component in Concessionary Leases

BC77. As discussed in paragraphs BC20–BC23, this [draft] Standard includes requirements for concessionary leases. The IPSASB considered the accounting for the non-exchange component in concessionary leases for lessors.

BC78. Contrary to revenue from non-exchange transactions, the IPSASB's literature does not currently include specific requirements for expenses from non-exchange transactions. As stated in paragraph BC23, such requirements are currently being developed in the IPSASB's project on Revenue and Non-Exchange Expenses.

BC79. However, IPSAS 29 provides guidance on how to account for the non-exchange component in concessionary loans from the transferor side. The IPSASB considered the applicability of those accounting requirements to the non-exchange component of concessionary leases.

BC80. As stated in paragraphs BC6 and BC35, the IPSASB is of the view that leases are financings of the right to use an underlying asset. The IPSASB is also of the view that an outstanding loan and a lease receivable have the same economic nature because both have fixed or determinable payments. Therefore, the financing component of loans and leases are comparable transactions.

BC81. According to paragraph BC15 of IPSAS 29, "the IPSASB […] considered that the initial granting of the loan results in a commitment of resources, in the form of a loan and a subsidy, on day one. The IPSASB was of the view that initial recognition of this subsidy as an expense on recognition of the transaction provides the most useful information for accountability purposes."

BC82. The IPSASB is of the view that the nature of the resource transferred does not affect the economic substance of a subsidy. Consequently, whether an entity grants a loan or transfers a right-of-use asset at below market terms should not modify the accounting for the non-exchange component as a subsidy granted on day one. The IPSASB is also of the view that recognizing the subsidy provides the most useful information for accountability purposes because it shows the cost of the decision to grant the concession.

BC83. The IPSASB noted that separately recognizing an expense for the non-exchange component in concessionary leases also implies recognizing at the same time a credit entry for the same non-exchange component. The IPSASB also noted that under the right-of-use model there is a simultaneous creation and transfer of the right-of-use asset to the lessee. No asset is derecognized in the lessor's financial statements (see paragraph BC40). On the contrary, when an entity makes a loan, the cash transferred to the borrower is derecognized in the lender's financial statements.

BC84. Therefore, the IPSASB considered three options to account for the non-exchange component in a concessionary lease by lessors:

(a) Option 1 – Measure concessionary leases at historical cost – The lessor does not recognize either the debit entry (expense) or the credit entry related to the non-exchange component in the lessor's accounts.

(b) Option 2 – Measure concessionary leases at fair value – The lessor recognizes the debit entry (expense) in surplus or deficit and the credit entry for the non-exchange component as a liability (unearned revenue) together with the exchange component of the lease, and unwinds this as lease revenue over the lease term.

(c) Option 3 – Measure concessionary leases at fair value – The lessor recognizes the debit entry (expense) and the credit entry for the non-exchange component directly in net assets/equity.

BC85. The IPSASB considered that the non-exchange component of the credit entry does not meet the definition of net assets/equity in IPSAS 1 because it is not consistent with any of the four components of net assets/equity, as described in paragraphs BC45 and BC46. As a consequence, the IPSASB rejected Option 3.

BC86. The IPSASB noted that the main difference between Options 1 and 2 is whether or not the subsidy is recognized in the lessor's accounts.

BC87. When discussing Options 1 or 2, the IPSASB considered the economics of the right-of use model when applied to concessionary leases from the lessor's perspective.

BC88. As stated in paragraph BC40, when a lease contract is signed, it creates a new resource (the right-of-use asset) separate from the underlying asset. As the creation of the new resource occurs at the same time as its transfer to the lessee, the lessor never recognizes the new resource in its statement of financial position. In other words, a lease under the right-of-use model is in substance a sale of an unrecognized right-of-use asset.

BC89. In this context, the items that the lessor recognizes in its financial statements are the result of transferring the new resource to the lessee, as follows:

(a) If the lease is at market terms, then the market lease payments are the same as the contractual lease payments (cash inflows).

(b) If the lease is at below market terms (concessionary lease), then the market lease payments are higher than the contractual lease payments (cash inflows).

BC90. Therefore, at initial recognition of a concessionary lease measured at fair value:

(a) The credit entry can be viewed as the full economic value of the resource created (the right-of-use asset) with two components:

(i) An exchange component, which corresponds to the future cash inflows (contractual lease payments) to be received by the lessor; and

(ii) A non-exchange component, which corresponds to the difference between the full economic value of the right-of-use asset created by the lease and the future cash inflows (contractual lease payments); and

(b) The debit entry can be viewed as the use or transfer of the economic value that resulted from the creation of the right-of-use asset, again with two components:

(i) An exchange component, which corresponds to the cash inflows (contractual lease payments) to be received by the lessor; and

(ii) A non-exchange component as one day expense or contribution from owners, which corresponds to the value of the subsidy in kind transferred to the lessee.

BC91. The IPSASB is of the view that a performance obligation to provide access to the underlying asset exists regardless of the amount of cash being transferred. This means that the lessor's liability (unearned revenue) encompasses both the exchange and non-exchange components in a concessionary lease.

BC92. The IPSASB also considered that Option 2 is consistent with the:

(a) Definitions of revenue and liability in the *Conceptual Framework* because they can arise from non-exchange transactions;

(b) Principles in the *Conceptual Framework*, IPSAS 16, IPSAS 17, IPSAS 23 and IPSAS 29 to measure non-exchange transactions at fair value; and

(c) Accounting for the subsidy:

(i) In concessionary loans as expense or contributions from owners on day one and as (interest) revenue over the loan term; and

(ii) By lessees in concessionary leases.

BC93. Therefore, the IPSASB decided to propose Option 2 in this [draft] Standard.

BC94. However, the IPSASB acknowledged that recognizing lease revenue in excess of the lease receivable can be considered counter-intuitive by those who view lease revenue as directly linked to cash inflows (contractual lease payments). This might raise understandability issues, where users may find it difficult to understand that recognizing an expense for the subsidy implies recognizing lease revenue in excess of the cash inflows over the lease term.

BC95. The IPSASB also acknowledged that some preparers may find that the cost of providing information about lease revenue in concessionary leases at fair value is higher than its benefits, especially when some users might not understand the meaning of recognizing lease revenue in excess of the cash inflows. Costs also include gathering sufficient information to determine whether leases are at below market rates.

BC96. Although the IPSASB decided that, on balance, it was appropriate to include Option 2 in this [draft] Standard, it acknowledged others could come to a different conclusion. The IPSASB therefore agreed to seek feedback from its constituents as to whether the conceptual reasons to recognize the subsidy in concessionary leases are outweighed by understandability and cost-benefit considerations.

Lessee Accounting (see paragraphs 63–112)

Recognition

BC97. As discussed in paragraphs BC6–BC8, the IPSASB considered the right-of-use model for lessee accounting in IFRS 16, and did not identify any public sector specific reason that would warrant different requirements in this [draft] Standard.

BC98. As the lessee accounting requirements in this [draft] Standard are based on IFRS 16, the Basis for Conclusions outlines only those areas where this [draft] Standard departs from the main requirements of IFRS 16, or where the IPSASB considered such departures.

Recognition Exemptions

BC99. The IPSASB considered the recognition exemptions in IFRS 16. The IPSASB did not identify a public sector specific reason that would warrant different recognition exemptions in this [draft] Standard.

BC100. The IPSASB also considered whether the permissible recognition exemptions in IFRS 16 should be a requirement or an option in this [draft] IPSAS. The IPSASB noted that, according to the IASB's research, leases of low value assets represent less than 1% of total non-current assets. In this context, the IPSASB considered that, on the one hand, making the recognition exemptions a requirement rather than an option would enhance the comparability between public sector entities and provide increased cost relief to them, with a low probability of a negative impact on the reliability and accuracy of financial statements. However, on the other hand, the IPSASB noted that requiring recognition exemptions for short-term leases may create a new arbitrage point, where entities could design their lease contracts to achieve desired accounting outcomes.

BC101. On balance, the IPSASB concluded that there was no public sector specific reason to require rather than permit recognition exemptions. The IPSASB also considered that, by not requiring the application of the exemptions, public sector entities would be able to adopt an approach that best provides faithful representation of leasing transactions in terms of their own statements of financial position.

BC102. The IPSASB noted that IFRS 16 does not set a specific monetary amount for a lease of a low value asset. Instead, the IASB included in paragraph BC100 of the Basis for Conclusions: “the IASB had in mind leases of underlying assets with a value, when new, in the order of magnitude of US$5,000 or less”. The IPSASB considered whether it was appropriate for public sector financial reporting to use the same or a different dollar amount, or not make any reference to a threshold in the Basis for Conclusions of this [draft] Standard.

BC103. The IPSASB acknowledged that, for many public sector entities that are services-based, a figure of US$5,000 might represent the value of most of their assets. The IPSASB concluded that public sector entities, if they decide to apply the exemption, should use a threshold for determining leases of low-value assets, considering the materiality of leasing transactions in relation to their financial statements, and that the IPSASB would not provide guidance on a specific monetary amount. In assessing materiality, preparers consider whether the omission of information could influence users’ assessments of accountability or their decision-making.

Measurement of the Right-of-Use Asset and Lease Liability

BC104. The IPSASB considered the measurement requirements of the right-of-use asset and the lease liability in IFRS 16 for lessee accounting. IFRS 16 requires the right-of-use asset and the lease liability to be initially measured at cost. However, IFRS 16 only deals with leases that are exchange transactions (leases at market terms). IFRS 16 does not provide guidance on how to account for leases that are non-exchange transactions (for example, concessionary leases).

BC105. As leases in the public sector quite often are concessionary leases, the IPSASB concluded that a cost model is not appropriate for these types of leases because applying IFRS 16 measurement requirements to concessionary leases would lead to an understatement of the right-of-use asset and a failure to recognize the subsidy from the lessor to the lessee in the financial statements of both the lessee and the lessor.

BC106. Therefore, the IPSASB decided to require in this [draft] Standard the right-of-use asset and the lease liability to be measured initially at cost where the leases are exchange transactions, and at fair value where the leases are concessionary leases. Additionally, the IPSASB amended IPSAS 23 to include right-of-use assets held by a lessee acquired through non-exchange transactions to be measured at fair value as at the date of acquisition according to the principles in this [draft] Standard.

BC107. The IPSASB considered the appropriate discount rate to be used in the measurement of the right-of-use asset and the lease liability in concessionary leases. The IPSASB is of the view that it is not appropriate to use the interest rate implicit in the lease to measure the right-of-use asset and lease liability in concessionary leases because it would lead to the same problem identified in paragraph BC105.

BC108. The IPSASB also considered whether it was appropriate to measure the right-of-use asset and the lease liability using the lessee’s incremental borrowing rate. The IPSASB noted that the lessee’s incremental borrowing rate tends to be a market interest rate or close to it. Therefore, the IPSASB concluded that it is appropriate to use the lessee’s incremental borrowing rate to measure the right-of-use asset and the lease liability in concessionary leases.

BC109. The IPSASB also noted that, in some jurisdictions, public sector entities do not have an incremental borrowing rate because they are precluded from obtaining funds directly from the banking system. In these circumstances, the IPSASB is of the view that market interest rates should be used to measure the right-of-use asset and the lease liability.

Presentation (Display and Disclosure)

BC110. The IPSASB decided to adopt in this [draft] Standard the *Conceptual Framework* approach on presentation by distinguishing information selected for display or disclosure. As a consequence, the presentation section has two sub-sections, on display and note disclosure.

BC111. Additionally, the IPSASB proposes disclosures for concessionary leases similar to disclosures for concessionary loans in IPSAS 30 because of their similar economic nature related to the financing component of the lease (lease receivable).

Non-Exchange Component in Concessionary Leases

BC112. The IPSASB considered the accounting for the non-exchange component in concessionary leases for lessees. The IPSASB concluded that the existing principles in IPSAS 23 for recognizing revenue from non-exchange transactions are also applicable to the non-exchange component in concessionary leases, including concessionary leases for zero or nominal consideration.

BC113. The IPSASB also concluded that, in determining whether a concessionary lease has identifiable exchange and non-exchange components, professional judgment is exercised. Where it is not possible to distinguish separate exchange and non-exchange components, the whole concessionary lease is treated as a non-exchange transaction.

BC114. Therefore, the IPSASB added additional guidance to IPSAS 23 in order to ensure a consistent accounting treatment of revenue recognition of the non-exchange component in concessionary leases.

Sale and Leaseback Transactions

Assessing Whether the Transfer of the Asset is a Sale

BC115. The IPSASB considered the requirement in IFRS 16 that an entity determines whether the transfer of an asset is accounted for as a sale of that asset depending on whether a performance obligation is satisfied in accordance with IFRS 15, *Revenue from Contracts with Customers*.

BC116. The IPSASB is of the view that a sale entered into as part of a sale and leaseback transaction should be accounted for in the same way as other sales of goods. However, currently the IPSASB does not have an IPSAS primarily drawn from IFRS 15. IPSAS 9 follows a 'risks and rewards of ownership' approach to the recognition of revenue from the sale of goods, rather than the control-based approach in IFRS 15.

BC117. The IPSASB considers that a new IPSAS on Leases should have a similar requirement to IFRS 16, adapted to reflect public sector issues. Therefore, the IPSASB decided that, until a new IPSAS on revenue is published, sales entered into as part of a sale and leaseback transaction should follow the requirements in IPSAS 9 for other sales of goods. The IPSASB has already issued a Consultation Paper on Revenue and Non-Exchange Expenses, primarily drawn from IFRS 15, to replace IPSAS 9 and IPSAS 11, *Construction Contracts*.

Sale and Leaseback Transaction at Below Market Terms

BC118. The IPSASB considered whether a leaseback transaction at below market terms should apply the requirements in IFRS 16.101(a) or the requirements to account for the non-exchange component in concessionary leases.

BC119. The IPSASB decided to account for the non-exchange component of a sale and leaseback transaction at below market terms in the same way as the non-exchange component in a concessionary lease required in [draft] IPSAS [X] ED (64) or the relevant IPSAS for the sale, as appropriate, in order to ensure a consistent accounting treatment with the IPSASB's literature.

Implementation Guidance

This guidance accompanies, but is not part of, [draft] IPSAS [X] (ED 64)

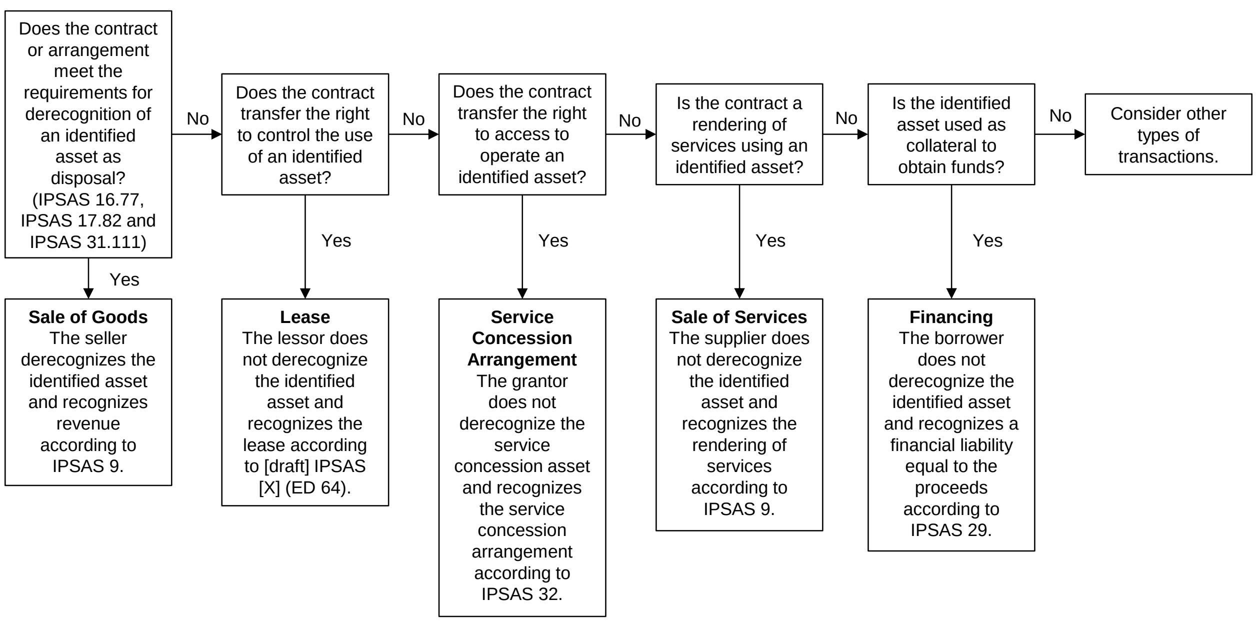
IG1. The purpose of this Implementation Guidance is to illustrate certain aspects of the requirements in [draft] IPSAS [X] (ED 64).

IG2. Some diagrams below set out the typical types of transactions involving identified assets and provides references to IPSASs that apply to those transactions. Other diagrams identify types of leases and provides references to paragraphs in [draft] IPSAS [X] (ED 64).

IG3. The list of transactions is not exhaustive. The purpose of the diagrams is to highlight the continuum of transactions. It is not the intention of the diagrams to convey the impression that bright lines exist between the accounting requirements of those types of transactions. The appropriate Standard should be taken into consideration for accounting for each type of transaction.

Relationship between Leases and Other Transactions

IG4. The diagram below summarizes the relationship between leases and other types of transactions that may involve an identified existing asset.



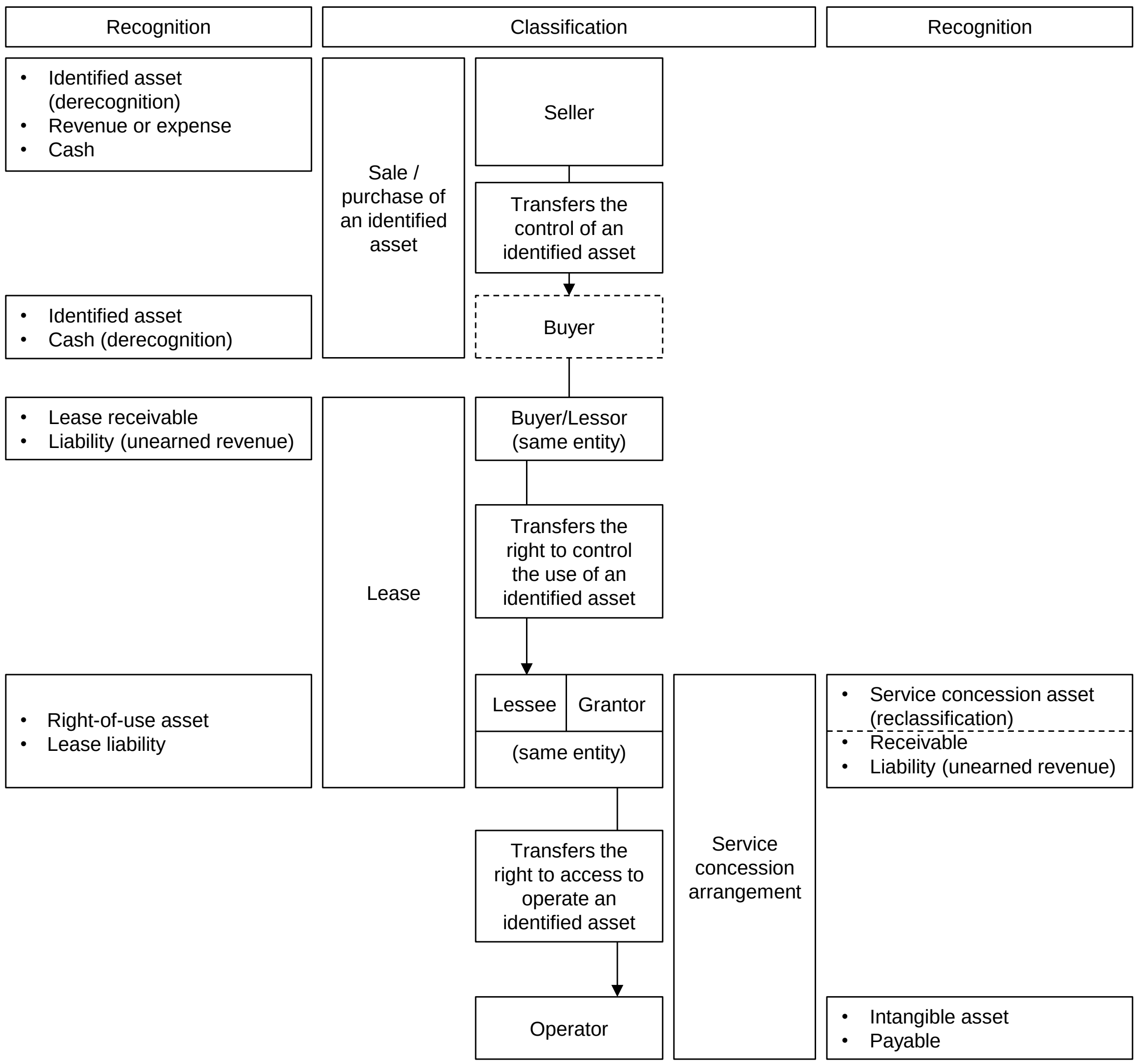
Types of Control in a Lease, Service Concession Arrangement and Service

IG5. The diagram below identifies the parties that control the identified asset in a lease, service concession arrangement and service. The diagram also identifies individual rights over identified assets that are controlled by those parties.

Classification / Type of control	Lease	Service concession arrangement	Service
Control of an identified asset	Lessor: Yes Lessee: No	Grantor: Yes Operator: No	Supplier: Yes Customer: No
Control of the right to use an identified asset	Lessor: No Lessee: Yes	Grantor: Yes Operator: No	Supplier: Yes Customer: No
Control of the right to access to operate an identified asset	Lessor: No Lessee: Yes	Grantor: No Operator: Yes	Supplier: Yes Customer: No

Relationship between Sale of an Identified Asset, Leases and Service Concession Arrangements

IG6. The diagram below summarizes the relationship between the sale of an identified asset, leases and service concession arrangements with three parties in cascading transactions, where the buyer and lessor are the same entity, and the lessee and grantor are also the same entity.

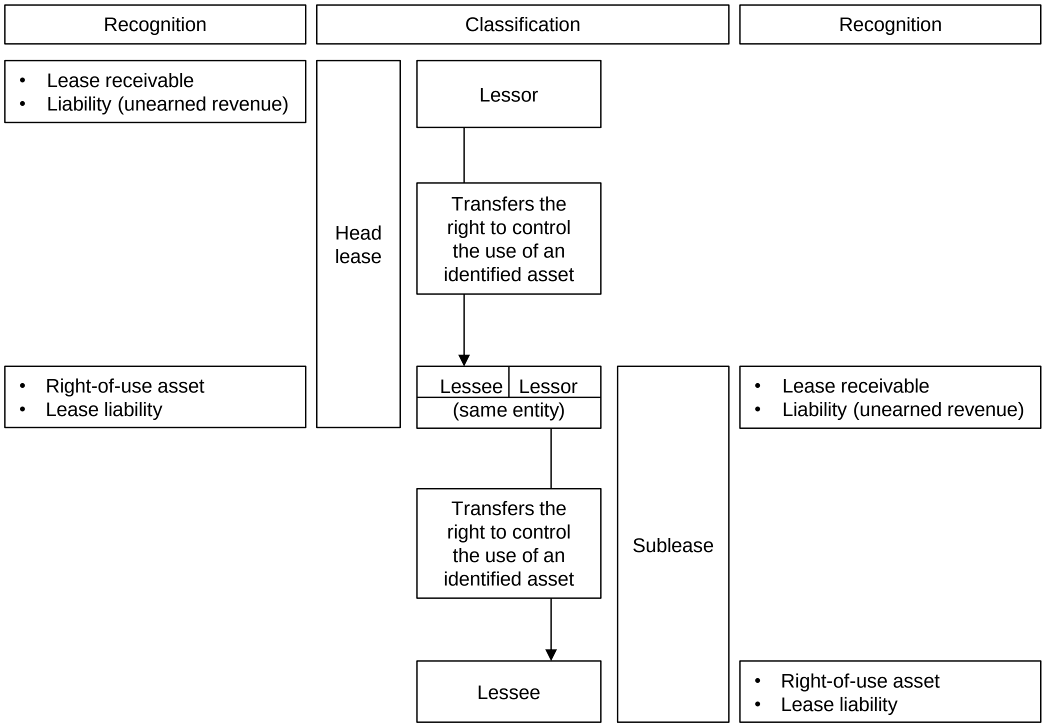


IG7. For simplification purposes, the above diagram assumes that neither the lessee nor the operator make an upfront payment in cash (total or partial) for receiving, respectively, the right-of-use asset and the intangible asset.

IG8. The above diagram must be read together with the diagrams in paragraphs IG2 and IG4 of IPSAS 32, *Service Concession Arrangements: Grantor* and Information Note 1 and 2 of IFRIC 12, *Service Concession Arrangements* issued by the International Accounting Standards Board.

Relationship between a Head Lease and a Sublease

IG9. The diagram below summarizes the relationship between a head lease and a sublease and their recognition requirements established by [draft] IPSAS [X] (ED 64).



Illustrative Examples

These examples accompany, but are not part of, [draft] IPSAS [X] (ED 64)

IE1. These examples portray hypothetical situations illustrating how an entity might apply some of the requirements in [draft] IPSAS [X] (ED 64) to particular aspects of a lease (or other contracts) on the basis of the limited facts presented. The analysis in each example is not intended to represent the only manner in which the requirements could be applied, nor are the examples intended to apply only to the specific operation illustrated. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying [draft] IPSAS [X] (ED 64).

Identifying a Lease (see paragraphs 6–8 and AG4–AG25)

IE2. The following examples illustrate how an entity determines whether a contract is, or contains, a lease.

Example 1–Rail Cars

Example 1A: a contract between Customer and a freight carrier (Supplier) provides Customer with the use of 10 rail cars of a particular type for five years. The contract specifies the rail cars; the cars are owned by Supplier. Customer determines when, where and which goods are to be transported using the cars. When the cars are not in use, they are kept at Customer's premises. Customer can use the cars for another purpose (for example, storage) if it so chooses. However, the contract specifies that Customer cannot transport particular types of cargo (for example, explosives). If a particular car needs to be serviced or repaired, Supplier is required to substitute a car of the same type. Otherwise, and other than on default by Customer, Supplier cannot retrieve the cars during the five-year period.

The contract also requires Supplier to provide an engine and a driver when requested by Customer. Supplier keeps the engines at its premises and provides instructions to the driver detailing Customer's requests to transport goods. Supplier can choose to use any one of a number of engines to fulfil each of Customer's requests, and one engine could be used to transport not only Customer's goods, but also the goods of other customers (i.e., if other customers require the transportation of goods to destinations close to the destination requested by Customer and within a similar timeframe, Supplier can choose to attach up to 100 rail cars to the engine).

The contract contains leases of rail cars. Customer has the right to use 10 rail cars for five years.

There are 10 identified cars. The cars are explicitly specified in the contract. Once delivered to Customer, the cars can be substituted only when they need to be serviced or repaired (see paragraph AG13). The engine used to transport the rail cars is not an identified asset because it is neither explicitly specified nor implicitly specified in the contract.

Customer has the right to control the use of the 10 rail cars throughout the five-year period of use because:

(a) Customer has the right to obtain substantially all of the economic benefits from use of the cars over the five-year period of use. Customer has exclusive use of the cars throughout the period of use, including when they are not being used to transport Customer's goods.

(b) Customer has the right to direct the use of the cars because the conditions in paragraph AG19(a) exist. The contractual restrictions on the cargo that can be transported by the cars are protective rights of Supplier and define the scope of Customer's right to use the cars. Within the scope of its right of use defined in the contract, Customer makes the relevant decisions about how and for what purpose the cars are used by being able to decide when and where the rail cars will be used and which goods are transported using the cars. Customer also determines whether and how the cars will be used when not being used to transport its goods (for example, whether and when they will be used for storage). Customer has the right to change these decisions during the five-year period of use.

Although having an engine and driver (controlled by Supplier) to transport the rail cars is essential to the efficient use of the cars, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the rail cars are used. Consequently, Supplier does not control the use of the cars during the period of use.

Example 1B: the contract between Customer and Supplier requires Supplier to transport a specified quantity of goods by using a specified type of rail car in accordance with a stated timetable for a period of five years. The timetable and quantity of goods specified are equivalent to Customer having the use of 10 rail cars for five years. Supplier provides the rail cars, driver and engine as part of the contract. The contract states the nature and quantity of the goods to be transported (and the type of rail car to be used to transport the goods). Supplier has a large pool of similar cars that can be used to fulfil the requirements of the contract. Similarly, Supplier can choose to use any one of a number of engines to fulfil each of Customer's requests, and one engine could be used to transport not only Customer's goods, but also the goods of other customers. The cars and engines are stored at Supplier's premises when not being used to transport goods.

The contract does not contain a lease of rail cars or of an engine.

The rail cars and the engines used to transport Customer's goods are not identified assets. Supplier has the substantive right to substitute the rail cars and engine because:

(a) Supplier has the practical ability to substitute each car and the engine throughout the period of use (see paragraph AG9(a)). Alternative cars and engines are readily available to Supplier and Supplier can substitute each car and the engine without Customer's approval.

(b) Supplier would benefit economically from substituting each car and the engine (see paragraph AG9(b)). There would be minimal, if any, cost associated with substituting each car or the engine because the cars and engines are stored at Supplier's premises and Supplier has a large pool of similar cars and engines. Supplier benefits from substituting each car or the engine in contracts of this nature because substitution allows Supplier to, for example, (i) use cars or an engine to fulfil a task for which the cars or engine are already positioned to perform (for example, a task at a rail yard close to the point of origin) or (ii) use cars or an engine that would otherwise be sitting idle because they are not being used by a customer.

Accordingly, Customer does not direct the use, nor have the right to obtain substantially all of the economic benefits from use, of an identified car or an engine. Supplier directs the use of the rail cars and engine by selecting which cars and engine are used for each particular delivery and obtains substantially all of the economic benefits from use of the rail cars and engine. Supplier is only providing freight capacity.

Example 2–Concession Space

A coffee company (Customer) enters into a contract with an airport operator (Supplier) to use a space in the airport to sell its goods for a three-year period. The contract states the amount of space and that the space may be located at any one of several boarding areas within the airport. Supplier has the right to change the location of the space allocated to Customer at any time during the period of use. There are minimal costs to Supplier associated with changing the space for the Customer: Customer uses a kiosk (that it owns) that can be moved easily to sell its goods. There are many areas in the airport that are available and that would meet the specifications for the space in the contract.

The contract does not contain a lease.

Although the amount of space Customer uses is specified in the contract, there is no identified asset. Customer controls its owned kiosk. However, the contract is for space in the airport, and this space can change at the discretion of Supplier. Supplier has the substantive right to substitute the space Customer uses because:

(a) Supplier has the practical ability to change the space used by Customer throughout the period of use (see paragraph AG9(a)). There are many areas in the airport that meet the specifications for the space in the contract, and Supplier has the right to change the location of the space to other space that meets the specifications at any time without Customer's approval.

(b) Supplier would benefit economically from substituting the space (see paragraph AG9(b)). There would be minimal cost associated with changing the space used by Customer because the kiosk can be moved easily. Supplier benefits from substituting the space in the airport because substitution allows Supplier to make the most effective use of the space at boarding areas in the airport to meet changing circumstances.

Example 3–Fibre-Optic Cable

Example 3A: Customer enters into a 15-year contract with a utilities company (Supplier) for the right to use three specified, physically distinct dark fibres within a larger cable connecting Hong Kong to Tokyo. Customer makes the decisions about the use of the fibres by connecting each end of the fibres to its electronic equipment (i.e., Customer 'lights' the fibres and decides what data, and how much data, those fibres will transport). If the fibres are damaged, Supplier is responsible for the repairs and maintenance. Supplier owns extra fibres, but can substitute those for Customer's fibres only for reasons of repairs, maintenance or malfunction (and is obliged to substitute the fibres in these cases).

The contract contains a lease of dark fibres. Customer has the right to use the three dark fibres for 15 years.

There are three identified fibres. The fibres are explicitly specified in the contract and are physically distinct from other fibres within the cable. Supplier cannot substitute the fibres other than for reasons of repairs, maintenance or malfunction (see paragraph AG13).

Customer has the right to control the use of the fibres throughout the 15-year period of use because:

(a) Customer has the right to obtain substantially all of the economic benefits from use of the fibres over the 15-year period of use. Customer has exclusive use of the fibres throughout the period of use.

(b) Customer has the right to direct the use of the fibres because the conditions in paragraph AG19(a) exist. Customer makes the relevant decisions about how and for what purpose the fibres are used by deciding (i) when and whether to light the fibres and (ii) when and how much output the fibres will produce (i.e., what data, and how much data, those fibres will transport). Customer has the right to change these decisions during the 15-year period of use.

Although Supplier's decisions about repairing and maintaining the fibres are essential to their efficient use, those decisions do not give Supplier the right to direct how and for what purpose the fibres are used. Consequently, Supplier does not control the use of the fibres during the period of use.

Example 3B: Customer enters into a 15-year contract with Supplier for the right to use a specified amount of capacity within a cable connecting Hong Kong to Tokyo. The specified amount is equivalent to Customer having the use of the full capacity of three fibre strands within the cable (the cable contains 15 fibres with similar capacities). Supplier makes decisions about the transmission of data (i.e., Supplier lights the fibres, makes decisions about which fibres are used to transmit Customer's traffic and makes decisions about the electronic equipment that Supplier owns and connects to the fibres).

The contract does not contain a lease.

Supplier makes all decisions about the transmission of its customers' data, which requires the use of only a portion of the capacity of the cable for each customer. The capacity portion that will be provided to Customer is not physically distinct from the remaining capacity of the cable and does not represent substantially all of the capacity of the cable (see paragraph AG15). Consequently, Customer does not have the right to use an identified asset.

Example 4–Office Unit

Customer enters into a contract with a property owner (Supplier) to use Office Unit A for a five-year period. Office Unit A is part of a larger office space with many office units.

Customer is granted the right to use Office Unit A. Supplier can require Customer to relocate to another office unit. In that case, Supplier is required to provide Customer with an office unit of similar quality and specifications to Office Unit A and to pay for Customer's relocation costs. Supplier would benefit economically from relocating Customer only if a major new tenant were to decide to occupy a large amount of office space at a rate sufficiently favorable to cover the costs of relocating Customer and other tenants in the office space. However, although it is possible that those circumstances will arise, at inception of the contract, it is not likely that those circumstances will arise.

The contract requires Customer to use Office Unit A to operate its well-known store brand to sell its goods during the hours that the larger office space is open. Customer makes all of the decisions about the use of the office unit during the period of use. For example, Customer decides on the mix of goods sold from the unit, the pricing of the goods sold and the quantities of inventory held. Customer also controls physical access to the unit throughout the five-year period of use.

The contract requires Customer to make fixed payments to Supplier, as well as variable payments that are a percentage of sales from Office Unit A.

Supplier provides cleaning and security services, as well as advertising services, as part of the contract.

The contract contains a lease of office space. Customer has the right to use Office Unit A for five years.

Office Unit A is an identified asset. It is explicitly specified in the contract. Supplier has the practical ability to substitute the office unit, but could benefit economically from substitution only in specific circumstances. Supplier's substitution right is not substantive because, at inception of the contract, those circumstances are not considered likely to arise (see paragraph AG11).

Customer has the right to control the use of Office Unit A throughout the five-year period of use because:

(a) Customer has the right to obtain substantially all of the economic benefits from use of Office Unit A over the five-year period of use. Customer has exclusive use of Office Unit A throughout the period of use. Although a portion of the cash flows derived from sales from Office Unit A will flow from Customer to Supplier, this represents consideration that Customer pays Supplier for the right to use the office unit. It does not prevent Customer from having the right to obtain substantially all of the economic benefits from use of Office Unit A.

(b) Customer has the right to direct the use of Office Unit A because the conditions in paragraph AG19(a) exist. The contractual restrictions on the goods that can be sold from Office Unit A, and when Office Unit A is open, define the scope of Customer's right to use Office Unit A. Within the scope of its right of use defined in the contract, Customer makes the relevant decisions about how and for what purpose Office Unit A is used by being able to decide, for example, the mix of products that will be sold in the office unit and the sale price for those products. Customer has the right to change these decisions during the five-year period of use.

Although cleaning, security, and advertising services are essential to the efficient use of Office Unit A, Supplier's decisions in this regard do not give it the right to direct how and for what purpose Office Unit A is used. Consequently, Supplier does not control the use of Office Unit A during the period of use and Supplier's decisions do not affect Customer's control of the use of Office Unit A.

Example 5–Truck Rental

Customer enters into a contract with Supplier for the use of a truck for one week to transport cargo from New York to San Francisco. Supplier does not have substitution rights. Only cargo specified in the contract is permitted to be transported on this truck for the period of the contract. The contract specifies a maximum distance that the truck can be driven. Customer is able to choose the details of the journey (speed, route, rest stops, etc.) within the parameters of the contract. Customer does not have the right to continue using the truck after the specified trip is complete.

The cargo to be transported, and the timing and location of pick-up in New York and delivery in San Francisco, are specified in the contract.

Customer is responsible for driving the truck from New York to San Francisco.

The contract contains a lease of a truck. Customer has the right to use the truck for the duration of the specified trip.

There is an identified asset. The truck is explicitly specified in the contract, and Supplier does not have the right to substitute the truck.

Customer has the right to control the use of the truck throughout the period of use because:

(a) Customer has the right to obtain substantially all of the economic benefits from use of the truck over the period of use. Customer has exclusive use of the truck throughout the period of use.

(b) Customer has the right to direct the use of the truck because the conditions in AG19(b)(i) exist. How and for what purpose the truck will be used (i.e., the transportation of specified cargo from New York to San Francisco within a specified timeframe) is predetermined in the contract. Customer directs the use of the truck because it has the right to operate the truck (for example, speed, route, rest stops) throughout the period of use. Customer makes all of the decisions about the use of the truck that can be made during the period of use through its control of the operations of the truck.

Because the duration of the contract is one week, this lease meets the definition of a short-term lease.

Example 6–Ship

Example 6A: Customer enters into a contract with a ship owner (Supplier) for the transportation of cargo from Rotterdam to Sydney on a specified ship. The ship is explicitly specified in the contract and Supplier does not have substitution rights. The cargo will occupy substantially all of the capacity of the ship. The contract specifies the cargo to be transported on the ship and the dates of pickup and delivery.

Supplier operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship. Customer is prohibited from hiring another operator for the ship or operating the ship itself during the term of the contract.

The contract does not contain a lease.

There is an identified asset. The ship is explicitly specified in the contract and Supplier does not have the right to substitute that specified ship.

Customer has the right to obtain substantially all of the economic benefits from use of the ship over the period of use. Its cargo will occupy substantially all of the capacity of the ship, thereby preventing other parties from obtaining economic benefits from use of the ship.

However, Customer does not have the right to control the use of the ship because it does not have the right to direct its use. Customer does not have the right to direct how and for what purpose the ship is used. How and for what purpose the ship will be used (i.e., the transportation of specified cargo from Rotterdam to Sydney within a specified timeframe) is predetermined in the contract. Customer has no right to change how and for what purpose the ship is used during the period of use. Customer has no other decision-making rights about the use of the ship during the period of use (for example, it does not have the right to operate the ship) and did not design the ship. Customer has the same rights regarding the use of the ship as if it were one of many customers transporting cargo on the ship.

Example 6B: Customer enters into a contract with Supplier for the use of a specified ship for a five-year period. The ship is explicitly specified in the contract and Supplier does not have substitution rights.

Customer decides what cargo will be transported, and whether, when and to which ports the ship will sail, throughout the five-year period of use, subject to restrictions specified in the contract.

Those restrictions prevent Customer from sailing the ship into waters at a high risk of piracy or carrying hazardous materials as cargo.

Supplier operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship. Customer is prohibited from hiring another operator for the ship of the contract or operating the ship itself during the term of the contract.

The contract contains a lease. Customer has the right to use the ship for five years.

There is an identified asset. The ship is explicitly specified in the contract, and Supplier does not have the right to substitute that specified ship.

Customer has the right to control the use of the ship throughout the five-year period of use because:

(a) Customer has the right to obtain substantially all of the economic benefits from use of the ship over the five-year period of use. Customer has exclusive use of the ship throughout the period of use.

(b) Customer has the right to direct the use of the ship because the conditions in paragraph AG19(a) exist. The contractual restrictions about where the ship can sail and the cargo to be transported by the ship define the scope of Customer's right to use the ship. They are protective rights that protect Supplier's investment in the ship and Supplier's personnel. Within the scope of its right of use, Customer makes the relevant decisions about how and for what purpose the ship is used throughout the five-year period of use because it decides whether, where and when the ship sails, as well as the cargo it will transport. Customer has the right to change these decisions throughout the five-year period of use.

Although the operation and maintenance of the ship are essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the ship is used. Instead, Supplier's decisions are dependent upon Customer's decisions about how and for what purpose the ship is used.

Example 7–Aircraft

Customer enters into a contract with an aircraft owner (Supplier) for the use of an explicitly specified aircraft for a two-year period. The contract details the interior and exterior specifications for the aircraft.

There are contractual and legal restrictions in the contract on where the aircraft can fly. Subject to those restrictions, Customer determines where and when the aircraft will fly, and which passengers and cargo will be transported on the aircraft. Supplier is responsible for operating the aircraft, using its own crew. Customer is prohibited from hiring another operator for the aircraft or operating the aircraft itself during the term of the contract.

Supplier is permitted to substitute the aircraft at any time during the two-year period and must substitute the aircraft if it is not working. Any substitute aircraft must meet the interior and exterior specifications in the contract. There are significant costs involved in outfitting an aircraft in Supplier's fleet to meet Customer's specifications.

The contract contains a lease. Customer has the right to use the aircraft for two years.

There is an identified asset. The aircraft is explicitly specified in the contract and, although Supplier can substitute the aircraft, its substitution right is not substantive because the conditions in paragraph AG9(b) do not exist. Supplier's substitution right is not substantive because of the significant costs involved in outfitting another aircraft to meet the specifications required by the contract such that Supplier is not expected to benefit economically from substituting the aircraft.

Customer has the right to control the use of the aircraft throughout the two-year period of use because:

(a) Customer has the right to obtain substantially all of the economic benefits from use of the aircraft over the two-year period of use. Customer has exclusive use of the aircraft throughout the period of use.

(b) Customer has the right to direct the use of the aircraft because the conditions in paragraph AG19(a) exist. The restrictions on where the aircraft can fly define the scope of Customer's right to use the aircraft. Within the scope of its right of use, Customer makes the relevant decisions about how and for what purpose the aircraft is used throughout the two-year period of use because it decides whether, where and when the aircraft travels as well as the passengers and cargo it will transport. Customer has the right to change these decisions throughout the two-year period of use.

Although the operation of the aircraft is essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the aircraft is used. Consequently, Supplier does not control the use of the aircraft during the period of use and Supplier's decisions do not affect Customer's control of the use of the aircraft.

Example 8–Contract for Shirts

Customer enters into a contract with a manufacturer (Supplier) to purchase a particular type, quality and quantity of shirts for a three-year period. The type, quality and quantity of shirts are specified in the contract.

Supplier has only one factory that can meet the needs of Customer. Supplier is unable to supply the shirts from another factory or source the shirts from a third party supplier. The capacity of the factory exceeds the output for which Customer has contracted (i.e., Customer has not contracted for substantially all of the capacity of the factory).

Supplier makes all decisions about the operations of the factory, including the production level at which to run the factory and which customer contracts to fulfil with the output of the factory that is not used to fulfil Customer's contract.

The contract does not contain a lease.

The factory is an identified asset. The factory is implicitly specified because Supplier can fulfil the contract only through the use of this asset.

Customer does not control the use of the factory because it does not have the right to obtain substantially all of the economic benefits from use of the factory. This is because Supplier could decide to use the factory to fulfil other customer contracts during the period of use.

Customer also does not control the use of the factory because it does not have the right to direct the use of the factory. Customer does not have the right to direct how and for what purpose the factory is used during the three-year period of use. Customer's rights are limited to specifying output from the factory in the contract with Supplier. Customer has the same rights regarding the use of the factory as other customers purchasing shirts from the factory. Supplier has the right to direct the use of the factory because Supplier can decide how and for what purpose the factory is used (i.e., Supplier has the right to decide the production level at which to run the factory and which customer contracts to fulfil with the output produced).

Either the fact that Customer does not have the right to obtain substantially all of the economic benefits from use of the factory, or that Customer does not have the right to direct the use of the factory, would be sufficient in isolation to conclude that Customer does not control the use of the factory.

Example 9–Contract for Energy/Power

Example 9A: a utility company (Customer) enters into a contract with a power company (Supplier) to purchase all of the electricity produced by a new solar farm for 20 years. The solar farm is explicitly specified in the contract and Supplier has no substitution rights. The solar farm is owned by Supplier and the energy cannot be provided to Customer from another asset. Customer designed the solar farm before it was constructed—Customer hired experts in solar energy to assist in determining the location of the farm and the engineering of the equipment to be used. Supplier is responsible for building the solar farm to Customer's specifications, and then operating and maintaining it. There are no decisions to be made about whether, when or how much electricity will be produced because the design of the asset has predetermined those decisions. Supplier will receive tax credits relating to the construction and ownership of the solar farm, while Customer receives renewable energy credits that accrue from use of the solar farm.

The contract contains a lease. Customer has the right to use the solar farm for 20 years.

There is an identified asset because the solar farm is explicitly specified in the contract, and Supplier does not have the right to substitute the specified solar farm.

Customer has the right to control the use of the solar farm throughout the 20-year period of use because:

(a) Customer has the right to obtain substantially all of the economic benefits from use of the solar farm over the 20-year period of use. Customer has exclusive use of the solar farm; it takes all of the electricity produced by the farm over the 20-year period of use as well as the renewable energy credits that are a by-product from use of the solar farm. Although Supplier will receive economic benefits from the solar farm in the form of tax credits, those economic benefits relate to the ownership of the solar farm rather than the use of the solar farm and, thus, are not considered in this assessment.

(b) Customer has the right to direct the use of the solar farm because the conditions in paragraph AG19(b)(ii) exist. Neither Customer, nor Supplier, decides how and for what purpose the solar farm is used during the period of use because those decisions are predetermined by the design of the asset (i.e., the design of the solar farm has, in effect, programmed into the asset any relevant decision-making rights about how and for what purpose the solar farm is used throughout the period of use). Customer does not operate the solar farm; Supplier makes the decisions about the operation of the solar farm. However, Customer's design of the solar farm has given it the right to direct the use of the farm. Because the design of the solar farm has predetermined how and for what purpose the asset will be used throughout the period of use, Customer's control over that design is substantively no different from Customer controlling those decisions.

Example 9B: Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for three years. The power plant is owned and operated by

Supplier. Supplier is unable to provide power to Customer from another plant. The contract sets out the quantity and timing of power that the power plant will produce throughout the period of use, which cannot be changed in the absence of extraordinary circumstances (for example, emergency situations). Supplier operates and maintains the plant on a daily basis in accordance with industry-approved operating practices. Supplier designed the power plant when it was constructed some years before entering into the contract with Customer—Customer had no involvement in that design.

The contract does not contain a lease.

There is an identified asset because the power plant is explicitly specified in the contract, and Supplier does not have the right to substitute the specified plant.

Customer has the right to obtain substantially all of the economic benefits from use of the identified power plant over the three-year period of use. Customer will take all of the power produced by the power plant over the three-year period of use.

However, Customer does not have the right to control the use of the power plant because it does not have the right to direct its use. Customer does not have the right to direct how and for what purpose the plant is used. How and for what purpose the plant is used (i.e., whether, when and how much power the plant will produce) is predetermined in the contract. Customer has no right to change how and for what purpose the plant is used during the period of use. Customer has no other decision-making rights about the use of the power plant during the period of use (for example, it does not operate the power plant) and did not design the plant. Supplier is the only party that can make decisions about the plant during the period of use by making the decisions about how the plant is operated and maintained. Customer has the same rights regarding the use of the plant as if it were one of many customers obtaining power from the plant.

Example 9C: Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for 10 years. The contract states that Customer has rights to all of the power produced by the plant (i.e., Supplier cannot use the plant to fulfil other contracts).

Customer issues instructions to Supplier about the quantity and timing of the delivery of power. If the plant is not producing power for Customer, it does not operate.

Supplier operates and maintains the plant on a daily basis in accordance with industry-approved operating practices.

The contract contains a lease. Customer has the right to use the power plant for 10 years.

There is an identified asset. The power plant is explicitly specified in the contract and Supplier does not have the right to substitute the specified plant.

Customer has the right to control the use of the power plant throughout the 10-year period of use because:

(a) Customer has the right to obtain substantially all of the economic benefits from use of the power plant over the 10-year period of use. Customer has exclusive use of the power plant; it has rights to all of the power produced by the power plant throughout the 10-year period of use.

(b) Customer has the right to direct the use of the power plant because the conditions in paragraph AG19(a) exist. Customer makes the relevant decisions about how and for what purpose the power plant is used because it has the right to determine whether, when and how much power the plant will produce (i.e., the timing and quantity, if any, of power produced) throughout the period of use. Because Supplier is prevented from using the power plant for another purpose, Customer's decision-making about the timing and quantity of power produced, in effect, determines when, and whether, the plant produces output.

Although the operation and maintenance of the power plant are essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the power plant is used. Consequently, Supplier does not control the use of the power plant during the period of use. Instead, Supplier's decisions are dependent upon Customer's decisions about how and for what purpose the power plant is used.

Example 10—Contract for Network Services

Example 10A: Customer enters into a contract with a telecommunications company (Supplier) for network services for two years. The contract requires Supplier to supply network services that meet a specified quality level. In order to provide the services, Supplier installs and configures servers at Customer's premises—Supplier determines the speed and quality of data transportation in the network using the servers. Supplier can reconfigure or replace the servers when needed to continuously provide the quality of network services defined in the contract. Customer does not operate the servers or make any significant decisions about their use.

The contract does not contain a lease. Instead, the contract is a service contract in which Supplier uses the equipment to meet the level of network services determined by Customer.

There is no need to assess whether the servers installed at Customer's premises are identified assets. This assessment would not change the analysis of whether the contract contains a lease because Customer does not have the right to control the use of the servers.

Customer does not control the use of the servers because Customer's only decision-making rights relate to deciding upon the level of network services (the output of the servers) before the period of use—the level of network services cannot be changed during the period of use without modifying the contract. For example, even though Customer produces the data to be transported, that activity does not directly affect the configuration of the network services and, thus, it does not affect how and for what purpose the servers are used.

Supplier is the only party that can make relevant decisions about the use of the servers during the period of use. Supplier has the right to decide how data is transported using the servers, whether to reconfigure the servers and whether to use the servers for another purpose. Accordingly, Supplier controls the use of the servers in providing network services to Customer.

Example 10B: Customer enters into a contract with an information technology company (Supplier) for the use of an identified server for three years. Supplier delivers and installs the server at Customer's premises in accordance with Customer's instructions, and provides repair and maintenance services for the server, as needed, throughout the period of use. Supplier substitutes the server only in the case of malfunction. Customer decides which data to store on the server and how to integrate the server within its operations. Customer can change its decisions in this regard throughout the period of use.

The contract contains a lease. Customer has the right to use the server for three years.

There is an identified asset. The server is explicitly specified in the contract. Supplier can substitute the server only if it is malfunctioning (see paragraph AG13).

Customer has the right to control the use of the server throughout the three-year period of use because:

(a) Customer has the right to obtain substantially all of the economic benefits from use of the server over the three-year period of use. Customer has exclusive use of the server throughout the period of use.

(b) Customer has the right to direct the use of the server (because the conditions in paragraph AG19(a) exist). Customer makes the relevant decisions about how and for what purpose the server is used because it has the right to decide which aspect of its operations the server is used to support and which data it stores on the server. Customer is the only party that can make decisions about the use of the server during the period of use.

Lessee: Leases of Low-Value Assets and Portfolio Application (see paragraphs 64–65, AG1 and AG40–AG45)

IE3. The following example illustrates how a lessee might (a) apply paragraphs AG40–AG45 of [draft] IPSAS [X] (ED 64) to leases of low-value assets; and (b) determine portfolios of leases to which it would apply the requirements in [draft] IPSAS [X] (ED 64).

Example 11— Leases of Low-Value Assets and Portfolio Application

A public sector entity (Lessee) with offices in each province/state of the country has the following leases:

(a) Leases of real estate (both office buildings and warehouses).

(b) Leases of equipment.

(c) Leases of cars, both for sales personnel and senior management and of varying quality, specification and value.

(d) Leases of trucks and vans used for delivery purposes, of varying size and value.

(e) Leases of IT equipment for use by individual employees (such as laptop computers, desktop computers, hand held computer devices, desktop printers and mobile phones).

(f) Leases of servers, including many individual modules that increase the storage capacity of those servers. The modules have been added to the mainframe servers over time as Lessee has needed to increase the storage capacity of the servers.

(g) Leases of office equipment:

(i) Office furniture (such as chairs, desks and office partitions);

(ii) Water dispensers; and

(iii) *High-capacity multifunction photocopier devices.*

Leases of low-value assets

Lessee determines that the following leases qualify as leases of low-value assets on the basis that the underlying assets, when new, are individually of low value:

(a) Leases of IT equipment for use by individual employees; and

(b) Leases of office furniture and water dispensers.

Lessee elects to apply the requirements in paragraph 65 of [draft] IPSAS [X] (ED 64) in accounting for all of those leases.

Although each module within the servers, if considered individually, might be an asset of low value, the leases of modules within the servers do not qualify as leases of low-value assets. This is because each module is highly interrelated with other parts of the servers. Lessee would not lease the modules without also leasing the servers.

Portfolio application

As a result, Lessee applies the recognition and measurement requirements in [draft] IPSAS [X] (ED 64) to its leases of real estate, equipment, cars, trucks and vans, servers and high-capacity multifunction photocopier devices. In doing so, Lessee groups its company cars, trucks and vans into portfolios.

Lessee's cars are leased under a series of master lease agreements. Lessee uses eight different types of car, which vary by price and are assigned to staff on the basis of seniority and territory. Lessee has a master lease agreement for each different type of car. The individual leases within each master lease agreement are all similar (including similar start and end dates), but the terms and conditions generally vary from one master lease agreement to another. Because the individual leases within each master lease agreement are similar to each other, Lessee reasonably expects that applying the requirements of [draft] IPSAS [X] (ED 64) to each master lease agreement would not result in a materially different effect than applying the requirements of [draft] IPSAS [X] (ED 64) to each individual lease within the master lease agreement. Consequently, Lessee concludes that it can apply the requirements of [draft] IPSAS [X] (ED 64) to each master lease agreement as a portfolio. In addition, Lessee concludes that two of the eight master lease agreements are similar and cover substantially similar types of cars in similar territories. Lessee reasonably expects that the effect of applying [draft] IPSAS [X] (ED 64) to the combined portfolio of leases within the two master lease agreements would not differ materially from applying [draft] IPSAS [X] (ED 64) to each lease within that combined portfolio. Lessee, therefore, concludes that it can further combine those two master lease agreements into a single lease portfolio.

Lessee's trucks and vans are leased under individual lease agreements. There are 6,500 leases in total. All of the truck leases have similar terms, as do all of the van leases. The truck leases are generally for four years and involve similar models of truck. The van leases are generally for five years and involve similar models of van. Lessee reasonably expects that applying the requirements of [draft] IPSAS [X] (ED 64) to portfolios of truck leases and van leases, grouped by type of underlying asset, territory and the quarter of the year within which the lease was entered into, would not result in a materially different effect from applying those requirements to each individual truck or van lease. Consequently, Lessee applies the requirements of [draft] IPSAS [X] (ED 64) to different portfolios of truck and van leases, rather than to 6,500 individual leases.

Allocating Consideration to Components of a Contract (see paragraphs 9–14 and AG27–AG28)

IE4. The following example illustrates the allocation of consideration in a contract to lease and non-lease components by a lessee.

Example 12–Lessee Allocation of Consideration to Lease and Non-Lease Components of a Contract

Lessor leases a server, a desktop computer and a computed tomography machine to Lessee to be used in Lessee's hospital operations for four years. Lessor also agrees to maintain each item of *equipment throughout the lease term. The total consideration in the contract is CU600,000*[(a)]*, payable in annual instalments of CU150,000, and a variable amount that depends on the hours of work performed in maintaining the computed tomography machine. The variable payment is capped at 2 per cent of the replacement cost of the computed tomography machine. The consideration includes the cost of maintenance services for each item of equipment.*

Lessee accounts for the non-lease components (maintenance services) separately from each lease of equipment applying paragraph 9 of [draft] IPSAS [X] (ED 64). Lessee does not elect the practical expedient in paragraph 13 of [draft] IPSAS [X] (ED 64). Lessee considers the requirements in paragraph AG27 of [draft] IPSAS [X] (ED 64) and concludes that the lease of the server, the lease of the desktop computer and the lease of the computed tomography machine are each separate lease components. This is because:

(a) Lessee can benefit from use of each of the three items of equipment on its own or together with other readily available resources (for example, Lessee could readily lease or purchase an alternative desktop computer or computed tomography machine to use in its operations); and

(b) Although Lessee is leasing all three items of equipment for one purpose (i.e., to engage in hospital operations), the machines are neither highly dependent on, nor highly interrelated with, each other. Lessee's ability to derive benefit from the lease of each item of equipment is not significantly affected by its decision to lease, or not lease, the other equipment from Lessor.

Consequently, Lessee concludes that there are three lease components and three non-lease components (maintenance services) in the contract. Lessee applies the guidance in paragraphs 11–12 of [draft] IPSAS [X] (ED 64) to allocate the consideration in the contract to the three lease components and the non-lease components.

Several suppliers provide maintenance services for a similar server and a similar desktop computer. Accordingly, there are observable standalone prices for the maintenance services for those two items of leased equipment. Lessee is able to establish observable stand-alone prices for the maintenance of the server and the desktop computer of CU32,000 and CU16,000, respectively, assuming similar payment terms to those in the contract with Lessor. The computed tomography machine is highly specialized and, accordingly, other suppliers do not lease or provide maintenance services for similar computed tomography machine. Nonetheless, Lessor provides four-year maintenance service contracts to customers that purchase similar computed tomography machines from Lessor. The observable consideration for those four-year maintenance service contracts is a fixed amount of CU56,000, payable over four years, and a variable amount that depends on the hours of work performed in maintaining the long-reach computed tomography machine. That variable payment is capped at 2 per cent of the replacement cost of the computed tomography machine. Consequently, Lessee estimates the stand-alone price of the maintenance services for the computed tomography machine to be CU56,000 plus any variable amounts. Lessee is able to establish observable stand-alone prices for the leases of the server, the desktop computer and the computed tomography machine of CU170,000, CU102,000 and CU224,000, respectively.

Lessee allocates the fixed consideration in the contract (CU600,000) to the lease and non-lease components as follows:

CU	Server	Desktop computer	Computed tomography machine	Total
Lease	170.000	102.000	224.000	**496.000**
Non-lease				**104.000**
Total fixed consideration				**600.000**

Lessee allocates all of the variable consideration to the maintenance of the computed tomography machine, and, thus, to the non-lease components of the contract. Lessee then accounts for each lease component applying the guidance in [draft] IPSAS [X] (ED 64), treating the allocated consideration as the lease payments for each lease component.

(a) In these Illustrative Examples, currency amounts are denominated in 'currency units' (CU).

Lessee Measurement (see paragraphs 68–92 and AG29–AG36)

IE5. The following example illustrates how a lessee measures right-of-use assets and lease liabilities. It also illustrates how a lessee accounts for a change in the lease term.

Example 13–Measurement by a Lessee and Accounting for a Change in the Lease Term

Part 1—Initial measurement of the right-of-use asset and the lease liability

Lessee enters into a 10-year lease of a floor of a building, with an option to extend for five years. Lease payments are CU50,000 per year during the initial term and CU55,000 per year during the optional period, all payable at the beginning of each year. To obtain the lease, Lessee incurs initial direct costs of CU20,000, of which CU15,000 relates to a payment to a former tenant occupying that floor of the building and CU5,000 relates to a commission paid to the real estate agent that arranged the lease. As an incentive to Lessee for entering into the lease, Lessor agrees to reimburse to Lessee the real estate commission of CU5,000 and Lessee's leasehold improvements of CU7,000.

At the commencement date, Lessee concludes that it is not reasonably certain to exercise the option to extend the lease and, therefore, determines that the lease term is 10 years.

The interest rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a 10-year term, and with similar collateral.

At the commencement date, Lessee makes the lease payment for the first year, incurs initial direct costs, receives lease incentives from Lessor and measures the lease liability at the present value of the remaining nine payments of CU50,000, discounted at the interest rate of 5 per cent per annum, which is CU355,391.

Lessee initially recognizes assets and liabilities in relation to the lease as follows.

Right-of-use asset	CU405,391	
Lease liability		CU355,391
Cash (lease payment for the first year)		CU50,000
Right-of-use asset	CU20,000	

Cash (initial direct costs)		CU20,000
Cash (lease incentive)	CU5,000	
Right-of-use asset		CU5,000

Lessee accounts for the reimbursement of leasehold improvements from Lessor applying other relevant Standards and not as a lease incentive applying [draft] IPSAS [X] (ED 64). This is because costs incurred on leasehold improvements by Lessee are not included within the cost of the right-of-use asset.

Part 2—Subsequent measurement and accounting for a change in the lease term

In the sixth year of the lease, Lessee acquires Entity A. Entity A has been leasing a floor in another building. The lease entered into by Entity A contains a termination option that is exercisable by Entity A. Following the acquisition of Entity A, Lessee needs two floors in a building suitable for the increased workforce. To minimize costs, Lessee (a) enters into a separate eight-year lease of another floor in the building leased that will be available for use at the end of Year 7 and (b) terminates early the lease entered into by Entity A with effect from the beginning of Year 8.

Moving Entity A's staff to the same building occupied by Lessee creates an economic incentive for Lessee to extend its original lease at the end of the non-cancellable period of 10 years. The acquisition of Entity A and the relocation of Entity A's staff is a significant event that is within the control of Lessee and affects whether Lessee is reasonably certain to exercise the extension option not previously included in its determination of the lease term. This is because the original floor has greater utility (and thus provides greater benefits) to Lessee than alternative assets that could be leased for a similar amount to the lease payments for the optional period—Lessee would incur additional costs if it were to lease a similar floor in a different building because the workforce would be located in different buildings. Consequently, at the end of Year 6, Lessee concludes that it is now reasonably certain to exercise the option to extend its original lease as a result of its acquisition and planned relocation of Entity A.

Lessee's incremental borrowing rate at the end of Year 6 is 6 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a nine-year term, and with similar collateral. Lessee expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, depreciates the right-of-use asset on a straight-line basis.

The right-of-use asset and the lease liability from Year 1 to Year 6 are as follows.

	Lease liability				**Right-of-use asset**		
Year	**Beginning balance CU**	**Lease payment CU**	**5% interest expense CU**	**Ending balance CU**	**Beginning balance CU**	**Depreciation charge CU**	**Ending balance CU**
1	**355,391**	-	17,770	**373,161**	**420,391**	(42,039)	**378,352**
2	**373,161**	(50,000)	16,158	**339,319**	**378,352**	(42,039)	**336,313**
3	**339,319**	(50,000)	14,466	**303,785**	**336,313**	(42,039)	**294,274**
4	**303,785**	(50,000)	12,689	**266,474**	**294,274**	(42,039)	**252,235**
5	**266,474**	(50,000)	10,823	**227,297**	**252,235**	(42,039)	**210,196**

6	**227,297**	(50,000)	8,865	**186,162**	**210,196**	(42,039)	**168,157**

At the end of the sixth year, before accounting for the change in the lease term, the lease liability is CU186,162 (the present value of four remaining payments of CU50,000, discounted at the original interest rate of 5 per cent per annum). Interest expense of CU8,865 is recognized in Year 6. Lessee's right-of-use asset is CU168,157.

Lessee remeasures the lease liability at the present value of four payments of CU50,000 followed by five payments of CU55,000, all discounted at the revised discount rate of 6 per cent per annum, which is CU378,174. Lessee increases the lease liability by CU192,012, which represents the difference between the remeasured liability of CU378,174 and its previous carrying amount of CU186,162. The corresponding adjustment is made to the right-of-use asset to reflect the cost of the additional right of use, recognized as follows.

Right-of-use asset	CU192,012	
Lease liability		CU192,012

Following the remeasurement, the carrying amount of Lessee's right-of-use asset is CU360,169 (i.e., CU168,157 + CU192,012). From the beginning of Year 7 Lessee calculates the interest expense on the lease liability at the revised discount rate of 6 per cent per annum.

The right-of-use asset and the lease liability from Year 7 to Year 15 are as follows.

	Lease liability				**Right-of-use asset**		
Year	**Beginning balance CU**	**Lease payment CU**	**6% interest expense CU**	**Ending balance CU**	**Beginning balance CU**	**Depreciation charge CU**	**Ending balance CU**
7	**378,174**	(50,000)	19,690	**347,864**	**360,169**	(40,019)	**320,150**
8	**347,864**	(50,000)	17,872	**315,736**	**320,150**	(40,019)	**280,131**
9	**315,736**	(50,000)	15,944	**281,680**	**280,131**	(40,019)	**240,112**
10	**281,680**	(50,000)	13,901	**245,581**	**240,112**	(40,019)	**200,093**
11	**245,581**	(55,000)	11,435	**202,016**	**200,093**	(40,019)	**160,074**
12	**202,016**	(55,000)	8,821	**155,837**	**160,074**	(40,019)	**120,055**
13	**155,837**	(55,000)	6,050	**106,887**	**120,055**	(40,019)	**80,036**
14	**106,887**	(55,000)	3,113	**55,000**	**80,036**	(40,018)	**40,018**
15	**55,000**	(55,000)	-	**-**	**40,018**	(40,018)	**-**

Variable Lease Payments (see paragraphs 76, 90, 93(b) and 94)

IE6. The following example illustrates how a lessee accounts for variable lease payments that depend on an index and variable lease payments not included in the measurement of the lease liability.

Example 14–Variable Lease Payments Dependent on an Index and Variable Lease Payments Linked to Sales

Example 14A—Lessee enters into a 10-year lease of property with annual lease payments of CU50,000, payable at the beginning of each year. The contract specifies that lease payments will increase every two years on the basis of the increase in the Consumer Price Index for the preceding 24 months. The Consumer Price Index at the commencement date is 125. This example ignores any initial direct costs. The rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a 10-year term, and with similar collateral.

At the commencement date, Lessee makes the lease payment for the first year and measures the lease liability at the present value of the remaining nine payments of CU50,000, discounted at the interest rate of 5 per cent per annum, which is CU355,391.

Lessee initially recognizes assets and liabilities in relation to the lease as follows.

Right-of-use asset	CU405,391	
Lease liability		CU355,391
Cash (lease payment for the first year)		CU50,000

Lessee expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, depreciates the right-of-use asset on a straight-line basis.

During the first two years of the lease, Lessee recognizes in aggregate the following related to the lease.

Interest expense	CU33,928	
Lease liability		CU33,928
Depreciation charge	CU81,078 (CU405,391 ÷ 10 × 2 years)	
Right-of-use asset		CU81,078

At the beginning of the second year, Lessee makes the lease payment for the second year and recognizes the following.

Lease liability	CU50,000	
Cash		CU50,000

At the beginning of the third year, before accounting for the change in future lease payments resulting from a change in the Consumer Price Index and making the lease payment for the third year, the lease liability is CU339,319 (the present value of eight payments of CU50,000 discounted at the interest rate of 5 per cent per annum = CU355,391 + CU33,928 – CU50,000).

At the beginning of the third year of the lease the Consumer Price Index is 135.

The payment for the third year, adjusted for the Consumer Price Index, is CU54,000 (CU50,000 × 135 ÷ 125). Because there is a change in the future lease payments resulting from a change in the Consumer Price Index used to determine those payments, Lessee remeasures the lease liability to reflect those revised lease payments, i.e. the lease liability now reflects eight annual lease payments of CU54,000.

At the beginning of the third year, Lessee remeasures the lease liability at the present value of eight payments of CU54,000 discounted at an unchanged discount rate of 5 per cent per annum, which is CU366,464. Lessee increases the lease liability by CU27,145, which represents the difference between the remeasured liability of CU366,464 and its previous carrying amount of CU339,319. The corresponding adjustment is made to the right-of-use asset, recognized as follows.

Right-of-use asset	CU27,145	
Lease liability		CU27,145

At the beginning of the third year, Lessee makes the lease payment for the third year and recognizes the following.

Lease liability	CU54,000	
Cash		CU54,000

Example 14B—Assume the same facts as Example 14A except that Lessee is also required to make variable lease payments for each year of the lease, which are determined as 1 per cent of Lessee's sales generated from the leased property.

At the commencement date, Lessee measures the right-of-use asset and the lease liability recognized at the same amounts as in Example 14A. This is because the additional variable lease payments are linked to future sales and, thus, do not meet the definition of lease payments. Consequently, those payments are not included in the measurement of the asset and liability.

Right-of-use asset	CU405,391	
Lease liability		CU355,391
Cash (lease payment for the first year)		CU50,000

Lessee prepares financial statements on an annual basis. During the first year of the lease, Lessee generates sales of CU800,000 from the leased property.

Lessee incurs an additional expense related to the lease of CU8,000 (CU800,000 × 1 per cent), which Lessee recognizes in profit or loss in the first year of the lease.

Lease Modifications (see paragraphs 95–97)

IE7. Examples 15–19 illustrate the requirements of [draft] IPSAS [X] (ED 64) regarding lease modifications for a lessee.

Example 15—Modification that is a Separate Lease

Lessee enters into a 10-year lease for 2,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to include an additional 3,000 square metres of office space in the same building. The additional space is made available for use by Lessee at the end of the second quarter of Year 6. The increase in total consideration for the lease is commensurate with the current market rate for the new 3,000 square metres of office space, adjusted for the discount that Lessee receives reflecting that Lessor does not incur costs that it would otherwise have incurred if leasing the same space to a new tenant (for example, marketing costs).

Lessee accounts for the modification as a separate lease, separate from the original 10-year lease. This is because the modification grants Lessee an additional right to use an underlying asset, and the increase in consideration for the lease is commensurate with the stand-alone price of the additional right-of-use adjusted to reflect the circumstances of the contract. In this example, the additional underlying asset is the new 3,000 square metres of office space. Accordingly, at the commencement date of the new lease (at the end of the second quarter of Year 6), Lessee recognises a right-of-use asset and a lease liability relating to the lease of the additional 3,000 square metres of office space. Lessee does not make any adjustments to the accounting for the original lease of 2,000 square metres of office space as a result of this modification.

Example 16—Modification that Increases the Scope of the Lease by Extending the Contractual Lease Term

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are CU100,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 7, Lessee and Lessor agree to amend the original lease by extending the contractual lease term by four years. The annual lease payments are unchanged (i.e., CU100,000 payable at the end of each year from Year 7 to Year 14). Lessee's incremental borrowing rate at the beginning of Year 7 is 7 per cent per annum.

At the effective date of the modification (at the beginning of Year 7), Lessee remeasures the lease liability based on: (a) an eight-year remaining lease term, (b) annual payments of CU100,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. The modified lease liability equals CU597,130. The lease liability immediately before the modification (including the recognition of the interest expense until the end of Year 6) is CU346,511. Lessee recognizes the difference between the carrying amount of the modified lease liability and the carrying amount of the lease liability immediately before the modification (CU250,619) as an adjustment to the right-of-use asset.

Example 17—Modification that Decreases the Scope of the Lease

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are CU50,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to reduce the space to only 2,500 square metres of the original space starting from the end of the first quarter of Year 6. The annual fixed lease payments (from Year 6 to Year 10) are CU30,000. Lessee's incremental borrowing rate at the beginning of Year 6 is 5 per cent per annum.

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on: (a) a five-year remaining lease term, (b) annual payments of CU30,000 and (c) Lessee's incremental borrowing rate of 5 per cent per annum. This equals CU129,884.

Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset on the basis of the remaining right-of-use asset (i.e., 2,500 square metres corresponding to 50 per cent of the original right-of-use asset).

50 per cent of the pre-modification right-of-use asset (CU184,002) is CU92,001. Fifty per cent of the pre-modification lease liability (CU210,618) is CU105,309. Consequently, Lessee reduces the carrying amount of the right-of-use asset by CU92,001 and the carrying amount of the lease liability by CU105,309. Lessee recognizes the difference between the decrease in the lease liability and the decrease in the right-of-use asset (CU105,309 – CU92,001 = CU13,308) as a gain in surplus or deficit at the effective date of the modification (at the beginning of Year 6).

Lessee recognizes the difference between the remaining lease liability of CU105,309 and the modified lease liability of CU129,884 (which equals CU24,575) as an adjustment to the right-of-use asset reflecting the change in the consideration paid for the lease and the revised discount rate.

Example 18—Modification that Both Increases and Decreases the Scope of the Lease

Lessee enters into a 10-year lease for 2,000 square metres of office space. The annual lease payments are CU100,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to (a) include an additional 1,500 square metres of space in the same building starting from the beginning of Year 6 and (b) reduce the lease term from 10 years to eight years. The annual fixed payment for the 3,500 square metres is CU150,000 payable at the end of each year (from Year 6 to Year 8). Lessee's incremental borrowing rate at the beginning of Year 6 is 7 per cent per annum.

The consideration for the increase in scope of 1,500 square metres of space is not commensurate with the stand-alone price for that increase adjusted to reflect the circumstances of the contract. Consequently, Lessee does not account for the increase in scope that adds the right to use an additional 1,500 square metres of space as a separate lease.

The pre-modification right-of-use asset and the pre-modification lease liability in relation to the lease are as follows.

	Lease liability				**Right-of-use asset**		
	Beginning balance	**6% interest expense**	**Lease payment**	**Ending balance**	**Beginning balance**	**Depreciation charge**	**Ending balance**
Year	**CU**	**CU**	**CU**	**CU**	**CU**	**CU**	**CU**
1	**736,009**	44,160	(100,000)	**680,169**	**736,009**	(73,601)	**662,408**
2	**680,169**	40,810	(100,000)	**620,979**	**662,408**	(73,601)	**588,807**
3	**620,979**	37,259	(100,000)	**558,238**	**588,807**	(73,601)	**515,206**
4	**558,238**	33,494	(100,000)	**491,732**	**515,206**	(73,601)	**441,605**
5	**491,732**	29,504	(100,000)	**421,236**	**441,605**	(73,601)	**368,004**
6	**421,236**				**368,004**		

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability on the basis of: (a) a three-year remaining lease term, (b) annual payments of CU150,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. The modified liability equals CU393,647, of which (a) CU131,216 relates to the increase of CU50,000 in the annual lease payments from Year 6 to Year 8 and (b) CU262,431 relates to the remaining three annual lease payments of CU100,000 from Year 6 to Year 8.

<u>Decrease in the lease term</u>

At the effective date of the modification (at the beginning of Year 6), the pre-modification right-of-use asset is CU368,004. Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset based on the remaining right-of-use asset for the original 2,000 square metres of office space (i.e., a remaining three-year lease term rather than the original five-year lease term). The remaining right-of-use asset for the original 2,000 square metres of office space is CU220,802 (i.e., CU368,004 ÷ 5 × 3 years).

At the effective date of the modification (at the beginning of Year 6), the pre-modification lease liability is CU421,236. The remaining lease liability for the original 2,000 square metres of office space is CU267,301 (i.e., present value of three annual lease payments of CU100,000, discounted at the original discount rate of 6 per cent per annum).

Consequently, Lessee reduces the carrying amount of the right-of-use asset by CU147,202 (CU368,004 – CU220,802), and the carrying amount of the lease liability by CU153,935 (CU421,236 – CU267,301). Lessee recognizes the difference between the decrease in the lease liability and the decrease in the right-of-use asset (CU153,935 – CU147,202 = CU6,733) as a gain in surplus or deficit at the effective date of the modification (at the beginning of Year 6).

Lease liability	CU153,935	
Right-of-use asset		CU147,202
Gain		CU6,733

At the effective date of the modification (at the beginning of Year 6), Lessee recognises the effect of the remeasurement of the remaining lease liability reflecting the revised discount rate of 7 per cent per annum, which is CU4,870 (CU267,301 – CU262,431), as an adjustment to the right-of-use asset.

Lease liability	CU4,870	
Right-of-use asset		CU4,870

Increase in the leased space

At the commencement date of the lease for the additional 1,500 square metres of space (at the beginning of Year 6), Lessee recognizes the increase in the lease liability related to the increase in scope of CU131,216 (i.e., present value of three annual lease payments of CU50,000, discounted at the revised interest rate of 7 per cent per annum) as an adjustment to the right-of-use asset.

Right-of-use asset	CU131,216	
Lease liability		CU131,216

The modified right-of-use asset and the modified lease liability in relation to the modified lease are as follows.

	Lease liability				**Right-of-use asset**		
	Beginning balance	**7% interest expense**	**Lease payment**	**Ending balance**	**Beginning balance**	**Depreciation charge**	**Ending balance**
Year	**CU**	**CU**	**CU**	**CU**	**CU**	**CU**	**CU**
6	**393,647**	27,556	(150,000)	**271,203**	**347,148**	(115,716)	**231,432**
7	**271,203**	18,984	(150,000)	**140,187**	**231,432**	(115,716)	**115,716**
8	**140,187**	9,813	(150,000)	**-**	**115,716**	(115,716)	**-**

Example 19—Modification that is a Change in Consideration Only

Lessee enters into a 10-year lease for 5,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to reduce the lease payments from CU100,000 per year to CU95,000 per year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. Lessee's incremental borrowing rate at the beginning of Year 6 is 7 per cent per annum. The annual lease payments are payable at the end of each year.

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on: (a) a five-year remaining lease term, (b) annual payments of CU95,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. Lessee recognises the difference between the carrying amount of the modified liability (CU389,519) and the lease liability immediately before the modification (CU421,236) of CU31,717 as an adjustment to the right-of-use asset.

Subleases (see paragraph AG56–AG57)

IE8. Example 20 illustrate the application of the requirements in [draft] IPSAS [X] (ED 64) for an intermediate lessor that enters into a head lease and a sublease of the same underlying asset.

Example 20—Sublease

Head lease—An intermediate lessor enters into a five-year lease for 5,000 square metres of office space (the head lease) with Entity A (the head lessor).

Sublease—At commencement of the head lease, the intermediate lessor subleases the 5,000 square metres of office space for two years to a sublessee.

When the intermediate lessor enters into the sublease, the intermediate lessor retains the lease liability and the right-of-use asset relating to the head lease in its statement of financial position.

At the commencement date of the sublease, the intermediate lessor:

(a) Recognizes a lease receivable; and

(b) Recognizes a liability (unearned revenue);

During the term of the sublease, the intermediate lessor:

(a) Recognizes a depreciation charge for the right-of-use asset and interest on the lease liability; and

(b) Recognizes lease revenue (from the unwinding of the liability (unearned revenue)) and interest revenue from the sublease.

Lessee: Note Disclosure (see paragraphs 110 and AG52–AG53)

IE9. Example 21 illustrates how a lessee with different types of lease portfolios might comply with the disclosure requirements described in paragraphs 110 and AG52 of [draft] IPSAS [X] (ED 64) about variable lease payments. This example shows only current period information. IPSAS 1, *Presentation of Financial Statements* requires an entity to present comparative information.

Example 21—*Variable Payment Terms*

Lessee with a high volume of leases with some consistent payment terms

Example 21A: City XYZ (Lessee) operates four retail stores selling touristic merchandise about the city—A, B, C and D. Lessee has a high volume of property leases. Lessee's group policy is to negotiate variable payment terms for newly established stores. Lessee concludes that information about variable lease payments is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that information about the proportion of total lease payments that arise from variable payments, and the sensitivity of those variable lease payments to changes in sales, is the information that is relevant to users of its financial statements. This information is similar to that reported to Lessee's senior management about variable lease payments.

Some of the property leases within the city contain variable payment terms that are linked to sales generated from the store. Variable payment terms are used, when possible, in newly established stores in order to link rental payments to store cash flows and minimize fixed costs. Fixed and variable rental payments by store for the period ended 31 December 20X0 are summarized below.

	Stores	**Fixed payments**	**Variable payments**	**Total payments**	**Estimated annual impact on total store rent of a 1% increase in sales**
	No.	**CU**	**CU**	**CU**	**%**
Store A	4,522	3,854	120	3,974	0.03%
Store B	965	865	105	970	0.11%
Store C	124	26	163	189	0.86%
Store D	652	152	444	596	0.74%
	6,263	**4,897**	**832**	**5,729**	**0.15%**

Refer to the management commentary for store information presented on a like-for-like basis and to Note X for segmental information applying IPSAS 18, *Segment Reporting* relating to Stores A–D.

Example 21B: City XYZ (Lessee) has a high volume of property leases of retail stores selling touristic merchandise about the city. Many of these leases contain variable payment terms linked to sales from the store. Lessee's group policy sets out the circumstances in which variable payment terms are used and all lease negotiations must be approved centrally. Lease payments are monitored centrally. Lessee concludes that information about variable lease payments is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that information about the different types of contractual terms it uses with respect to variable lease payments, the effect of those terms on its financial performance and the sensitivity of variable lease payments to changes in sales is the information that is relevant to users of its financial statements. This is similar to the information that is reported to Lessee's senior management about variable lease payments.

Many of the property leases within the city contain variable payment terms that are linked to the volume of sales made from leased stores. These terms are used, when possible, in order to match lease payments with stores generating higher cash flows. For individual stores, up to 100 per cent of lease payments are on the basis of variable payment terms and there is a wide range of sales percentages applied. In some cases, variable payment terms also contain minimum annual payments and caps.

Lease payments and terms for the period ended 31 December 20X0 are summarized below.

	Stores	**Fixed payments**	**Variable payments**	**Total payments**
	No.	**CU**	**CU**	**CU**
Fixed rent only	1,490	1,153	-	1,153
Variable rent with no minimum	986	-	562	562
Variable rent with minimum	3,089	1,091	1,435	2,526
	5,565	**2,244**	**1,997**	**4,241**

A 1 per cent increase in sales across all stores in the city would be expected to increase total lease payments by approximately 0.6–0.7 per cent. A 5 per cent increase in sales across all stores in the city would be expected to increase total lease payments by approximately 2.6–2.8 per cent.

Lessee with a high volume of leases with a wide range of different payment terms

Example 21C: City XYZ (Lessee) has a high volume of property leases of retail stores selling touristic merchandise about the city. These leases contain a wide range of different variable payment terms. Lease terms are negotiated and monitored by local management. Lessee concludes that information about variable lease payments is relevant to users of its financial statements and is not available elsewhere in its financial statements. Lessee concludes that information about how its property lease portfolio is managed is the information that is relevant to users of its financial statements. Lessee also concludes that information about the expected level of variable lease payments in the coming year (similar to that reported internally to senior management) is also relevant to users of its financial statements.

Many of the property leases within the city contain variable payment terms. Local management is responsible for store margins. Accordingly, lease terms are negotiated by local management and contain a wide range of payment terms. Variable payment terms are used for a variety of reasons, including minimizing the fixed cost base for newly established stores or for reasons of margin control and operational flexibility. Variable lease payment terms vary widely across the group:

(a) The majority of variable payment terms are based on a range of percentages of store sales;

(b) Lease payments based on variable terms range from 0–20 per cent of total lease payments on an individual property; and

(c) Some variable payment terms include minimum or cap clauses.

The overall financial effect of using variable payment terms is that higher rental costs are incurred by stores with higher sales. This facilitates the management of margins across the city stores.

Variable rent expenses are expected to continue to represent a similar proportion of store sales in future years.

IE10. Example 22 illustrates how a lessee with different types of lease portfolios might comply with the disclosure requirements described in paragraphs 110 and AG53 of [draft] IPSAS [X] (ED 64) about extension options and termination options. This example shows only current period information. IPSAS 1 requires an entity to present comparative information.

Example 22—Extension Options and Termination Options

Lessee with a high volume of leases, that have a wide range of different terms and conditions, which are not managed centrally

Example 22A: Lessee has a high volume of equipment leases with a wide range of different terms and conditions. Lease terms are negotiated and monitored by local management. Lessee concludes that information about how it manages the use of termination and extension options is the information that is relevant to users of its financial statements and is not available elsewhere in its financial statements. Lessee also concludes that information about (a) the financial effect of reassessing options and (b) the proportion of its short-term lease portfolio resulting from leases with annual break clauses is also relevant to users of its financial statements.

Extension and termination options are included in a number of equipment leases across the economic entity. Local teams are responsible for managing their leases and, accordingly, lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. Extension and termination options are included, when possible, to provide local management with greater flexibility to align its need for access to equipment with the fulfilment of customer contracts. The individual terms and conditions used vary across the economic entity.

The majority of extension and termination options held are exercisable only by Lessee and not by the respective lessors. In cases in which Lessee is not reasonably certain to use an optional extended lease term, payments associated with the optional period are not included within lease liabilities.

During 20X0, the financial effect of revising lease terms to reflect the effect of exercising extension and termination options was an increase in recognized lease liabilities of CU489.

In addition, Lessee has a number of lease arrangements containing annual break clauses at no penalty. These leases are classified as short-term leases and are not included within lease liabilities. The short-term lease expense of CU30 recognized during 20X0 included CU27 relating to leases with an annual break clause.

Lessee with a high volume of leases with some consistent terms and options

Example 22B: City XYZ (Lessee) has a high volume of property leases containing penalty-free termination options that are exercisable at the option of Lessee. Lessee's policy is to have termination options in leases of more than five years, whenever possible. Lessee has a central property team that negotiates leases. Lessee concludes that information about termination options is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that information about (a) the potential exposure to future lease payments that are not included in the measurement of lease liabilities and (b) the proportion of termination options that have been exercised historically is the information that is relevant to users of its financial statements. Lessee also notes that presenting this information on *the basis of the same operation for which segment information is disclosed applying IPSAS 18 is relevant to users of its financial statements. This is similar to the information that is reported to Lessee's senior management about termination options.*

Many of the property leases across the city contain termination options. These options are used to limit the period to which the city is committed to individual lease contracts and to maximize operational flexibility in terms of opening and closing individual offices. For most leases of offices, recognized lease liabilities do not include potential future rental payments after the exercise date of termination options because Lessee is not reasonably certain to extend the lease beyond that date. This is the case for most leases for which a longer lease period can be enforced only by Lessee and not by the landlord, and for which there is no penalty associated with the option.

Potential future rental payments relating to periods following the exercise date of termination options are summarized below.

Segment	**Lease liabilities recognised (discounted)**	**Potential future lease payments not included in lease liabilities (undiscounted)**		
		Payable during 20X1–20X5	**Payable during 20X6–20Y0**	**Total**
	CU	**CU**	**CU**	**CU**
Operation A	569	71	94	165
Operation B	2,455	968	594	1,562
Operation C	269	99	55	154
Operation D	1,002	230	180	410
Operation E	914	181	321	502
	5,209	**1,549**	**1,244**	**2,793**

The table below summarizes the rate of exercise of termination options during 20X0.

Segment	**Termination option exercisable during 20X0**	**Termination option not exercised**	**Termination option exercised**
	No. of leases	**No. of leases**	**No. of leases**
Operation A	33	30	3
Operation B	86	69	17
Operation C	19	18	1
Operation D	30	5	25
Operation E	66	40	26
	234	**162**	**72**

Example 22C: Lessee has a high volume of large equipment leases containing extension options that are exercisable by Lessee during the lease. Lessee's policy is to use extension options to align, when possible, committed lease terms for large equipment with the initial contractual term of associated customer contracts, whilst retaining flexibility to manage its large equipment and *reallocate assets across contracts. Lessee concludes that information about extension options is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that (a) information about the potential exposure to future lease payments that are not included in the measurement of lease liabilities and (b) information about the historical rate of exercise of extension options is the information that is relevant to users of its financial statements. This is similar to the information that is reported to Lessee's senior management about extension options.*

Many of the large equipment leases across the economic entity contain extension options. These terms are used to maximize operational flexibility in terms of managing contracts. These terms are not reflected in measuring lease liabilities in many cases because the options are not reasonably certain to be exercised. This is generally the case when the underlying large equipment has not been allocated for use on a particular customer contract after the exercise date of an extension option. The table below summarizes potential future rental payments relating to periods following the exercise dates of extension options.

Segment	Lease liabilities recognised (discounted)	Potential future lease payments not included in lease liabilities (discounted)	Historical rate of exercise of extension options
	CU	CU	%
Operation A	569	799	52%
Operation B	2,455	269	69%
Operation C	269	99	75%
Operation D	1,002	111	41%
Operation E	914	312	76%
	5,209	**1,590**	**67%**

Concessionary Leases (see paragraphs 15, 22, 29, 32, 35, 40, 62, 71–74, 78, 88, 92, and AG58–AG61)

IE11. Examples 23–24 illustrate the application of the requirements in [draft] IPSAS [X] (ED 64) for concessionary leases for lessors and lessees.

Example 23–Concessionary Lease (Lessor)–Subsidy Results from 30% Lower Contract Lease Payments than Market Value of Lease Payments.

A municipality (Lessor) enters into a lease with a public sector not-for profit organization (Lessee) to use a building over a period of 5 years with the condition to use it for providing medical services to the population in general. The annual market lease payment is CU5,312,420 with a market interest rate at 5% and the lessee pays only 70% of the annual market lease payment.

- *The agreement stipulates that the lease should be paid over the 5 year period as follows*:

  Year 1: CU3,718,694

  Year 2: CU3,718,694

  Year 3: CU3,718,694

Year 4: CU3,718,694

Year 5: CU3,718,694

- *The lease includes conditions. To the extent the conditions are not met, the lease is cancelled and the right to use the underlying asset returns to the lessor. The conditions are met on a straight-line basis.*
- *Depreciation of the underlying asset is not considered in the example because it is within the scope of other IPSASs.*

Analysis

As it is a concessionary lease, the fair value of the liability (unearned revenue) is assessed independently from the fair value of the contractual lease payments. The value of the liability (unearned revenue) is not given. However, the fair value of the liability (unearned revenue) can be assessed by discounting the annual market lease payments using a market interest rate at 5%. The liability (unearned revenue) represents the total economic value created by the lease contract and is divided in two components:

(a) An exchange component—Representing the portion of the economic value created by the lease contract to be received by the lessor as future cash inflows (CU16.100.000–see Table 1 below); and

(b) A non-exchange component—Representing the portion of the economic value created by the lease contract that the lessor transferred to the lessee as a subsidy in kind, recognized separately as an expense, and for which there is a performance obligation by the lessor (CU6.900.000–see Table 1 below). (Note: An entity would consider whether the substance of the CU6,900,000 is a contribution from owners or expense; assume for purposes of this example that the CU6,900,000 is expense).

The non-exchange component of CU6,900,000 and the lease payments are accounted for in accordance with this [draft] Standard.

The journal entries to account for the concessionary lease are as follows:

1.	On initial recognition, the entity recognizes the following:			
Dr		Lease receivable	16,100,000	
Dr		Expense	6,900,000	
	Cr	Liability (unearned revenue)		23,000,000
2.	Year 1: The entity recognizes the following:			
Dr		Lease receivable	805,000	
	Cr	Interest revenue (refer to Table 2 below)		805,000
Recognition of interest using the effective interest method (CU16,100,000 × 5%)				
Dr		Bank	3,718,694	
	Cr	Lease receivable (refer to Table 2 below)		3,718,694
Recognition of lease payment				
Dr		Liability (unearned revenue)	4,600,000	

	Cr	Revenue		4,600,000

Recognition of revenue and unwinding of the liability (unearned revenue)

3. Year 2: The entity recognizes the following:

Dr		Lease receivable	659,315	
	Cr	Interest revenue		659,315

Recognition of interest using the effective interest method (CU13,186,306 × 5%)

Dr		Bank	3,718,694	
	Cr	Lease receivable		3,718,694

Recognition of lease payment

Dr		Liability (unearned revenue)	4,600,000	
	Cr	Revenue		4,600,000

Recognition of revenue and unwinding of the liability (unearned revenue)

4. Year 3: The entity recognizes the following:

Dr		Lease receivable	506,346	
	Cr	Interest revenue		506,346

Recognition of interest using the effective interest method (CU10,126,927 × 5%)

Dr		Bank	3,718,694	
	Cr	Lease receivable		3,718,694

Recognition of lease payment

Dr		Liability (unearned revenue)	4,600,000	
	Cr	Revenue		4,600,000

Recognition of revenue and unwinding of the liability (unearned revenue)

5. Year 4: The entity recognizes the following:

Dr		Lease receivable	345,729	
	Cr	Interest revenue		345,729

Recognition of interest using the effective interest method (CU6,914,579 × 5%)

Dr		Bank	3,718,694	
	Cr	Lease receivable		3,718,694

Recognition of lease payment

Dr		Liability (unearned revenue)	4,600,000	
	Cr	Revenue		4,600,000

Recognition of revenue and unwinding of the liability (unearned revenue)

6. Year 5: The entity recognizes the following:

Dr		Lease receivable	177,081	
	Cr	Interest revenue		177,081

Recognition of interest using the effective interest method (CU3,541,614 × 5%)

Dr		Bank	3,718,694	
	Cr	Lease receivable		3,718,694

Recognition of lease payment

Dr		Liability (unearned revenue)	4,600,000	
	Cr	Revenue		4,600,000

Recognition of revenue and unwinding of the liability (unearned revenue)

Calculations:

Table 1: Annual Lease Payments (Using Market Interest Rate at 5%)

	Undiscounted Annual Market Lease Payments	Present Value of Annual Market Lease Payments	70% of: Undiscounted Annual Contractual Lease Payments	70% of: Present Value of Annual Contractual Lease Payments	Off-market portion of the lease
	(1)	(2)	(3)	(4)	5=(2)-(4)
Year 1	5,312,420	5,059,448	3,718,694	3,541,614	1,517,834
Year 2	5,312,420	4,818,522	3,718,694	3,372,965	1,445,557
Year 3	5,312,420	4,589,068	3,718,694	3,212,348	1,376,721
Year 4	5,312,420	4,370,541	3,718,694	3,059,379	1,311,162
Year 5	5,312,420	4,162,420	3,718,694	2,913,694	1,248,726
Total	**26,562,102**	**23,000,000**	**18,593,471**	**16,100,000**	**6,900,000**

Table 2: Calculation of Lease Liability Balance and Interest Using the Effective Interest Rate

	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU	Total
Capital balance	**16,100,000**	**13,186,306**	**10,126,927**	**6,914,579**	**3,541,614**	
Interest payable	805,000	659,315	506,346	345,729	177,081	2,493,471
Principal	2,913,694	3,059,379	3,212,348	3,372,965	3,541,614	16,100,000
Contractual Lease payments	3,718,694	3,718,694	3,718,694	3,718,694	3,718,694	
Capital balance	**13,186,306**	**10,126,927**	**6,914,579**	**3,541,614**	**0**	

Liability (unearned revenue)	23,000,000
Less: Present value of cash inflows (fair value of lease liability on initial recognition)	16,100,000
Off-market portion of lease to be recognized as an expense	6,900,000

Example 24–Concessionary Lease (Lessee)–Subsidy Results from 30% Lower Contract Lease Payments than Market Lease Payments.

A public sector not-for profit organization (Lessee) enters into a lease with a municipality (Lessor) to use a building over a period of 5 years with the condition to use it for providing medical services to the population in general. The annual market lease payment is CU5,312,420 with a market interest rate at 5% and the lessee pays only 70% of the annual market lease payment.

- *The agreement stipulates that the lease should be paid over the 5 year period as follows*:

  Year 1: CU3,718,694

  Year 2: CU3,718,694

  Year 3: CU3,718,694

  Year 4: CU3,718,694

  Year 5: CU3,718,694

- *The lease includes conditions. To the extent the conditions are not met, the lease is cancelled and the right to use the underlying asset returns to the lessor. The conditions are met on a straight-line basis.*
- *Depreciation of the right-of-use asset is not considered in the example for simplification purposes.*

Analysis

As it is a concessionary lease, the fair value of the right-of-use asset is assessed separately from the fair value of the contractual lease payments. The public sector not-for profit organization (Lessee) has effectively received a subsidy of CU6,900,000 (which is the difference between the fair value of the right-of-use asset (measured at the present value of the market lease payments– see Table 1 below) and the present value of the contractual lease payments). (Note: An entity would consider whether the substance of the CU6,900,000 is a contribution from owners or revenue; assume for purposes of this example that the CU6,900,000 is revenue).

The off-market portion of CU6,900,000 is accounted for in accordance with IPSAS 23 and the lease payments in accordance with this [draft] Standard.

The journal entries to account for the concessionary lease are as follows:

1. On initial recognition, the entity recognizes the following (the entity subsequently measures concessionary lease at amortized cost):

Dr		Right-of-use asset	23,000,000	
	Cr	Lease liability (refer to Table 1 below)		16,100,00
	Cr	Liability or non-exchange revenue (refer to Table 1 below)		6,900,000

Recognition of the lease at fair value

IPSAS 23 is considered in recognizing either a liability or revenue for the off-market portion of the lease. Paragraph IG55 of that Standard provides journal entries for the recognition and measurement of the off-market portion of the lease deemed to be non-exchange revenue.

2. Year 1: The entity recognizes the following:

Dr		Interest expense (refer to Table 2 below)	805,000	
	Cr	Lease liability		805,000

Recognition of interest using the effective interest method (CU16,000,000 × 5%)

Dr		Lease liability (refer to Table 2 below)	3,718,694	
	Cr	Bank		3,718,694

Recognition of lease payment

3. Year 2: The entity recognizes the following:

Dr		Interest expense	659,315	
	Cr	Lease liability		659,315

Recognition of interest using the effective interest method (CU13,186,306 × 5%)

Dr		Lease liability	3,718,694	
	Cr	Bank		3,718,694

Recognition of lease payment

4. Year 3: The entity recognizes the following:

Dr	Interest expense	506,346	
Cr	Lease liability		506,346

Recognition of interest using the effective interest method (CU10,126,927 × 5%)

Dr	Lease liability	3,718,694	
Cr	Bank		3,718,694

Recognition of lease payment

5. Year 4: The entity recognizes the following:

Dr	Interest expense	345,729	
Cr	Lease liability		345,729

Recognition of interest using the effective interest method (CU6,914,579 × 5%)

Dr	Lease liability	3,718,694	
Cr	Bank		3,718,694

Recognition of lease payment

6. Year 5: The entity recognizes the following:

Dr	Interest expense	177,081	
Cr	Lease liability		177,081

Recognition of interest using the effective interest method (CU3,541,614 × 5%)

Dr	Lease liability	3,718,694	
Cr	Bank		3,718,694

Recognition of lease payment

Calculations:

Table 1: Annual Lease Payments (Using Market Interest Rate at 5%)

	Undiscounted Annual Market Lease Payments	Present Value of Annual Market Lease Payments	70% of: Undiscounted Annual Contractual Lease Payments	70% of: Present Value of Annual Contractual Lease Payments	Off-market portion of the lease to be recognized as non-exchange revenue
	(1)	**(2)**	**(3)**	**(4)**	**5=(2)-(4)**
Year 1	5,312,420	5,059,448	3,718,694	3,541,614	1,517,834
Year 2	5,312,420	4,818,522	3,718,694	3,372,965	1,445,557
Year 3	5,312,420	4,589,068	3,718,694	3,212,348	1,376,721
Year 4	5,312,420	4,370,541	3,718,694	3,059,379	1,311,162
Year 5	5,312,420	4,162,420	3,718,694	2,913,694	1,248,726
Total	**26,562,102**	**23,000,000**	**18,593,471**	**16,100,000**	**6,900,000**

Table 2: Calculation of Lease Liability Balance and Interest Using the Effective Interest Rate

	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU	Total
Capital balance	**16,100,000**	**13,186,306**	**10,126,927**	**6,914,579**	**3,541,614**	
Interest payable	805,000	659,315	506,346	345,729	177,081	2,493,471
Principal	2,913,694	3,059,379	3,212,348	3,372,965	3,541,614	16,100,000
Contractual Lease payments	3,718,694	3,718,694	3,718,694	3,718,694	3,718,694	
Capital balance	**13,186,306**	**10,126,927**	**6,914,579**	**3,541,614**	**0**	

Right-of-use asset	23,000,000
Less: Present value of cash outflows (fair value of lease liability on initial recognition)	16,100,000
Off-market portion of the lease to be recognized as non-exchange revenue	6,900,000

Sale and Leaseback Transactions (see paragraphs 113–118)

IE12. Example *25*–26 illustrates the application of the requirements in paragraphs 114–117 of [draft] IPSAS [X] (ED 64) for a seller-lessee and a buyer-lessor.

Example 25–Sale and Leaseback Transaction at Above Market Terms (Additional Financing)

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of CU2,000,000. Immediately before the transaction, the building is carried at a cost of CU1,000,000. At the same time, Seller-lessee enters into an above market terms contract with Buyer-lessor for the right to use the building for 18 years, with annual payments of CU120,000 payable at the end of each year. The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements of IPSAS 9, Revenue from Exchange Transactions*. Accordingly, Seller-lessee and Buyer-lessor account for the transaction as a sale and leaseback. This example ignores any initial direct costs.*

The fair value of the building at the date of sale is CU1,800,000. Because the consideration for the sale of the building is not at fair value, Seller-lessee and Buyer-lessor make adjustments to measure the sale proceeds at fair value. The amount of the excess sale price of CU200,000 (CU2,000,000 – CU1,800,000) is recognized as additional financing provided by Buyer-lessor to Seller-lessee.

The interest rate implicit in the lease is 4.5 per cent per annum, which is readily determinable by Seller-lessee. The present value of the annual payments (18 payments of CU120,000, discounted at 4.5 per cent per annum) amounts to CU1,459,200, of which CU200,000 relates to the additional financing and CU1,259,200 relates to the lease—corresponding to 18 annual payments of CU16,447 and CU103,553, respectively.

<u>Seller-lessee</u>

At the commencement date, Seller-lessee measures the right-of-use asset arising from the leaseback of the building at the proportion of the previous carrying amount of the building that relates to the right of use retained by Seller-lessee, which is CU699,555. This is calculated as: CU1,000,000 (the carrying amount of the building) ÷ CU1,800,000 (the fair value of the building) × CU1,259,200 (the discounted lease payments for the 18-year right-of-use asset).

Seller-lessee recognizes only the amount of the gain that relates to the rights transferred to Buyer-lessor of CU240,355 calculated as follows. The gain on sale of building amounts to CU800,000 (CU1,800,000 – CU1,000,000), of which:

(a) CU559,645 (CU800,000 ÷ CU1,800,000 × CU1,259,200) relates to the right to use the building retained by Seller-lessee; and

(b) CU240,355 (CU800,000 ÷ CU1,800,000 × (CU1,800,000 – CU1,259,200)) relates to the rights transferred to Buyer-lessor.

At the commencement date, Seller-lessee accounts for the transaction as follows.

Cash	CU2,000,000	
Right-of-use asset	CU699,555	
Building		CU1,000,000
Lease liability		CU1,259,200
Financial liability		CU200,000
Gain on rights transferred		CU240,355

<u>Buyer-lessor</u>

At the commencement date, Buyer-lessor accounts for the transaction as follows.

Building	CU1,800,000	
Lease receivable	CU1,259,200	
Financial asset	CU200,000 (18 payments of CU16,447, discounted at 4.5 per cent per annum)	
Liability (unearned revenue)		CU1,259,200
Cash		CU2,000,000

After the commencement date, Buyer-lessor accounts for the lease by treating CU103,553 of the annual payments of CU120,000 as lease payments. The remaining CU16,447 of annual payments received from Seller-lessee are accounted for as (a) payments received to settle the financial asset of CU200,000 and (b) interest revenue.

Example 26–Sale and Leaseback Transaction at Below Market Terms (Concessionary Leaseback)

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) at fair value for cash of CU1,800,000. Immediately before the transaction, the building is carried at a cost of CU1,000,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 18 years, with annual payments of CU103,553 at the end of each year. The terms and conditions of the transaction are such that the:

(a) Transfer of the building by Seller-lessee satisfies the requirements of IPSAS 9;

(b) Non-exchange component included in the concessionary leaseback is recognized by Seller-lessee as liability (unearned revenue) on initial recognition, according to IPSAS 23, Revenue from Non-Exchange Transactions (Taxes and Transfers)*;*

(c) *The credit entry for the non-exchange component included in the concessionary leaseback is recognized by Buyer-lessor as a liability (unearned revenue), according to this* [draft] *Standard; and*

(d) *The debit entry for the non-exchange component included in the concessionary leaseback is recognized by Buyer-lessor as a non-exchange expense, according to this* [draft] *Standard.*

Accordingly, Seller-lessee and Buyer-lessor account for the transaction as a sale and concessionary leaseback. This example ignores any initial direct costs. The annual market lease payment is CU120,000. The market interest rate is 4.5 per cent per annum. The present value of the annual market lease payments amounts to CU1,459,200 (18 payments of CU120,000, discounted at 4.5 per cent per annum). The present value of the agreed annual lease payments (18 payments of CU103,553, discounted at 4.5 per cent per annum), amounts to CU1,259,200.

Because the consideration for the annual payments is below fair value, Buyer-lessor gives a subsidy to Seller-lessee of CU200,000 (CU1,459,200 – CU1,259,200).

<u>Seller-lessee</u>

At the commencement date, Seller-lessee measures the right-of-use asset arising from the leaseback of the building at the proportion of the previous carrying amount of the building that relates to the right of use retained by Seller-lessee, which is CU810,667. This is calculated as: CU1,000,000 (the carrying amount of the building) ÷ CU1,800,000 (the fair value of the building) × CU1,459,200 (the discounted lease payments for the 18-year right-of-use asset at fair value).

Seller-lessee recognizes only the amount of the gain that relates to the rights transferred to Buyer-lessor of CU151,467 calculated as follows. The gain on sale of building amounts to CU800,000 (CU1,800,000 – CU1,000,000), of which:

(c) CU648,533 (CU800,000 ÷ CU1,800,000 × CU1,459,200) relates to the right to use the building retained by Seller-lessee; and

(d) CU151,467 (CU800,000 ÷ CU1,800,000 × (CU1,800,000 – CU1,459,200)) relates to the rights transferred to Buyer-lessor.

At the commencement date, Seller-lessee accounts for the transaction as follows.

Cash	CU1,800,000	
Right-of-use asset	CU810,667	
Building		CU1,000,000
Lease liability		CU1,259,200
Liability or non-exchange revenue (concessionary element)		CU200,000
Gain on rights transferred		CU151,467

Recognition of the concessionary leaseback at fair value

IPSAS 23 is considered in recognizing either a liability or revenue for the off-market portion of the concessionary leaseback by the Seller-lessee. Paragraph IG56 of that Standard provides journal entries for the recognition and measurement of the off-market portion of the concessionary leaseback deemed to be non-exchange revenue.

<u>Buyer-lessor</u>

At the commencement date, Buyer-lessor accounts for the transaction as follows.

Building	CU1,800,000	
Lease receivable	CU1,259,200 (18 payments of CU103,553, discounted at 4.5 per cent per annum)	
Non-exchange expense (concessionary element)	CU200,000	
Liability (unearned revenue)		CU1,459,200
Cash		CU1,800,000

Comparison with IFRS 16

[draft] IPSAS [X] (ED 64), *Leases* is drawn primarily from IFRS 16 (2016), *Leases*.

The main differences between [draft] IPSAS [X] (ED 64) and IFRS 16 are as follows:

- [draft] IPSAS [X] (ED 64) uses the right-of-use model in lessor accounting. IFRS 16 retains the risks and rewards incidental to ownership model in lessor accounting that exists in IAS 17, *Leases*.
- [draft] IPSAS [X] (ED 64) provides guidance on how to account for leases at market terms and at below market terms (concessionary leases) for both lessors and lessees. IFRS 16 only provides guidance on how to account for leases at market terms.
- [draft] IPSAS [X] (ED 64) clarifies the accounting treatment of budget funding or cancellation clauses that are normally used in the public sector for budgetary reasons. IFRS 16 does not provide such guidance.
- [draft] IPSAS [X] (ED 64) uses different terminology from IFRS 16. For example, [draft] IPSAS [X] (ED 64) uses the terms “revenue”, “operation” and “segment”, while IFRS 16 uses the terms “income”, “business unit” and “business segment’, respectively.
- [draft] IPSAS [X] (ED 64) accounts for the non-exchange component of a sale and leaseback transaction at below market terms in the same way as the non-exchange component in a concessionary lease. IFRS 16 accounts for the non-exchange component of a sale and leaseback transaction at below market terms as a prepayment of lease payments.
- [draft] IPSAS [X] (ED 64) presentation requirements distinguishes information selected for display or disclosure in two sub-sections of presentation. IFRS 16 presentation requirements are separate from disclosures.

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Exposure Draft (ED) 64 Summary—*Leases*

This summary provides an overview of Exposure Draft 64, *Leases*.

Project objective: This ED proposes new requirements for lease accounting covering both lessors and lessees to replace IPSAS 13, *Leases*.

Development of ED 64: The IPSASB's Leases project is a convergence project with IFRS 16, *Leases*. In developing ED 64, the IPSASB applied its Policy Paper on *Process for Reviewing and Modifying IASB Documents*. Based on this process, the IPSASB proposes to adopt the IFRS 16 right-of-use model for lessees. However, the IPSASB decided not to adopt the IFRS 16 risks and rewards incidental to ownership model for lessors. Instead, the IPSASB is also proposing the right-of-use model for lessors. The IPSASB is also proposing new public sector specific guidance on concessionary leases for both lessors and lessees.

The project stage: The IPSASB issued this ED in January 2018.

Next steps: The IPSASB seeks feedback on ED 64 to guide it in developing a final International Public Sector Accounting Standard® (IPSAS®) that revises accounting requirements for leases.

Comment deadline: ED 64 is open for public comment until June 30, 2018.

How to respond: Respondents are asked to submit their comments electronically through the IPSASB website, using the "Submit a Comment" link. Please submit comments in both a PDF and Word file. All comments will be considered a matter of public record and will ultimately be posted on the website.

Why the IPSASB Undertook this Project?

IFRS 16 replaces IAS 17. As IPSAS 13 was based on IAS 17, the IPSASB decided to revise its leasing requirements in order to maintain convergence with the underlying IFRS, where appropriate.

IFRS 16, *Leases*

IPSAS 13, *Leases* was drawn primarily from International Accounting Standard (IAS) 17, *Leases*, issued by the International Accounting Standards Board (IASB). In January 2016, the IASB issued International Financial Reporting Standard (IFRS) 16, *Leases*. IFRS 16 replaces IAS 17 and a number of related interpretations.

The IASB's goal was to address stakeholder criticism that the IAS 17 risks and rewards incidental to ownership model:

(a) Did not require lessees to recognize assets and liabilities arising from operating leases;

(b) Had two different accounting models for leases that allowed transactions that were economically similar to be accounted for very differently; and

(c) Did not provide adequate information about a lessor's exposure to credit risk and asset risk.

In this context, the IPSASB decided to revise its leasing requirements in order to address the same issues in the public sector, while maintaining convergence with IFRS 16, where appropriate.

Concessionary leases

Quite often public sector entities and international organizations enter into a lease at below market terms (a concessionary lease). IFRS 16 requires leases to be measured at cost. Applying IFRS 16 measurement requirements to concessionary leases would lead to an understatement of the right-of-use asset and no recognition of the subsidy from the lessor to the lessee in the financial statements of both the lessor and the lessee.

Therefore, the IPSASB decided to propose new public sector specific requirements to account for concessionary leases in ED 64.

Development of ED 64—Lessee accounting

The IPSASB's Leases project is a convergence project with IFRS 16, *Leases* that follows IPSASB's policy document *Process for Reviewing and Modifying IASB Documents,* also known as "*Rules of the Road*".

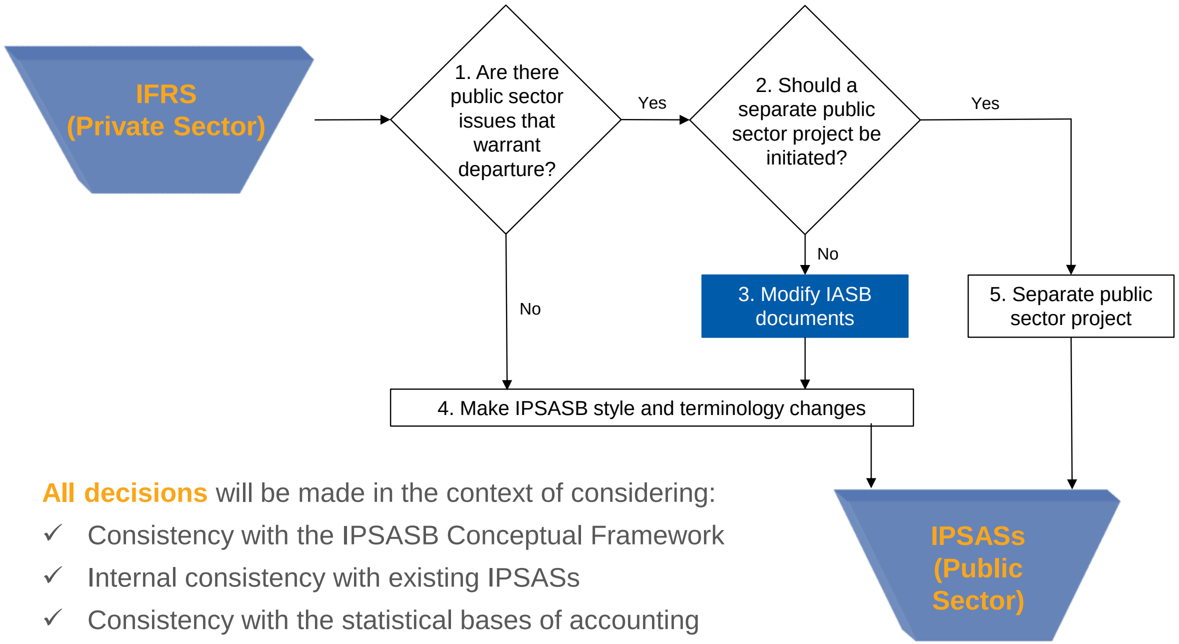
Lessee accounting in ED 64 is converged with IFRS 16.

"*Rules of the Road*"

The IPSASB is of the view that the economics of a lease transaction were the same in both the public and private sector. Consequently, when developing its Leases project, the IPSASB followed the decision tree below as set out in the "*Rules of the Road*".

Lessee accounting in IFRS 16

When applying the "*Rules of the Road*", the IPSASB considered that there were no public sector issues that warranted departure from the new lease accounting model for lessees in IFRS 16—the right-of-use model. Consequently, ED 64 proposes the right-of-use model for lessees converged with IFRS 16.



All decisions will be made in the context of considering:

- ✓ Consistency with the IPSASB Conceptual Framework
- ✓ Internal consistency with existing IPSASs
- ✓ Consistency with the statistical bases of accounting

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Development of ED 64—Lessor accounting

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Convergence with IFRS 16 for lessor accounting would give rise to a number of public sector specific issues.

ED 64 proposes the right-of-use model also for lessors to address public sector specific issues, while ensuring consistency with IPSASB's literature and lessee accounting.

Departure from IFRS 16 lessor accounting

For lessors, IFRS 16 retained the risks and rewards incidental to ownership model in IAS 17 (reflected in IPSAS 13). When the lessor and the lessee are public sector entities in the same lease contract, the lack of consistency between lessor and lessee accounting in IFRS 16 leads to:

(a) The underlying asset not being recognized by the lessor nor by the lessee if the lessor classifies the lease as a finance lease; and

(b) The lessor not recognizing a lease receivable if the lease is classified as an operating lease, while the lessee always recognizes a lease liability.

The above situations could give rise to a number of practical issues that are more prevalent in the public sector:

(a) Consolidation issues where the lessor and lessee are part of the same economic entity and separate records needs to be maintained for the underlying asset and lease receivable;

(b) Understandability issues because of different accounting models for the same transaction—it may be difficult for users to distinguish between a lease and the sale of an asset in lessor's financial statements.

(c) Asymmetrical information in the public sector—different recognition criteria for the same transaction distorts the analysis of the financial position of public sector entities.

The IPSASB concluded that:

(a) The risks and rewards incidental to ownership model is inconsistent with:

(i) *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the *Conceptual Framework)*; and

(ii) Control-based approach in other IPSAS, for example IPSAS 32, *Service Concession Arrangements: Grantor.*

(b) The lessor should not derecognize the underlying asset because in a lease the lessor is transferring the right to use an underlying asset to the lessee, not the underlying asset itself.

(c) The lease receivable meets the definition of an asset and should always be recognized.

As a consequence, the IPSASB decided to depart from IFRS 16 for lessor accounting and propose a single right-of-use model for lessors specifically designed for public sector financial reporting.

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What is the right-of-use model in lease accounting?

The right-of-use model is based on the principle that lease contracts simultaneously create, transfer and finance a right to use an underlying asset.

Characteristics of the right-of-use model

ED 64 proposes a single model for lease accounting based on the principle that lease contracts simultaneously:

(a) Create an asset (the right-of-use asset) separate from the underlying asset;

(b) Transfer the right to use an underlying asset (the right-of-use asset) from the lessor to the lessee, not the underlying asset itself; and

(c) Finance the right to use an underlying asset.

Under the right-of-use model, a lease is, in substance, a sale of an unrecognized right-of-use asset, for which the lessor has a performance obligation to provide access to the underlying asset to the lessee, in exchange for cash.

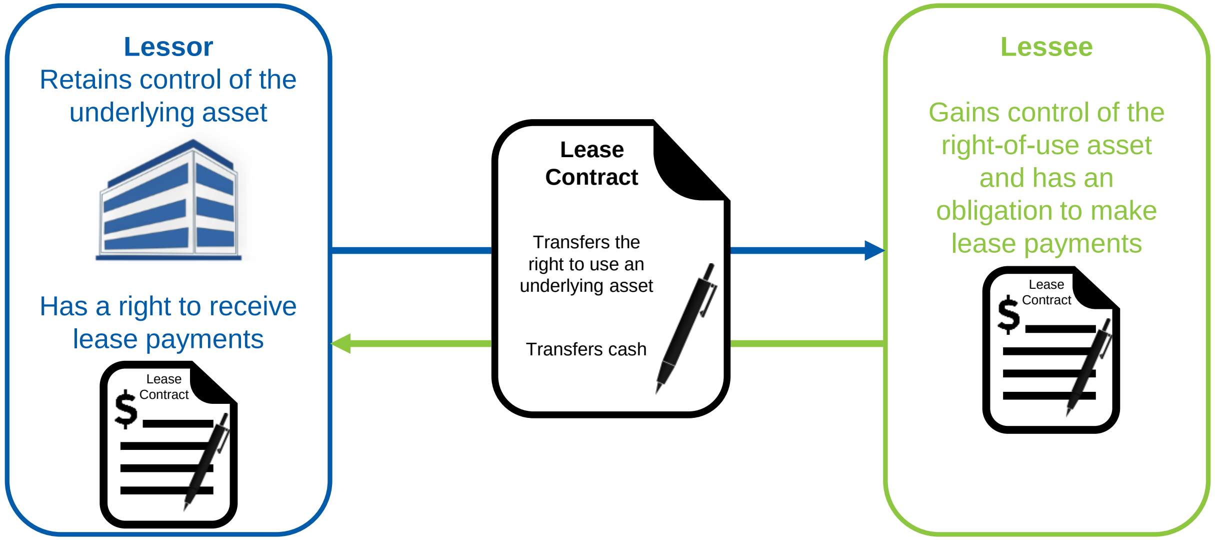
Control of the underlying asset versus control of the right-of-use asset

The right-of-use model distinguishes the:

(a) Underlying asset from the right-of-use asset as separate economic phenomena; and

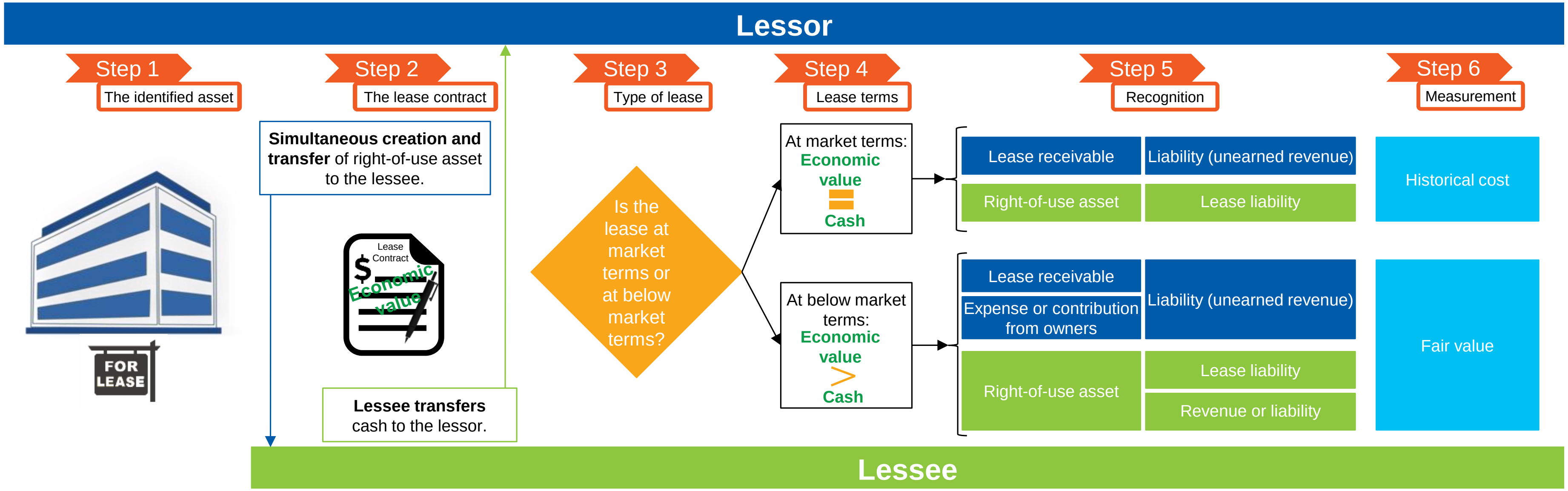
(b) Control of the underlying asset held by the lessor from the control of the right-of-use asset held by the lessee.

ED 64 provides guidance on how to account for the underlying asset, the lease in the lessor's accounts (the sale of the right-of-use asset) and the lease in the lessee's accounts (the purchase of the right-of-use asset).



What is the right-of-use model in lease accounting?

IPSASB right-of-use model in six steps



What changes in lease accounting?

ED 64 proposes to retain substantially the definition of a lease in IPSAS 13, but to change the guidance on how to apply it.

Definition of a lease

The definition of a lease in ED 64 is applicable to both parties of a lease contract, i.e. the supplier ('the lessor') and the customer ('the lessee').

ED 64 proposes determining whether a contract contains a lease on the basis of whether the customer has the right to control the use of an identified asset for a period of time.

Lease versus service concession arrangement versus service

The new guidance on identifying a lease may exclude from the scope of ED 64 certain arrangements that may have been considered within the scope of IPSAS 13:

(a) Service concession arrangements within the scope of IPSAS 32, *Service Concession Arrangements: Grantor* (for example, some contracts to use an identified asset); and

(b) Service contracts (for example, some supply contracts).

Type of control \ Classification	Lease	Service concession arrangement	Service
Control of an identified asset	Lessor: Yes Lessee: No	Grantor: Yes Operator: No	Supplier: Yes Customer: No
Control of the right to use an identified asset	Lessor: No Lessee: Yes	Grantor: Yes Operator: No	Supplier: Yes Customer: No
Control of the right to access to operate an identified asset	Lessor: No Lessee: Yes	Grantor: No Operator: Yes	Supplier: Yes Customer: No

What changes in lease accounting?

In IPSAS 13, the focus is on the underlying asset—who recognizes the underlying asset?

In ED 64, the focus is on the right-of-use asset—how to account for the sale and purchase of the right-of-use asset by lessors and lessees, respectively?

Risks and rewards incidental to ownership versus control of the underlying asset

In IPSAS 13, the focus is on the underlying asset—the underlying asset is recognized by lessors or lessees depending on who has substantially all the risks and rewards incidental to ownership of an asset.

On the contrary, in the right-of-use model proposed in ED 64 the focus is on the accounting for the new resource created by the lease contract—the right-of-use asset.

This means that lessors account for the underlying asset separately from the sale of the right-of-use asset created by the lease contract because the IPSASB is of the view that both are separate economic phenomena. The proposed guidance is consistent with the grant of a right to the operator model with existing assets in IPSAS 32, *Service Concession Arrangements: Grantor*, where the grantor sells a right to access to operate an identified asset to the operator (the other party to the transaction).

On the other hand, lessees account for the purchase of the right-of-use asset, not the purchase of the underlying asset itself. The proposed guidance is consistent with IFRS 16, *Leases*.

Concessionary leases

ED 64 proposes new public sector specific requirements to account for concessionary leases for both lessors and lessees based on the right-of-use model.

The proposed guidance for accounting for the subsidy is consistent with IPSASB literature on accounting for non-exchange transactions and concessionary loans.

The IPSASB is of the view that the nature of the resource transferred does not affect the economic substance of a subsidy. Consequently, whether an entity grants a loan or transfers a right-of-use asset at below market terms the accounting for the subsidy should be the same.

What changes in lessor accounting?

IPSASB®

ED 64 proposes the right-of-use model for lessors by distinguishing the retention of control of the underlying asset by the lessor from the transfer of control of the right-of-use asset to the lessee.

Recognition and measurement of leases at market terms—General guidance

ED 64 proposes to change significantly how a lessor accounts for leases (except for short-term leases) applying IPSAS 13.

ED 64 proposes:

(a) Continuing to recognize the underlying asset in the lessor's accounts because the lessor continues to control the underlying asset in a lease. In IPSAS 13 the underlying asset is derecognized if the lessor classifies the lease as finance lease;

(b) Recognizing a liability (unearned revenue) because the lessor sells an unrecognized right-of-use asset to the lessee and has a present obligation to provide access to the underlying asset to the lessee. In IPSAS 13 the lessor does not recognize a liability (unearned revenue).

(c) Recognizing a lease receivable because the lessor gains control of the right to receive lease payments from the lessee. In IPSAS 13 the lease receivable is not recognized if the lessor classifies the lease as operating lease.

ED 64 proposes measuring the:

a) Underlying asset according to the applicable IPSAS in order to ensure consistency with IPSASB's literature;

b) Lease receivable initially at the present value of the future lease payments because it is consistent with the approach used to measure other similar assets (e.g. loans in IPSAS 29, *Financial Instruments: Recognition and Measurement*); and

c) Liability (unearned revenue) initially at the initial value of the lease receivable, plus the amount of any lease payments received at or before the commencement date of the lease that relate to future periods because it is consistent with the approach used to measure other similar liabilities (e.g. the grant of a right to the operator model with existing assets in IPSAS 32, *Service Concession Arrangements: Grantor*).

Recognition exemption

IPSAS 13 does not have any recognition exemption for lessors. ED 64 proposes to introduce a recognition exemption for short-term leases—leases of 12 months or less.

ED 64 proposes to account for short-term leases in the same way as operating leases under IPSAS 13—as revenue on a straight-line basis over the lease term or another systematic basis.

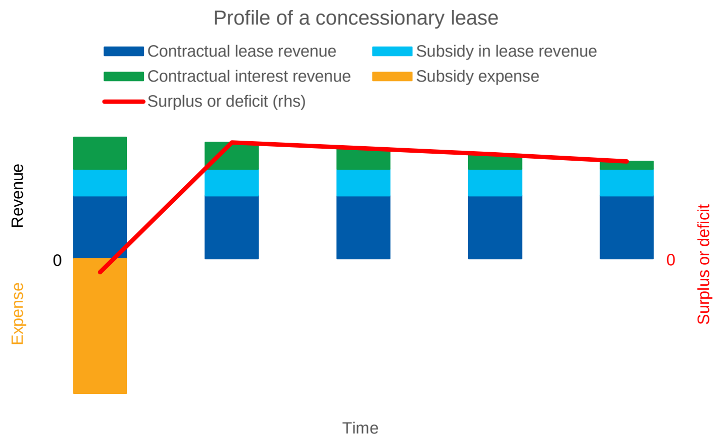
Lessor—Accounting for the subsidy in concessionary leases

ED 64 proposes to account for the subsidy in concessionary leases in the same way as in concessionary loans.

Recognition and measurement

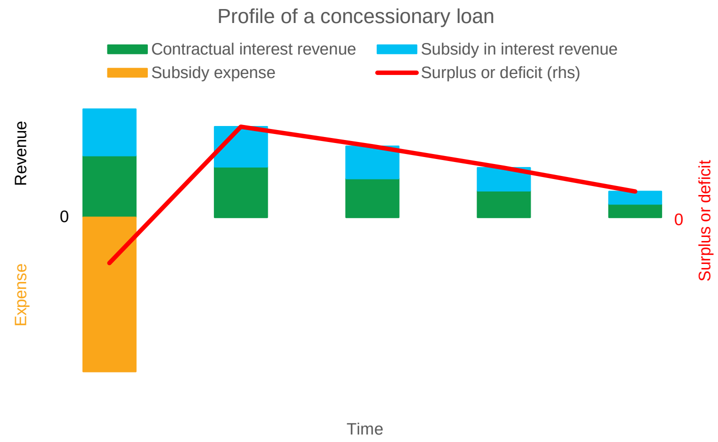
Liability (unearned revenue)

ED 64 proposes measuring the liability (unearned revenue) in a concessionary lease at fair value by discounting market lease payments using a market interest rate. The liability (unearned revenue) represents the full economic value of the resource created (the right-of-use asset) and transferred to the lessee, which is higher than the future cash inflows (contractual lease payments).



Subsidy as expense on day-one

Consistent with the accounting treatment of concessionary loans in IPSAS 29, *Financial Instruments: Recognition and Measurement*, ED 64 proposes recognizing the subsidy granted to lessees as a day-one expense, except if it is a contribution from owners. The IPSASB is of the view that recognizing the subsidy as a day-one expense provides the most useful information for accountability purposes because it shows the cost of the decision to grant the concession.



Subsidy as revenue over the lease term

As leases result in transferring an unrecognized right-of-use asset to the lessee and loans result in transferring recognized cash to the borrower, the initial credit entry in leases is a liability (unearned revenue) and in loans is the derecognition of cash. As the lessor has a present obligation to provide access to the lessee to the underlying asset regardless of the amount of cash being transferred, which prevents the lessor recognizing revenue on day one, the liability (unearned revenue) also includes the subsidy. Consistent with concessionary loans, subsequently the subsidy will also be recognized as revenue over the lease term together with the cash component of the lease.

What changes in lessee accounting?

IPSASB®

ED 64 proposes the right-of-use model for lessees, which distinguishes the right to use an underlying asset (which the lessee controls) and the underlying asset itself (which the lessee does not control).

Recognition and measurement of leases at market terms—General guidance

ED 64 proposes to change significantly how a lessee accounts for leases (except for short-term leases and leases of low-value assets) applying IPSAS 13.

ED 64 proposes recognizing:

(a) A right-of-use asset because the lessee controls the right to use the underlying asset. In IPSAS 13 the lessee recognizes the underlying asset in a finance lease, but not in an operating lease.

(b) A lease liability because the lessee has a present obligation to make lease payments that arises from the lease contract (once the underlying asset has been available to the lessee), which results in future outflows of economic benefits from the lessee. In IPSAS 13 the lease liability is not recognized if the lessee classifies the lease as operating lease.

ED 64 proposes measuring the right-of-use asset and the lease liability at cost by reference to the present value of the lease payments because it is consistent with the approach to measure other similar assets in IPSAS.

Recognition exemptions

IPSAS 13 does not have recognition exemptions for lessees. ED 64 proposes two recognition exemptions for:

(a) Short-term leases; and

(b) Leases for which the underlying asset is of low value.

ED 64 proposes accounting for leases under recognition exemptions in the same way as operating leases under IPSAS 13: as expense on a straight-line basis over the lease term or another systematic basis.

IPSASB®

Lessee—Accounting for the subsidy in concessionary leases

ED 64 proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23.

Recognition and Measurement

For lessees, ED 64 proposes that concessionary leases should be measured at fair value because it avoids an understatement of the right-of-use asset and recognizes the subsidy received by the lessee.

Right-of-use asset

ED 64 proposes that the right-of-use asset in a concessionary lease should be measured at fair value by discounting market lease payments using a market interest rate in order to determine the fair value of the purchase of the right-of-use asset. This is consistent with requirements in the IPSASB literature on the measurement of assets resulting from non-exchange transactions.

Subsidy as revenue or liability on day one

ED 64 also proposes recognizing the subsidy in accordance with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* as revenue on day one, except if a present obligation exists, e.g., where specific conditions imposed on the transferred asset (the right-of-use asset) by the recipient result in a present obligation. Where a present obligation exists, it is recognized as a liability. As the entity satisfies the present obligation, the liability is reduced and an equal amount of revenue is recognized.

This approach to revenue recognition in concessionary leases is also consistent with the approach in concessionary loans.

Sale and leaseback transactions

ED 64 proposes to recognize right-of-use assets and its related lease liabilities for all sale and leaseback transactions.

ED 64 also proposes to account for concessionary leasebacks in accordance with the guidance for concessionary leases.

Less incentive for off balance sheet accounting and improved comparability of financial information

When applying IPSAS 13, an entity has an incentive for selling the assets that it owns and lease those assets back through operating leases because it would report less assets and less financial debt—thus improving its financial indicators. However, in substance the entity was neither changing its operations nor the use of the assets that it leased back.

ED 64 proposes recognizing the rights to use those same assets and related liabilities for all sale and leaseback transactions and restricts the amount of any gain recognized on the sale of an asset.

As a result, the proposals in ED 64 provide less incentive for entities to enter into sale and leaseback transactions and more comparability of financial information reported in the statement of financial position between entities that lease assets and entities that buy assets.

Accounting for concessionary leasebacks in the same way as in concessionary leases

ED 64 proposes accounting for the subsidy in a concessionary leaseback consistent with concessionary leases. IFRS 16 accounts for the subsidy component in a concessionary leaseback as a prepayment of lease payments.


Recognition
Measurement
Is the transfer of the asset a sale?
Yes
No
Seller-lessee
Right-of-use asset
Proportion of the previous carrying amount of the asset that relates to the right of use
Lease liability
According to ED 64
Buyer-lessor
Underlying asset
According to the applicable IPSAS
Lease
According to ED 64
Seller-lessee
Financial liability
Buyer-lessor
Financial asset
According to IPSAS 29

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Next Steps:

The deadline for comments is June 30, 2018.

During the comment period, the IPSASB members are available to discuss the proposals with a wide range of parties.

How can I comment on the proposals?

ED 64 requests comments on four Specific Matters for Comment (SMC) as follows:

(a) Proposal of the IFRS 16 right-of-use model for lessee accounting (SMC 1);

(b) Proposal to depart from the IFRS 16 risks and rewards model for lessor accounting (SMC 2);

(c) Proposal of a single right-of-use model for lessor accounting consistent with lessee accounting (SMC 3); and

(d) Proposal to account for the subsidy in concessionary leases in the same way as in concessionary loans (SMC 4).

Respondents are also welcome to comment on any other matter they think the IPSASB should consider in forming its views.

Respondents are asked to submit their comments electronically through the IPSASB website, using the "Submit a Comment" link. Please submit comments in both a PDF file and a Word file.

Comment letters will be posted on the IPSASB website.

The IPSASB will carefully consider all feedback and discuss responses at its public meetings after the comment period has ended.

Stay informed

The IPSASB's website will indicate the meetings at which feedback on the ED will be discussed. The dates and the locations of 2018 meetings are available at:

http://www.ipsasb.org/meetings

To stay up to date about the project, please visit:

http://www.ipsasb.org/projects/leases

IPSASB
International Public Sector Accounting Standards Board®

Proposed Strategy and Work Plan

Proposed Strategy and Work Plan 2019–2023

Consultation January 2018
Comments due: June 15, 2018

IPSASB International Public Sector Accounting Standards Board®

Mission	The International Public Sector Accounting Standards Board® (IPSASB®) serves the public interest by developing high-quality accounting standards and other publications for use by public sector entities around the world in the preparation of general purpose financial reports.
Outputs	The IPSASB's authoritative standards include: • International Public Sector Accounting Standards™ (IPSAS™) which set out requirements for financial reporting in General Purpose Financial Statements (GPFSs); and • Cash Basis IPSAS. The IPSASB's non-authoritative guidance and other publications include: • The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities; • Recommended Practice Guidelines (RPGs) applicable to the preparation and presentation of General Purpose Financial Reports (GPFRs); and • Staff papers and other documents.
Impacts	The use of International Public Sector Accounting Standards™ (IPSAS™): • Enhances transparency through comparability and quality of accrual-based financial information, enabling users to assess the financial status of public sector entities; • Increases accountability by communicating the nature and amount of resources controlled by public sector entities and how they are used, allowing users to hold governments and other public sector entities to account; and • Contributes to better information for decision makers in public sector entities to use in making judgements and delivering goods and services to users efficiently.
Strategic Input	The IPSASB Consultative Advisory Group (CAG) is a forum composed of individuals from public and private sector organizations who are interested in, or affected by, the IPSASB's work, including those engaged in the preparation, audit, or evaluation of public sector financial reports. Interaction with the CAG is a key element of the IPSASB's due process.
Oversight	The IPSASB sets its standards in accordance with a transparent due process. Its governance and standard setting activities are overseen by the Public Interest Committee (PIC).
Structures and Processes	The structures and processes that support the IPSASB are facilitated by the International Federation of Accountants® (IFAC®).
Funding	The IPSASB receives financial support from IFAC®, the Asian Development Bank, the Chartered Professional Accountants of Canada, the New Zealand External Reporting Board, and the governments of Canada and New Zealand.

IPSASB Proposed Strategy and Work Plan 2019–2023

Contents

Foreword

By Ian Carruthers, IPSASB Chair

2017 marked the twentieth anniversary of the IPSAS development program. During that period, the IPSASB and its predecessor—the IFAC Public Sector Committee—developed 40 International Public Sector Accounting Standards (IPSAS), as well as three *Recommended Practice Guidelines* (RPGs), an IPSAS on reporting under the cash basis of accounting and, *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (Conceptual Framework). These, together with the introduction of a governance framework and an immense amount of outreach work by members, and others associated with its activities, have progressively allowed the IPSASB to mature into the global standard setter for public sector financial reporting.

The IPSASB's first-ever Strategy and Work Plan consultation during 2014, together with completion of the Conceptual Framework in the second half of 2014, were landmark achievements for the IPSASB. Both have fundamentally shaped its current activities. Our work is also increasingly being influenced by the implementation in the past couple of years of our new governance and advisory framework, comprising the Public Interest Committee (PIC) and the Consultative Advisory Group (CAG). Both of these have a public interest focus that strongly influences the IPSASB's work.

This is a critical time for the IPSASB, as the pace and scale of IPSAS adoption have increased significantly in recent years. This is a trend that looks likely to continue, with the number of governments around the world adopting accrual accounting estimated to increase from 31% in 2015 to 71% in 2020[1]. Our standards and guidance will therefore increasingly need to meet the practical requirements of a significantly expanding potential user group.

The 2015 Strategy positioned our work for the first time in the context of the drive to strengthen Public Financial Management (PFM) globally. As a result of the feedback from our constituents, the majority of our work since then has focused on IPSAS development and maintenance. In

1 Source: PwC publication: *Global Survey on Accounting and Financial Reporting by Central Governments* (2nd Edition) 14 September 2015.

selecting and scoping the projects in our current Work Plan, the IPSASB attempted to strike a balance between addressing key public sector issues, and maintaining convergence with the major new standards issued by the International Accounting Standards Board (IASB). As the IPSASB progresses the projects approved in 2015, with a number due for completion by the end of 2018, it is now considering the direction to take in the five-year period 2019–2023, and how to allocate its resources in terms of prioritizing new projects, and other potential areas of work.

Based on the feedback obtained through the many outreach events that the IPSASB, Technical Advisors and its alumni collectively undertake, as well as the Public Sector Standard Setters Forum meetings held in 2016 and 2017, the IPSASB believes it should continue to focus its work on developing high-quality financial reporting standards for the public sector. However, the IPSASB also believes it needs to sharpen the focus of its activities in the area of promoting awareness of IPSAS and the benefits of their adoption and implementation, in particular by working more closely with global and regional bodies to raise the profile of IPSAS with financial regulators and markets, all of whom we believe should be key advocates and more consistent supporters of IPSAS adoption.

The responses to the IPSASB's first-ever Strategy and Work Plan consultation during 2014, provided valuable input that has helped shape the way the IPSASB works and its Work Plan since then. The new Strategy and Work Plan will drive the IPSASB's work during the 5-year period from 2019, as well as play a key role in strengthening PFM globally going forward. This consultation now provides the opportunity for you to have your say on its priorities for the period 2019–2023, and through doing so, to help shape the future of global public sector financial reporting standards.

To ensure the proposed direction and priorities will indeed best serve the public interest, the IPSASB needs your input and looks forward to receiving your comments.

Ian Carruthers,
IPSASB Chair ■

IPSASB Current Strategy '2015 Forward— Leading Through Change'

The IPSASB's current strategy, "*2015 Forward—Leading Through Change*" published in September 2015 has a single strategic objective:

Strengthening public financial management and knowledge globally through increasing adoption of accrual-based IPSAS by:

- *Developing high-quality public sector financial reporting standards;*
- *Developing other publications for the public sector; and*
- *Raising awareness of IPSAS and the benefits of their adoption.*

It therefore firmly positions the IPSASB's activities in the broader public financial management (PFM) landscape. The IPSASB's high-quality accounting standards facilitate credible high-quality financial reporting[2] that is transparent and allows users the ability to hold governments and other public sector entities to account in their use of public resources, which is in the public interest.

The Strategy also identified projects that the IPSASB would add to its Work Plan for the period from 2015 through 2018. The following projects have been completed since 2015;

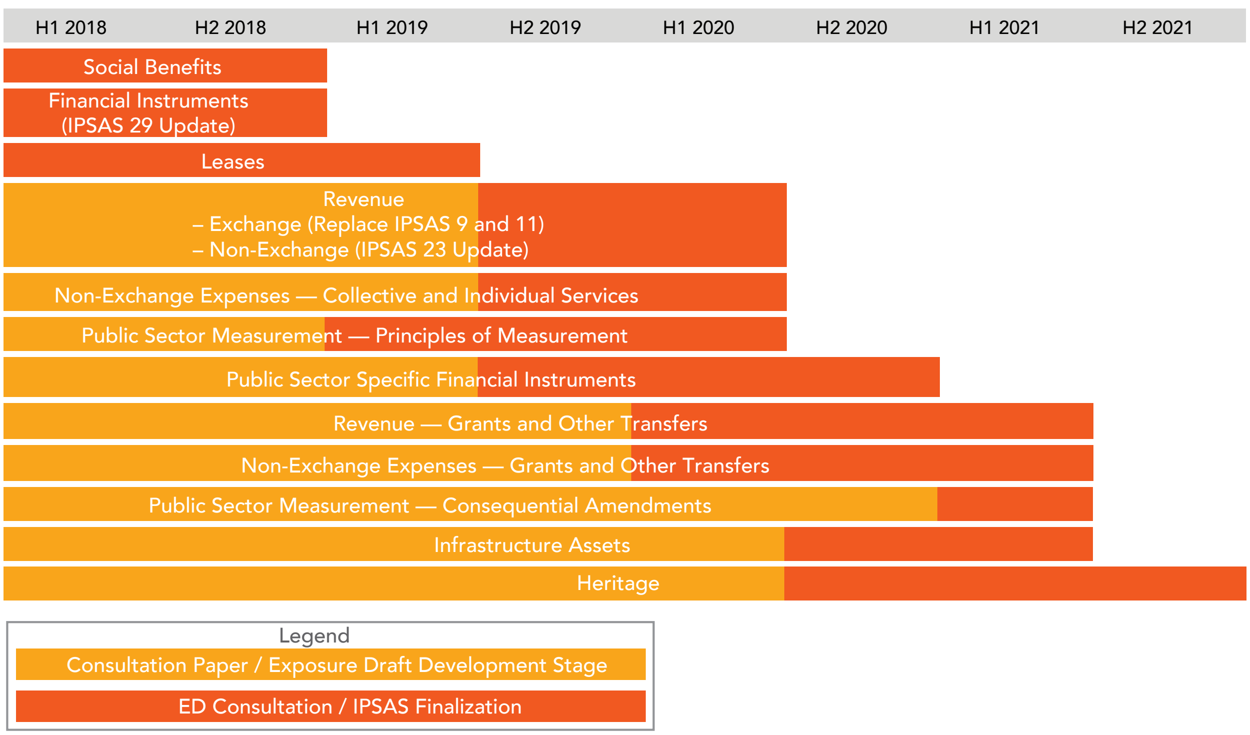
- IPSAS 33, *First Time Adoption of Accrual Basis IPSAS*—provides requirements and guidance for entities adopting to help with the transition to IPSAS.
- IPSAS 34–38, *Accounting for Interests in Other Entities*—updated standards to implement changes introduced by IFRS 10-12 in the public sector context.
- IPSAS 39, *Employee Benefits*—updated standard to incorporate changes to IAS 19 *Employee Benefits*.
- IPSAS 40, *Public Sector Combinations*—provides requirements and guidance on classification of combinations of public sector operations.
- *The Applicability of IPSAS*—revises the approach to how the IPSASB communicates the entities for which it develops IPSAS, by setting out principles and acknowledging the role of regulators in determining financial reporting requirements in their jurisdictions.

2 High-quality financial reporting is dependent on high-quality accounting standards. IPSAS are the only internationally recognized accounting standards set specifically for the public sector. IPSAS set out principles which require financial reporting that faithfully represent the economics of transactions. IPSAS are high-quality accounting standards, developed independently through a rigorous due process that serves the public interest. IPSAS can be readily applied to prepare high-quality financial reports that are useful for decision-making purposes, and which provide the transparency to allow users to hold decision makers to account for their use of public resources.

- Recommended Practice Guideline 3, *Reporting Service Performance Information*—provides principled guidance for reporting service performance information by public sector entities.

The current Work Plan aims to strike a balance between using the Conceptual Framework to address key public sector specific financial reporting issues, and maintaining convergence, where appropriate, with the significant new standards that the International Accounting Standards Board (IASB) has issued recently. The IPSASB's current assessment is that by the end of 2018 it will have completed a number of its current projects, with the others being gradually completed in the period up to the second half of 2020 as shown in figure 1:

Figure 1: Projected timelines for the IPSASB's current projects



The above table sets out the expected progress for all ongoing projects on the current IPSASB Work Plan as at December 2017. The progress of each project will be dependent on the decisions taken by the IPSASB, feedback received from stakeholders[3] in each consultation phase, and the availability of staff resources. The IPSASB reviews Work Plan progress at each meeting. The above table will be updated in December 2018 when the final version of the 2019–2023 Strategy and Work Plan is approved.

The completion of the projects in the current Work Plan will progressively provide the space from 2019 onwards to undertake new projects. This Strategy Consultation sets out the IPSASB's proposals to address the current strategic considerations discussed in the next section, both in terms of the IPSASB's overall Strategic Objective and Themes, and the design and content of its Work Plan for the period 2019–2023. ■

3 This work plan assumes that CPs and EDs have standard 4-month consultation periods and assumes that there will not be any projects requiring EDs being re-exposed.

Strategic Considerations—IPSAS and PFM

Public Financial Management (PFM), in its broadest sense, is the system by which financial resources are planned, directed, and controlled, both externally to and internally within the public sector entity, to enable and influence the efficient and effective delivery of public service outcomes.

Citizens are affected by the financial management decisions of governments and other public sector entities. In many jurisdictions, the lack of complete and audited information about government finances continues to be a major cause of concern, which impacts government accountability and informed decision-making. Moreover, concerns about the sustainability of key government programs are widespread. The longer-term impacts of the sovereign debt crisis and other challenges faced by governments (particularly around demographics and aging populations) emphasize the ongoing urgent need to strengthen the quality of financial management in governments around the world.

Accounting standards can lead to improved quality of financial reporting, which has the potential to improve decision-making in the public sector. The increasing complexity of public sector finances, together with a greater focus on the quality of public financial management, has increased demand for high-quality standards and guidance on how to adopt and implement such standards. Adoption of IPSAS is a fundamental step that governments can take to improve financial reporting and PFM because IPSAS-based information provides a comprehensive picture of their financial performance and position.

The IPSASB is therefore committed to developing high-quality public sector accounting standards to support high-quality financial reporting. In doing this, the IPSASB's standard setting program helps increase confidence from citizens and financial markets in public institutions, which is key to economic and social stability. The application of IPSAS also facilitates governments and other public sector entities being more accountable to their citizens, and so enhances global fiscal stability, sustainability, and accountability.

These strategic considerations raise a number of challenges for the IPSASB to address during the period 2019–2023, including:

- The key gaps remaining in its public sectors specific standards and literature;
- Certain IPSAS are not up to date with the latest version of the IFRS equivalent;
- The accessibility of financial statements for non-specialist users, and civil society in general, needs improvement;

- Capacity constraints impact on the ability of many jurisdictions to undertake accrual transition projects which limits the pace of adoption. Promotion of, and support for, accrual adoption and IPSAS implementation, both in individual jurisdictions and globally, needs to be enhanced;
- The vision for, and guidance on using accrual information to strengthen PFM needs further development, as does the evidence base for such reforms; and
- Considering how the IPSASB can further help constituents actively contribute to its standard setting and other work going forward.

These challenges have all shaped the IPSASB's proposed Strategy and Work Plan for the period 2019–2023. ■

The IPSASB's Proposed Strategic Objective and Strategic Themes 2019–2023

- The overarching Strategic Objective that the IPSASB proposes to adopt for 2019–2023 refines the one currently in use in order to provide a sharper focus for its future work.

Strengthening Public Financial Management (PFM) globally through increasing adoption of accrual-based IPSAS.

Delivered through two main areas of activity, both of which have a public interest focus:

- Developing IPSAS and other high-quality financial reporting guidance for the public sector; and
- Raising awareness of IPSAS and the benefits of accrual adoption.

Specific Matter for Comment 1

Do you agree with the IPSASB's proposed Strategic Objective 2019–2023? If you agree please provide any additional reasoning not already discussed in the document. If you do not agree please explain your reasoning and your proposed alternative.

- In order to focus its work across these two areas of activity, the IPSASB proposes to base its Work Plan on five Strategic Themes:
    - Strategic Themes A through C address the development and maintenance of standards and other forms of guidance; and
    - Strategic Themes D and E focus on raising IPSAS awareness and promoting their adoption, as well as providing greater clarity over how the IPSASB plans to influence the work of others in strengthening PFM.

Developing IPSAS and other high-quality financial reporting guidance for the public sector

Theme A: Setting standards on public sector specific issues	As the global public sector accounting standard setter acting in the public interest, the IPSASB proposes that the majority of its efforts should continue to focus on this Theme in order to address key public sector specific reporting issues not already addressed by IPSAS. The Conceptual Framework will be used as a basis for addressing these challenging public sector reporting issues. In addition, the IPSASB's policy to reduce unnecessary differences with Government Finance Statistics (GFS)[4] will also be integral to its work. The IPSASB believes this is the main area where it can add value, as the issues under this theme have not been addressed by other standards setters and are important to users of financial statements in the public sector.
Theme B: Maintaining IFRS convergence	IFRS convergence has been a key pillar of IPSAS development since the inception of the standards program in 1997. In many instances, government activities are the same as corporate activities and so there are advantages for citizens and constituents in reporting such activities using common global financial reporting approaches where this is appropriate. The IPSASB's approach to using IASB literature where relevant[5] allows it, as a volunteer board with a small staff team, to develop standards efficiently that address the needs of public sector users. Its policy on reducing unnecessary GFS differences is also relevant to work under this theme.
Theme C: Developing guidance to meet users' broader financial reporting needs	The IPSASB recognizes that the characteristics of the public sector mean that user needs may not always be satisfied by the financial statements alone. Therefore, it has developed guidance on broader financial reporting (Recommended Practice Guidelines 1–3[6]), where specific public interest needs have been identified. The IPSASB will continue to monitor user needs as well as emerging issues and relevant work by other standard setters in the broader financial reporting space.

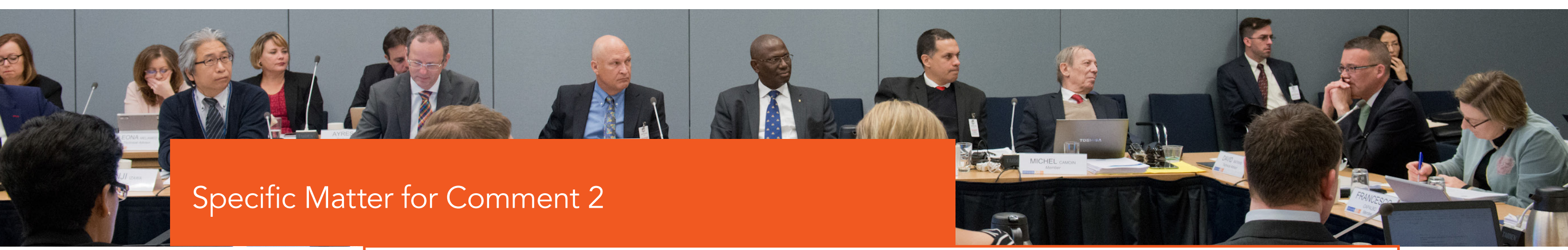
4 The IPSASB considers opportunities to reduce unnecessary differences with GFS in all projects to develop standards and guidance. For further details please see the IPSASB's *Process for Considering GFS Reporting Guidelines during the Development of IPSASs*.

5 The IPSASB also considers relevant IASB literature as part of its projects. For further details please see the IPSASB's *Process for Reviewing and Modifying IASB Documents*.

6 The IPSASB has developed three Recommended Practice Guidelines (RPGs), which are pronouncements that provide guidance on good practice in preparing general purpose financial reports (broader financial reporting) that are not financial statements. The following RPGs have been developed: RPG 1, *Reporting on the Long-Term Sustainability of an Entity's Finances*, RPG 2, *Financial Statement Discussion and Analysis* and RPG 3, *Reporting Service Performance Information*.

Raising awareness of IPSAS and the benefits of accrual adoption

Theme D: Promoting IPSAS adoption and implementation	Promoting and encouraging the adoption and implementation of IPSAS is in the public interest as it can lead to improvements in public sector financial reporting globally, which benefits users by providing greater transparency and provides information to inform better decision-making and accountability. The IPSASB therefore has a very active approach to outreach[7], enabling it to engage in a global dialogue with constituents on the adoption and implementation of IPSAS.
Theme E: Advocating the benefits of accrual in strengthening PFM	The IPSASB's view is that the use of accrual information provides the foundation for strong PFM. In furthering its Strategic Objective, the IPSASB works with other professional groups and sponsoring organizations to help develop the understanding of the PFM benefits of IPSAS adoption in improving transparency, accountability and decision-making.



Specific Matter for Comment 2

Do you agree with the IPSASB's five proposed Strategic Themes for the 2019–2023 period? If you agree please provide any additional reasoning not already discussed in the document. If you do not agree please explain your reasoning, including any proposed alternatives.

- The next section discusses the IPSASB's proposed Work Plan 2019–2023 in support of each of these Strategic Themes.

7 IPSASB members and staff undertake a considered and active constituent engagement strategy, including personal appearances, participation in discussion groups and forums, as well as using webinars and other methods of electronic communication, to inform and engage on various technical topics.

Proposed Work Plan 2019–2023

Developing IPSAS and other high-quality financial reporting guidance for the public sector

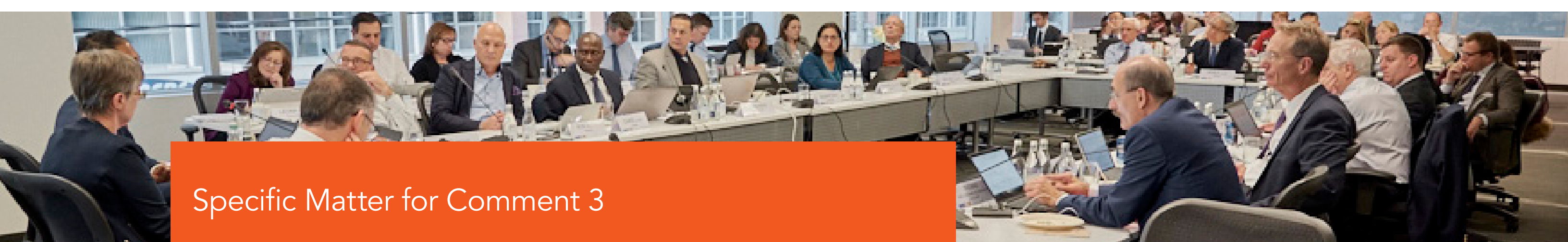
Themes A, B and C relate to the IPSASB's central role as a standard setter, and are therefore where it has prioritized specific projects that it proposes to add to the Work Plan 2019–2023.

Criteria for project prioritization

In selecting the projects under each Theme, the IPSASB has evaluated a list of potential projects against the following criteria in order to help assess which projects would provide the greatest public interest benefits to users:

1. ***Prevalence.*** Whether the financial reporting issue is widespread amongst public sector entities.
2. ***Consequences.*** Whether the issue impairs the ability of the financial statements to provide useful and transparent information for accountability and decision-making.
3. ***Urgency.*** Whether the emerging issue has recently gained significance and therefore requires consideration in the near term.
4. ***Technical and Resource Considerations.*** Whether a technically sound solution to the issue can be developed within a reasonable time period using available resources.

The above factors were considered together in the context of the resources available to the IPSASB, and the need for a balanced Work Plan that includes projects with a mix of complexities.



Specific Matter for Comment 3

Do you agree with the criteria the IPSASB has used in deciding the proposed issues to add to its Work Plan 2019–2023? If you agree please provide any additional reasoning not already discussed in the document. If you do not agree please explain why, including any proposed alternatives.

Theme A: Setting standards on public sector specific issues

- The IPSASB's primary focus recently has been in developing public sector specific standards as this is the area of main concern of users.

Public sector specific projects are a major area of the IPSASB's current and future work.

Current public sector specific projects

- Social Benefits—relate to key social programs, for example old age pensions and unemployment benefits and make up a significant proportion of public sector expenditure. The lack of international guidance on accounting for social benefits creates a public interest deficit. Information about social benefits can form a key input to the assessment of the sustainability of government services;
- Non-exchange expenses—relate to some of the most important areas of government and public sector entities' activity, such as universally accessible services including education and health care and collective services such as defense spending. Public sector transactions that give rise to non-exchange expenses are numerous and financially significant. The lack of international guidance on the recognition and measurement for non-exchange expenses creates a public interest deficit as it leads to inconsistent reporting;
- Revenue—the current IPSAS exchange revenue standards (IPSAS 9 and 11) are converged with IASB standards that have been superseded by the publication of IFRS 15, *Revenue from Contracts with Customers*, which provides the IPSASB an opportunity to update these standards. In addition, the approach in IFRS 15 has provided the IPSASB with an impetus to consider its approach to non-exchange revenue transactions and to address practical issues that have emerged in the application of IPSAS 23;
- Public Sector Measurement—translating the principles in the Conceptual Framework on measurement into more detailed guidance across the suite of IPSAS will help to ensure comparability and the assessment of value for money in the management of public sector assets and liabilities;
- Heritage—providing information on heritage items is in the public interest as it promotes effective management and preservation of such items for future generations; and

- Infrastructure Assets—citizens rely on such assets which are extensive in the public sector. The lack of specific guidance on the recognition and measurement of these assets causes practical difficulties for preparers (particularly those in the process of adopting IPSAS).

New public sector specific projects prioritized for inclusion in the 2019–2023 Work Plan

All potential projects have been assessed against the project prioritization criteria. The projects below are proposed because they provide the greatest public interest benefits. Appendix A provides summaries of the other potential projects that the IPSASB has considered, but not currently prioritized for inclusion in the Work Plan.

Natural Resources. The issue of accounting for natural resources in the public sector is prevalent in many jurisdictions. Governments often have little idea of the monetary value of natural resources until after they are extracted. However, the rights to extract such resources are often granted beforehand to third parties who then profit from their extraction. From a public interest perspective, this is an important issue, particularly in jurisdictions with resource-based and resource rich economies because the recognition and measurement of these assets impact their management and the benefits derived by citizens from their extraction. This project would not only have regard to extractive resources, but would also consider broader natural resources, such as water, natural phenomena and living species.

Discount Rates. Since the global financial crisis, the topic of discount rates used in the measurement of long-lived assets and liabilities with long settlement dates has been a public interest concern for constituents because of the low and negative interest rate environments around the world. Although discount rates are addressed in IPSAS, some constituents argue that the low/negative interest rate environment results in an increased impact on the statement of financial position which may not appropriately recognize the time value of money, which may promote suboptimal decision-making not in the public interest. The project would therefore have a strong linkage with the current Public Sector Measurement project, and would consider the conceptual basis for existing requirements for discounting across the suite of IPSAS as well as the consistency of those existing requirements.

Differential Reporting. Some constituents advocate the development of a less complex set of requirements for small and medium sized public sector entities, with generally simple transactions, for which full IPSAS requirements are too onerous. The lack of differential reporting options may be increasing the cost of adopting IPSAS and therefore creating a barrier to adoption. From a public interest perspective, consideration of the issue of differential reporting is one that may help alleviate capacity issues of governments adopting and implementing IPSAS. However, this needs to be considered in the context of the nature of the public sector, because even small and medium sized entities need to be accountable to constituents for their use of public funds.

Conceptual Framework limited-scope review. The IPSASB developed its own Conceptual Framework as the primary basis for its future standard setting activities. In finalizing its Framework in September 2014, it drew on relevant parts of the IASB's Framework at that point. The impending revisions to the IASB's Framework have therefore increasingly raised questions about whether the relevant aspects of the IPSASB's own Conceptual Framework should be revised. This project would therefore evaluate the changes made to the IASB's Conceptual Framework, and their relevance to the public sector. Linked to this work, the IPSASB also proposes to evaluate the need for changes to its literature in light of the IPSASB Conceptual Framework chapters on Elements and Recognition in Financial Statements. ■

Specific Matter for Comment 4

Do you agree with the projects that the IPSASB proposes to prioritize for addition to the Work Plan 2019–2023 on Theme A: *Setting standards on public sector specific issues (Natural Resources, Discount Rates, Differential Reporting and Conceptual Framework limited-scope Review)*? If not please explain your reasoning, and any proposed alternatives.

Theme B: Maintaining IFRS convergence

The IPSASB proposes to continue to work to maintain convergence with IFRS.

The IPSASB believes that maintaining convergence with IFRS is in the public interest for the following reasons:

- Common language. Global public sector standards should have consistent principles and accounting outcomes when the economics of transactions are the same.
- Mixed Group Consolidations[8]. Different requirements are costly to those applying IPSAS when there is no public sector specific reason to develop different accounting treatments. Therefore, reducing unnecessary differences minimizes the cost of developing consolidated financial statements.
- Leveraging Resources. When the transactions are the same in the public and private sector, it makes sense for the IPSASB to build off the best practices in private sector reporting and develop a converged standard.

The publication of IPSAS 39, *Employee Benefits* is a recent example of the IPSASB's work to maintain convergence with IFRS.

8 Mixed group consolidations are when the public sector consolidates entities it controls which apply private sector accounting standards such as IFRS.

This replaced an older version of the standard and notably eliminated options for accounting for actuarial gains and losses. The IPSASB has also completed a number of minor improvements projects.

Current active projects to maintain convergence following the issue of new IFRSs are:

- Financial Instruments (IFRS 9);
- Revenue (IFRS 15); and
- Leases (IFRS 16).

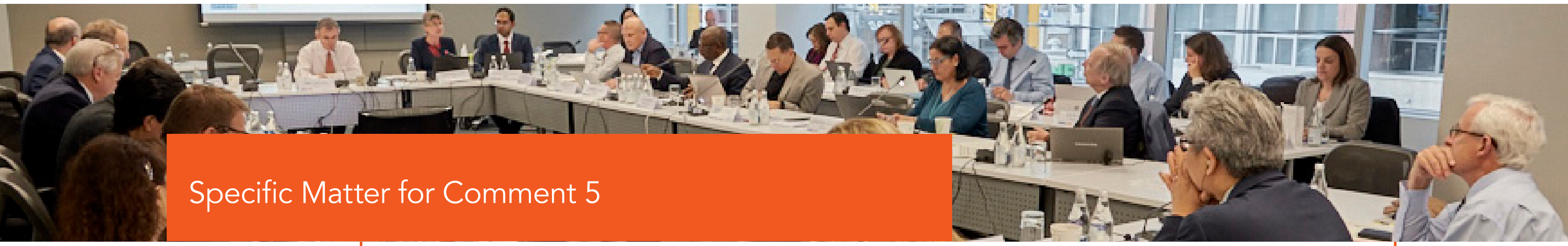
Despite these projects, a number of IPSAS remain based on older versions of IFRS. The next few years present a 'catch up' opportunity as a result of the IASB 2017–2021 Work Plan, where the focus is on completion of large-scale standard setting projects, while not undertaking any new major projects.

The IPSASB has identified a number of possible projects, categorized as major projects, narrow scope projects and minor improvements. Through applying the project prioritization criteria the IPSASB identified the following major project for inclusion in the Work Plan 2019–2023:

IPSAS 18, *Segment Reporting*. Concerns have been raised about the usefulness of the reporting requirements in IPSAS 18. There are two aspects to this potential project. Firstly, IPSAS 18 is based on IAS 14 *Segment Reporting* and this has been superseded by IFRS 8 *Operating Segments*. Secondly, the need for this project has been raised by constituents who have identified concerns with the quality and usefulness of IPSAS 18. These constituents urged the IPSASB to consider convergence with IFRS 8 and its applicability to public sector entities, as well as the potential to increase the usefulness of information for GFS.

In managing its Work Plan, the IPSASB will also aim to incorporate narrow scope convergence projects, based on the consideration of the availability of agenda time and staff resources[9], as well as the overall mix of complex projects dealing with public sector issues. The IPSASB will consider the potential public interest benefits of undertaking a particular project against the project evaluation criteria proposed above, and in terms of the overall balance of the Work Plan. It will also undertake regular minor improvements projects in order to address issues identified with current IPSAS as well as to incorporate relevant minor changes to IASB literature.

Detailed information related to each of the potential major projects not currently prioritized for inclusion in the 2019-23 Work Plan is provided in Appendix A. ■



Specific Matter for Comment 5

Do you agree with the project that the IPSASB proposes to prioritize for addition to the Work Plan 2019–2023 on Theme B: *Maintaining IFRS convergence* (IPSAS 18, *Segment Reporting*)? If not please explain your reasoning and any proposed alternatives.

9 The IPSASB may leverage staff resources of National Standard Setters when available to work on such IFRS narrow scope convergence projects.

Theme C: Developing guidance to meet users' broader financial reporting needs

The IPSASB proposes to monitor developments in this area rather than to undertake any specific projects.

The IPSASB has developed the following non-mandatory guidance addressing broader financial reporting needs that cannot be satisfied through general purpose financial statements alone:

- RPG 1, *Reporting on the Long-Term Sustainability of an Entity's Finances*;
- RPG 2, *Financial Statement Discussion and Analysis*; and
- RPG 3, *Reporting Service Performance Information*.

The IPSASB proposes that its main efforts during the first part of the 2019–2023 period be primarily focused on addressing public sector specific issues and to a lesser extent on maintaining convergence with IFRS. Given resource limits the IPSASB is not currently proposing to add any specific projects to the Work Plan during 2019–2023 period related to Theme C. However, it will consider whether to undertake any further work on long term financial sustainability in the light of constituent responses to ED 63 on Social Benefits.

In the interim, it will actively monitor developments in the broader narrative reporting area. Specifically, it proposes to consider the progress of the work related to Integrated Reporting <IR>, the Corporate Reporting Dialogue and the IASB's project on *Better Communication in Financial Reporting*, and become involved to the extent that this seems appropriate and necessary.

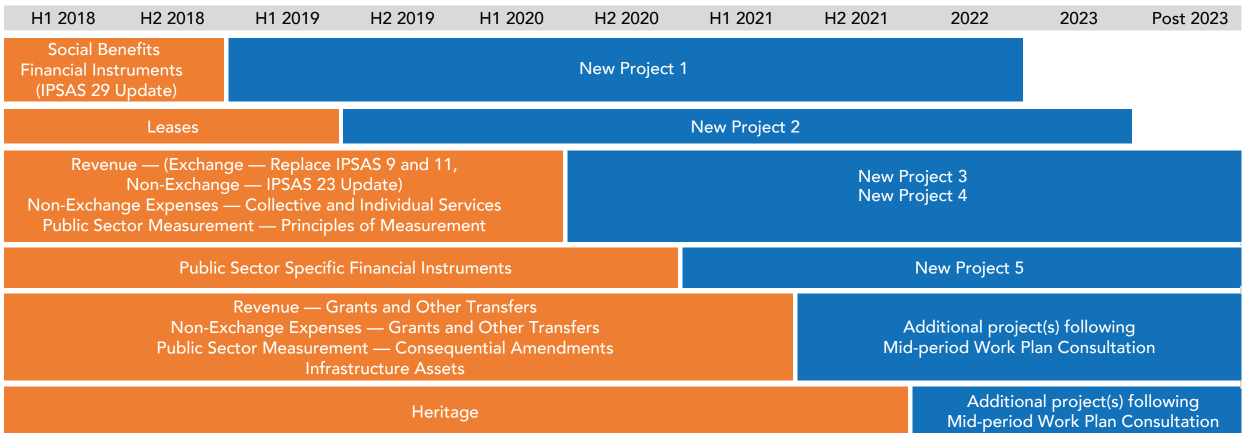
Project phasing and mid-period Work Plan update

The IPSASB will start the proposed new projects on a phased basis, with a mid-period consultation on project priorities in 2020.

The IPSASB proposes that the projects proposed under Themes A and B be prioritized for addition to the Work Plan 2019–2023 as the projects in the current Work Plan are completed and capacity becomes available. The IPSASB will undertake initial research phases for each project, to ensure it understands the scope of public sector issues and the resource requirements, as well as what the intended output is in terms of standards and/or guidance. To ensure that the IPSASB operates in the public interest of its constituents, it is important that it undertakes this initial research phase before initiating full projects.

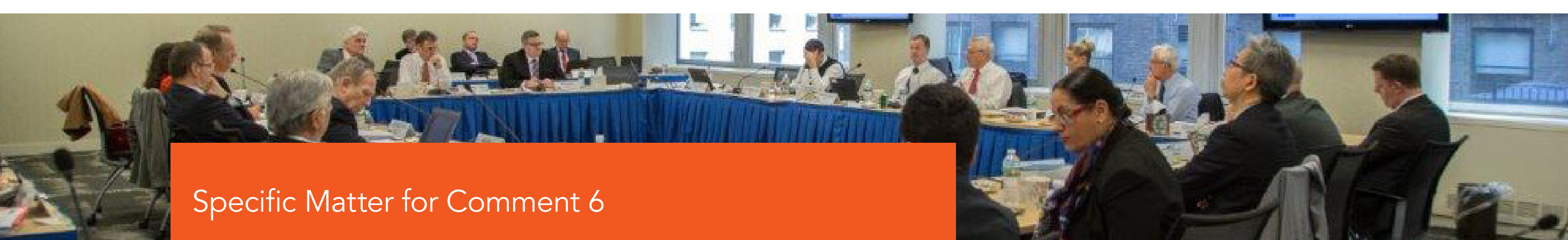
Anticipated progress with the IPSASB's current projects should mean that the proposed new projects are expected to commence progressively from 2019 onwards as shown in figure 2. The IPSASB will decide the order in which the specific new projects start, based on input from constituents, and in the light of its assessment of the priorities and resources at the relevant points in time.

Figure 2: Current Projects and Proposed Additions to the Work Plan 2019–2023



Note: Projects in orange represent current ongoing IPSASB projects, projects in blue represent those proposed for addition to the Work Plan 2019–2023. The bars represent the expected timing of completion for all ongoing projects, and the expected commencement and completion for new projects.

Although the Strategy and Work Plan is intended to remain in place throughout the period 2019–2023, the IPSASB is conscious that new reporting issues may emerge during that period, and that it will need to review priorities in the light of progress and evolving priorities. It therefore plans to hold a limited-scope public consultation during 2020 in order to obtain external input to its own ongoing consideration of these matters. In particular, the IPSASB may consider the addition of a specific Theme C project in the light of developments in the interim, the relative priority against other potential projects under Strategic Themes A and B, and available resources. ■



Specific Matter for Comment 6

Are there any projects in Appendix A that you believe should be added to the Work Plan 2019–2023 in place of a currently proposed project? If you believe that any Appendix A projects should be added, please explain your views on why the project should be included, which proposed project should not then be started and your reasoning.

Raising awareness of IPSAS and the benefits of accrual adoption

- The IPSASB sees the work related to raising awareness of IPSAS and the benefits of accrual adoption as a critical contribution to PFM reform. Given the complexity of the PFM landscape, and its own resource limitations, the IPSASB's view is that building relationships with those working in this space and engagement in their work is the most effective way of promoting the use of IPSAS in PFM reform projects. The IPSASB will therefore actively monitor the work of others in the PFM arena and look for appropriate opportunities to support their work on the international, regional and local levels through its Members, Technical Advisors, Staff and IPSASB Alumni.

The IPSASB recognizes that in some jurisdictions the public sector accounting expertise needed to implement IPSAS is limited. Further, ensuring that those using the standards understand the information being communicated is an ongoing challenge. The IPSASB responds to these challenges through its outreach activities which aim to influence others working in the wider PFM space to ensure activities are coordinated and the needs of jurisdictions are considered.

Theme D: Promoting IPSAS adoption and implementation

The PFM reform landscape within individual jurisdictions is complex, and the IPSASB's role is more limited than others groups, as shown in the table below.

Type of support	Entity Staff	Consultants / Contractors	Supranational and regional organizations	IPSASB
Promotion	✓	✓	✓	✓
Technical Guidance	✓		✓	✓
Financial	✓		✓	
Practical / Technical	✓	✓	✓	
Capacity Development	✓	✓	✓	

Promotion

The IPSASB's resources limit the extent to which it can promote IPSAS in individual jurisdictions. However, it has an active outreach program focused on speaking at conferences and attending key local meetings in support of the work of local adopters and implementers. Given the recent global momentum in the adoption of IPSAS, and indications that this momentum will continue in the 2019–2023 period, it is important that the IPSASB Chair, Board Members, Technical Advisors and Staff continue their program of outreach and engagement in order to support the efforts of:

- Those contemplating adoption and implementation;
- Those already in the process of adopting and implementing; and
- Those who have adopted and implemented.

Direct engagement is key because the needs of constituents differ depending on their progress on adoption.

The IPSASB's outreach activities in promoting adoption and implementation also present an opportunity to learn about issues that are important to users. This important feedback mechanism can identify public sector specific issues and areas for further IFRS convergence or other broader financial reporting needs that should be addressed in the future.

Technical Guidance

The IPSASB has recently updated its Cash Basis IPSAS, which sets out requirements for public sector entities reporting under the cash basis of accounting, in order to remove obstacles to adoption encountered in practice. In doing so, it has also clarified that it sees the Cash Basis IPSAS as a step on the path to adoption of the accrual basis, rather than an end in itself.

In order to support accrual adoption, the IPSASB has issued *Study 14: Transition to the Accrual Basis of Accounting: Guidance for Public Sector Entities*. Study 14 is a practical tool to help with common challenges encountered in the transition to accrual accounting and draws upon the experiences of jurisdictions that have been through the transition already. Since the issuance of the current version in 2010, the IPSASB proposes that it should be updated to reflect changes in the IPSAS suite of standards, as well as to include further best practice examples from recent experiences of those transitioning to accrual-based IPSAS.

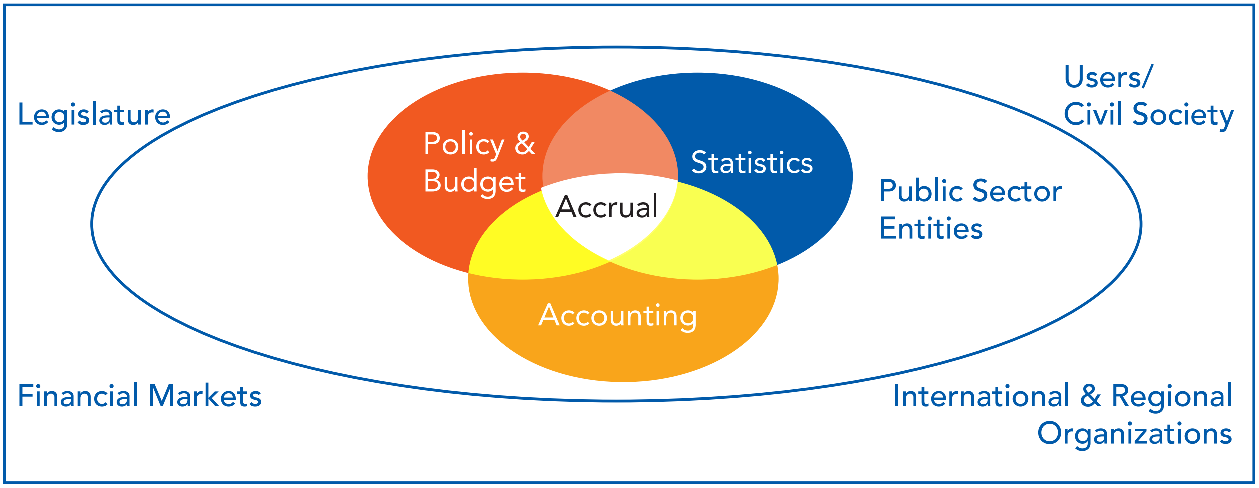
The IPSASB has recently increased its level of support for the implementation of new IPSAS through:

- Developing 'At A Glance' summaries for all significant IPSAS publications and pronouncements;
- Providing webinars on significant consultations and final pronouncements;
- Publishing an annual Handbook, which is a one stop shop to all of the IPSASB's current pronouncements;
- Issuing Staff Questions and Answers (Q & A) publications highlighting aspects of IPSASB's suite of standards which are relevant to implementation, such as the recent Q & A on Materiality; and
- Creating training materials as well as delivery of limited training activities to support IPSAS understanding. ■

Theme E: Advocating the benefits of accrual in strengthening PFM

Moving to IPSAS provides many benefits, including contributing to the delivery of Sustainable Development Goals. In order to maximize these benefits, the IPSASB believes that accrual-based information should be used for as many purposes as possible. Figure 3 illustrates the various potential users of, and the variety of uses for, accrual information in PFM.

Figure 3: Uses/Users of accrual in PFM



Other international and regional organizations provide guidance and thought leadership, or otherwise influence the use of accrual information in these broader areas of PFM. The IPSASB believes it is important to build relationships with these organizations, so that its accrual accounting expertise is drawn upon by them, in order to expand the use of accrual information for PFM purposes, and to increase the alignment between the requirements of these different user groups. In turn, their knowledge and expertise can influence the IPSASB's own work. In many cases, the IPSASB already has relationships with these organizations through its oversight and advisory structures as well as through their Observer roles on the IPSASB.

Recently the IPSASB has worked to establish more formal outreach opportunities and has actively participated in forums in this area, such as:

- The annual Organisation for Economic Co-operation and Development (OECD) Public Sector Accruals Symposium;
- Engagement with the Government Finance Statistics (GFS) Community through participation in the IMF GFS advisory committee;
- Participation in the joint IMF/World Bank/IPSASB Seminar: Transparency and Beyond: Harnessing the Power of Accrual in Managing Public Finances;
- World Bank Governance Forum; and
- Various activities and engagement with the International Organisation of Supreme Audit Institutions (INTOSAI).

The IPSASB believes that its advocacy work in the area of increasing the use of accrual in PFM should be taken forward through:

- Further work with the GFS community on reducing unnecessary differences between IPSAS and GFS in order to facilitate the use of IPSAS data for GFS purposes, and in turn its use in supporting budgetary and macroeconomic policy decisions;
- Participating in international and regional organization-sponsored PFM-related events;
- Participation in training and other 'internal' events for these organizations' staff in order to raise awareness and disseminate knowledge of IPSAS;
- Commenting on guidance and thought leadership papers during their development; and participation in relevant working groups. ■

Specific Matter for Comment 7

The IPSASB views building relationships with those working in the PFM space and engaging in their work as critical to furthering the use of IPSAS in PFM reform projects. Therefore, under Themes D and E, the IPSASB will actively monitor the work of others and look for appropriate opportunities to engage and support that work.

– Do you agree with the IPSASB's proposed approach under these Themes? If so, are you aware of any ongoing initiatives which the IPSASB should monitor and look to engage with (please provide details).

– If you do not agree, please explain your reasoning along with any proposed alternatives, and how those might be resourced.

Managing Strategy Delivery and Work Plan Output Quality

IPSAS support high-quality financial reporting for the public sector globally because they are:		
Internationally recognized	Designed specifically for the public sector	Developed independently through a rigorous due process

The proposed Strategy and Work Plan 2019–2023 is ambitious, and will draw on the full capacity of the IPSASB to continue to deliver high-quality standards in a timely manner. The IPSASB's current capacity includes:

- Seventeen volunteer members and a remunerated independent Chair who collectively commit approximately 13,000 hours of time annually.[10]
- An experienced full-time technical and administrative team of eight staff, with the IPSASB's administrative structures and processes facilitated by IFAC.
- An annual operating budget[11] that supports staffing, meeting, travel and other direct costs necessary for the IPSASB to be able to execute its Strategy and carry out its Work Plan.

Managing delivery of the IPSASB's Strategy and the high-quality of Work Plan outputs within these resource constraints, and with due consideration of the external context in which it operates, is a priority of the IPSASB leadership.

Key focus areas include:

International Recognition

- The strength of the IPSASB's reputation and global acceptance of the IPSAS—Managed through:
  - Ongoing commitment to ensuring both the quality and timeliness of delivery of new standards. This includes developing high-quality principle-based standards that are usable and provide users with information that is relevant and faithfully representative;
  - Appointments through the independent nominations process which provide a diverse mix of IPSASB members, with the requisite skills, resources and capacity to contribute to the projects on the Work Plan; and
  - Attracting, developing and retaining diverse, knowledgeable and highly qualified staff.

10 In addition, most IPSASB members are aided by technical advisors.

11 The IPSASB receives support from the Asian Development Bank, the Chartered Professional Accountants of Canada, the New Zealand External Reporting Board, and the governments of Canada and New Zealand. The structures and processes that support the operations of the IPSASB are facilitated by the International Federation of Accountants (IFAC).

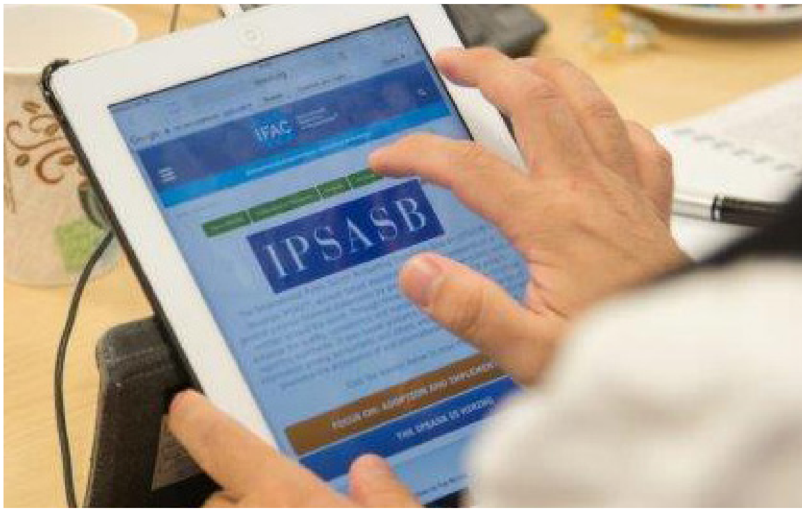
Public Sector Specific

- Relevance and focused on key public sector specific issues—Managed through:
  - Collaborating with national public sector accounting standard setting boards and the IASB to leverage their work and resources, including staff support when possible;
  - Use of task forces and task based groups to aid in standards development work; and
  - Optimizing IPSASB plenary time, balancing debates on both strategic and technical considerations, and continuous improvement of effective and issues-focused material.

Rigorous Due Process

- Strong public interest focus—Managed through:
  - Clearly documented processes reviewed and overseen by the PIC;
  - Formal public consultations at ED stage (and CP stage where appropriate);
  - A close and active governance dialogue with the PIC and the IPSASB CAG. Including a focused responsiveness to their advice, observations, and recommendations and a steadfast commitment to developing high-quality standards in the public interest.
- Operational effectiveness and stability—Managed through:
  - Organizing and conducting IPSASB meetings and other activities in the most effective, efficient and timely way;
  - Using the IPSASB, staff and other resources in a focused and effective manner; and
  - Maintaining relationships with existing funders, and ongoing consideration of additional approaches to increase and broaden funding base.
- Robust outreach and communication with constituents—Managed through:
  - Development and release of supporting communication material, such as 'At a Glance' and Q&A documents, webinars and podcasts, for example when addressing complex issues;
  - An extensive Chair, member and staff outreach program;
  - Platforms such as the Public Sector Standard Setters Forums to discuss national issues of international relevance; and
  - Use of technology to make meetings accessible, such as live streaming key sessions when possible.

The IPSASB will continue to monitor external developments and evaluate how changes may impact its approach to delivery of its Strategic Objective. This includes monitoring the growth of demands on the IPSASB as the adoption and implementation of IPSAS increases. ■



Requests for Comments

- This Consultation, *IPSASB Strategy and Work Plan 2019–2023*, was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The proposals in this Consultation document may be modified in light of comments received before being issued in final form. **Comments are requested by June 15, 2018.**

Respondents are asked to submit their comments electronically through the IPSASB website, using the "Submit a Comment" link. Please submit comments in both a PDF ***and*** Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. This publication may be downloaded from the IPSASB website: www.ipsasb.org. The approved text is published in the English language.

Specific Matters for Comments

Specific Matter for Comment 1
Do you agree with the IPSASB's proposed Strategic Objective 2019–2023? If you agree please provide any additional reasoning not already discussed in the document. If you do not agree please explain your reasoning and your proposed alternative.

Specific Matter for Comment 2
Do you agree with the IPSASB's five proposed Strategic Themes for the 2019–2023 period? If you agree please provide any additional reasoning not already discussed in the document. If you do not agree please explain your reasoning, including any proposed alternatives.

Specific Matter for Comment 3
Do you agree with the criteria the IPSASB has used in deciding the proposed issues to add to its Work Plan 2019–2023? If you agree please provide any additional reasoning not already discussed in the document. If you do not agree please explain why, including any proposed alternatives.

Specific Matter for Comment 4
Do you agree with the projects that the IPSASB proposes to prioritize for addition to the Work Plan 2019–2023 on Theme A: *Setting standards on public sector specific issues (Natural Resources, Discount Rates, Differential Reporting and Conceptual Framework limited-scope Review)*? If not please explain your reasoning, and any proposed alternatives.

Specific Matter for Comment 5
Do you agree with the project that the IPSASB proposes to prioritize for addition to the Work Plan 2019–2023 on Theme B: *Maintaining IFRS convergence* (IPSAS 18, *Segment Reporting*)? If not please explain your reasoning, and any proposed alternatives.

Specific Matter for Comment 6
Are there any projects in Appendix A that you believe should be added to the Work Plan 2019–2023 in place of a currently proposed project? If you believe that any Appendix A projects should be added, please explain your views on why the project should be included, which proposed project should not then be started and why.

Specific Matter for Comment 7

The IPSASB views building relationships with those working in the PFM space and engaging in their work as critical to furthering the use of IPSAS in PFM reform projects. Therefore, under Themes D and E, the IPSASB will actively monitor the work of others and look for appropriate opportunities to engage and support that work.

– Do you agree with the IPSASB's proposed approach under these Themes? If so, are you aware of any ongoing initiatives which the IPSASB should monitor and look to engage with (please provide details).

– If you do not agree, please explain your reasoning along with any proposed alternatives, and how those might be resourced.

Strategy and Work Plan Consultation Timeline

Month/Year	Activity
January 2018	Issue Consultation Document
February 2018-June 2018	Roundtables and IPSASB member outreach
September 2018	Review responses / Draft Strategy Development
December 2018	Approve final Strategy and Work Plan 2019–2023
January 2019	Publish Strategy and Work Plan 2019–2023
2019–2023	Implement Strategy and Work Plan 2019–2023

Appendix A: Projects Considered but not Prioritized for the IPSASB Work Plan 2019–2023

This appendix outlines projects that have been considered for the Work Plan 2019–2023 but have not currently been prioritized for inclusion. Although these projects have not been included at this time, they will be considered and evaluated when future Work Plan consultations are undertaken. The IPSASB intends to undertake a mid-term Work Plan consultation in 2020.

Theme A: Setting standards on public sector specific issues

Intangible Assets–Public Sector Specific

Responses to the October 2012 Consultation Paper, *IPSAS and Government Finance Statistics (GFS) Reporting Guidelines*, highlighted the view that differences remain between IPSAS and GFS on the treatment of costs related to research and development (R&D). IPSAS 31, *Intangible Assets*, is based on IAS 38, *Intangible Assets*, which has rigorous requirements for the recognition of intangibles. Some constituents question if research has different objectives in the public sector that justify capitalization prior to the development stage under specific circumstances. Some also note that this project is related to the project below on *Sovereign Powers and their Impact on Financial Reporting*.

Sovereign Powers and their Impact on Financial Reporting

This potential project was identified during development of the Public Sector Conceptual Framework. Governments are unique in that they have a number of sovereign powers, for example, the power to levy taxes and to issue permits, concessions and licenses. Some constituents have questioned whether a government's sovereign powers are intangible assets that should be recognized and measured in the financial statements.

Military Assets

IPSAS 17, *Property, Plant, and Equipment*, applies to specialist military equipment. These items or transactions usually account for a significant proportion of government expenditure. The IPSAS and Government Finance Statistics (GFS) project identified that guidance on the capitalization, classification and measurement of weapons and platforms would be helpful. This might lead to more uniform IPSAS application by governments and enhance consistency with GFS. One of the key aspects of the project is when to apply IPSAS 17 and when to apply IPSAS 12, *Inventories*. Another issue highlighted by constituents is the sensitivity of disclosing information on military assets.

Accounting for Tax Expenditures

IPSAS 23, *Revenue from Non-exchange Transactions (Taxes and Transfers)* has different requirements for tax expenses (benefits paid through the tax system, for example health insurance contributions) and tax expenditures (use of the tax system to encourage or discourage behaviors, for example allowing homeowners to deduct mortgage interest from gross income to reduce taxable income). IPSAS 23 requires taxation revenue to be presented net of tax expenditures. The treatment of tax expenditures raises a public interest concern because of the potential lack of transparency in the provision of tax concessions, which impairs the accountability of governments.

Asset Retirement Obligations

This project would consider the need for amendments to guidance related to legal and non-legally binding obligations for the decommissioning of tangible capital assets. This project would consider revisions to IPSAS 17, *Property, Plant, and Equipment* and IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* and would be informed by the Conceptual Framework.

IPSAS 22, Disclosure of Financial Information about the General Government Sector

IPSAS 22 was issued in December 2006. Since then there have been significant developments, including revisions to the GFS related pronouncements referenced in IPSAS 22. The Consultation Paper, *IPSASs and Government Finance Statistics (GFS) Reporting Guidelines*, outlined options for the future of IPSAS 22 given its very limited application (only one country is known to be applying IPSAS 22). Respondents' views on the future of IPSAS 22 were divided between the three options in the CP—withdraw, replace and revise. When IPSAS 22 was developed, it was noted that the benefits of applying IPSAS 22 might not exceed the costs for those governments that do not regularly report this information and it was on that basis that IPSAS 22 was not made mandatory. This project would identify revisions to IPSAS 22 arising from changes to GFS and barriers to implementation, and could build on changes in segment reporting requirements arising from the proposed revision of IPSAS 18. ■

Theme B: Maintaining IFRS convergence

IPSAS 1, Presentation of Financial Statements

IPSAS 1 is based on the December 2003 version of IAS 1 *Presentation of Financial Statements*. The IASB issued a revised version of IAS 1 in September 2007 which introduces other comprehensive income as a component of financial performance separate from profit or loss. There have been further subsequent amendments to IAS 1, notably in June 2011, and the IASB currently has a research project on the primary financial statements and an active project on materiality that has already resulted in a Practice Statement. Recent changes to IAS 1 have resulted from the IASB's ongoing Disclosure Initiative project. The chapter on Presentation in the IPSASB's Conceptual Framework completed in 2014, would also influence a future project to update IPSAS 1.

IPSAS 20, Related Party Disclosures

IPSAS 20, *Related Party Disclosures*, is based on the 1994 version of IAS 24, *Related Party Disclosures*. In 2009 the IASB issued a revised IAS 24 to simplify the definition of a "related party" and to provide a partial exemption from the disclosure requirements for some government-related entities. The structure and substance of IPSAS 20 differs significantly from IAS 24.

IFRS 5, Non-Current Assets Held for Sale and Discontinued Operations

The IPSASB has previously taken a view that the measurement requirements for non-current assets held for sale in IFRS 5 are not appropriate for the public sector. However, during the project to develop IPSAS 40, *Public Sector Combinations*, it was suggested that there may be a need to evaluate to the appropriateness of IFRS 5 to the public sector and that the IPSASB should undertake a convergence project.

IFRS 6, Exploration for and Evaluation of Mineral Resources

The IASB issued IFRS 6, *Exploration for and Evaluation of Mineral Resources*, as an interim standard until it develops a comprehensive standard for the exploration for and evaluation of mineral resources. IFRS 6 effectively allows an entity to continue to use the accounting policies applied immediately before the adoption of IFRS. Extractive industries are the exploration for, and discovery of minerals, oil and natural gas deposits, and the development and extraction of those deposits. The IPSASB has proposed that Natural Resources be included in the Work Plan 2019–2023. As a result of the interim nature as well the commercial focus of IFRS 6 the IPSASB will not converge with IFRS 6. However, IFRS 6 will be considered in the research phase to inform the IPSASB's work on this challenging topic.

IFRS 14, Regulatory Deferral Accounts

Rate regulation is the setting of customer prices for services or products often when an entity has a monopoly or dominant market position that gives it significant market power. In the public sector some controlled entities are subject to regulation, for example government owned telecommunications entities.

IFRS 14 is an interim standard while the IASB continues its project on Rate Regulated Activities. It is unlikely that the IPSASB would undertake a project on rate regulated activities until the IASB completes its project, as the impact of an IASB pronouncement on regulators would need to be assessed. If the IPSASB did initiate a project in this area, it would focus on governments and regulatory bodies that have rate regulatory powers.

IFRS 17, Insurance Contracts

IFRS 17 provides principle-based guidance to account for all types of insurance contracts. This is a topic with potential applicability in the public sector in areas such as export credit guarantees. However, to date the IPSASB has not identified a demand for an IPSAS, primarily drawn from IFRS 17 or a view that the absence of such an IPSAS creates a public interest deficit. The IPSASB included an optional insurance accounting approach in its ED 63, *Social Benefits* for those schemes which are fully funded and have the characteristics of insurance schemes and are managed like insurance contracts. This optional proposal for social benefits refers to an appropriate national or international insurance standard–IFRS 17 or a standard based on IFRS 17.

IAS 34, Interim Financial Reporting

A project on interim financial reporting would provide guidance on what should be included in interim reports. This project is likely to be most applicable for jurisdictions that have already adopted accrual-based IPSASs and so might result in the development of a Recommended Practice Guideline. The IASB provides non-mandatory guidance in IAS 34 and this might serve as the starting point. Issues that might need to be considered include whether full remeasurement of assets and liabilities is required at each interim reporting date. Only a limited number of jurisdictions produce interim accounts and it is questionable whether a public interest need exists related to this project. ■

Theme C: Developing guidance to meet users' broader financial reporting needs

Revising RPG 1, Reporting on the Long-Term Sustainability of an Entity's Finances

Since RPG 1 was issued the IPSASB has considered if such a report should be made mandatory. The ongoing Social Benefits project has highlighted the need for broader sustainability reporting, to complement information in the financial statements. Deteriorating public finances, ageing populations and low growth rates in many countries mean that the public interest benefits of this project are becoming more apparent. ED 63, Social Benefits asks constituents whether the IPSASB should initiate a project to make RPG 1 mandatory because of the broader financial reporting information needs related to Social Benefits. Depending on the ED 63 constituent feedback (comment period closes March 31, 2018), this project may be added to the Work Plan 2019–2023.

IASB Initiative—Better Communication in Financial Reporting

Borne out of the IASB's previous work related to its disclosure initiative, work in this area is based on the IASB's desire to make the communication of financial information more effective. The IASB's work related to this initiative relates to:

- Primary Financial Statements;
- Principles of Disclosure;
- Definition of Material;
- Materiality Practice Statement; and
- IFRS Taxonomy.

The IPSASB recently published a staff document: *The Application of the Concept of Materiality to the Preparation of Financial Statements* that provides reporting entities with guidance on making materiality judgments in the preparation of the financial statements. The IPSASB will monitor developments related to this IASB initiative to determine if outputs related to it may be applicable to improving financial communication in the public sector.

Defining Public Sector Key Financial Performance Indicators

Constituents argue that the benefits of accrual IPSAS are fully realized when the information is used to inform decision-making. The lack of defined key performance indicators for public sector entities is a limitation. Therefore a project that looks to identify and define such key performance indicators may enhance the power of accrual IPSAS and lead to better comparative information.

Public Sector Guidance for Cost Accounting

Cost accounting can benefit from high-quality accrual information. Guidance on cost accounting is important to PFM, because it is needed both to measure performance and to better evaluate if public sector entities are providing public services in an efficient manner. Some constituents consider there is a need for principles and a standardized methodology for cost accounting in order to promote better comparability of such information between entities and jurisdictions, with the aim of making better use of accrual information for management purposes. ■

Monitoring broader financial reporting initiatives

Integrated Reporting <IR>

In recent years alternative forms of broader financial reporting have emerged. In particular, <IR> is a process founded on integrated thinking that results in a periodic integrated report by an organization about value creation over time and related communications regarding aspects of value creation. An integrated report is a concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term. High-quality financial reporting is the foundation of an <IR> report and the work of the IPSASB can inform and enhance <IR>. Therefore it is important for the Board to monitor the work in this area.

Corporate Reporting Dialogue

The Corporate Reporting Dialogue (CRD) is an initiative designed to respond to market calls for greater coherence, consistency and comparability between corporate reporting frameworks, standards and related requirements. The IPSASB's constituents often raise similar concerns, which is why the IPSASB will continue to monitor CRD developments to assess their relevance to public sector financial reporting.

Global Reporting Initiative

The Global Reporting Initiative (GRI) helps businesses and governments worldwide understand and communicate their impact on critical sustainability issues such as climate change, human rights, governance and social well-being. This facilitates action to create social, environmental and economic benefits for everyone. The GRI Sustainability Reporting Standards are developed with multi-stakeholder contributions and rooted in the public interest. The GRI standards deal with issues that are of interest to the IPSASB's constituents and therefore the IPSASB will continue to monitor developments to consider their relevance to public sector financial reporting. ■

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Proposed Strategy and Work Plan

Proposed Strategy and Work Plan 2019–2023

Appendix B: Analysis of Potential Projects Against Selection Criteria

Potential Projects	Prevalence	Consequences	Urgency	Technical and Resource Considerations	Prioritized for Inclusion in the Work Plan 2019-2023
Theme A – Setting standards on public sector specific issues					
Natural Resources	In resource rich economies.	Currently the lack of guidance in this area impairs decision-making.	As IPSAS adoption increases.	Other standards setters have developed guidance in this space.	Yes
Discount Rates	Likely to impact on all reporting entities.	Significant to both balance sheet and performance statement. The principles underpinning IPSAS requirements and guidance are unclear and may not reflect current interest rate environment.	More urgent as a result of the current low/negative interest rate environment.	Other standard setters are undertaking work currently, which the IPSASB can draw on.	Yes
Differential Reporting	All jurisdictions that have entities of different sizes and complexities.	Will lead to more entities providing better financial information in a cost effective manner.	Identified as an issue impacting adoption and implementation of IPSAS.	Many standards setters have differential reporting models.	Yes

Potential Projects	Prevalence	Consequences	Urgency	Technical and Resource Considerations	Prioritized for Inclusion in the Work Plan 2019-2023
Limited Review of the Conceptual Framework	The Conceptual Framework underpins IPSAS standard setting activities.	The Conceptual Framework impacts on all IPSASB's standard setting activities and requirements and guidance in IPSAS.	IASB is expected to publish their revised Framework in Q1 2018. There will be issues not considered in the development of the IPSASB's Framework. Application of the IPSASB's Framework at standards level has also identified some issues which might justify minor revisions.	Feasible to consider minor changes based on items identified in applying the framework and arising from the IASB Framework when finalized.	Yes
Intangible Assets–Public Sector Specific	Expected to impact entities widely.	Questionable whether IPSAS 31, *Intangible Assets*, which is primarily drawn from IAS 38, *Intangible Assets*, provides relevant requirements for the recognition and measurement of some public sector specific intangible items.	Possibility that transactions and events potentially giving rise to public sector specific intangibles are increasing. However, IPSAS 31 provides guidance for such transactions and events.	Dependent on the current ongoing Measurement and Revenue projects. Strong links to the potential project on Sovereign Powers as that project would explore whether sovereign powers give rise to intangible assets. A further possible link to the proposed project on Natural Resources.	No

Potential Projects	Prevalence	Consequences	Urgency	Technical and Resource Considerations	Prioritized for Inclusion in the Work Plan 2019-2023
Sovereign Powers and their Impact on Financial Reporting	Expected to impact entities widely where public sector entities have sovereign powers.	Some question if public sector entities should be able to recognize assets related to sovereign powers (right to taxation, right to regulate). However, recognition of sovereign powers on their own was considered during the development of the IPSASB's Conceptual Framework and the decision was that sovereign powers on their own cannot be recognized as assets, because of the lack of a past event until the sovereign power is exercised and the rights exist to receive resources.	Unclear, some have identified addressing sovereign powers as an important issue. However, others consider that current IPSAS already appropriately address recognition and measurement of sovereign powers.	The IPSASB Conceptual Framework is clear that assets related to sovereign powers only arise when the power is exercised and the rights exist to receive resources. Therefore recognition of sovereign powers in themselves as assets does not appear feasible. There has not been an indication that the Conceptual Framework thinking in this area is flawed.	No

Potential Projects	Prevalence	Consequences	Urgency	Technical and Resource Considerations	Prioritized for Inclusion in the Work Plan 2019-2023
Military Assets	Mainly limited to national governments, but highly significant in terms of expenditure.	If IPSAS 12, *Inventories* and IPSAS 17, *Property, Plant, and Equipment* is applied appropriately military assets would be faithfully represented in the financial statements. Some question whether the disclosure requirements of IPSAS 17 are appropriate for military assets.	Not an emerging issue as IPSAS 12 and 17 set out requirements applicable for military inventory and property, plant and equipment. No evidence that existing requirements are flawed, although some would welcome greater clarity as to when IPSAS 12 and IPSAS 17 should be applied.	Would be dependent on the current Public sector Measurement Project, and the Infrastructure project might influence the approach and nature of output.	No

Potential Projects	Prevalence	Consequences	Urgency	Technical and Resource Considerations	Prioritized for Inclusion in the Work Plan 2019-2023
Accounting for Tax Expenditures	Limited to tax collecting entities.	A lack of transparency over tax expenditures provided by governments undermines the accountability of governments to resource providers.	Does not directly relate to the face of financial statements, but important accountability implications. These implications are increasing in some jurisdictions.	IPSASB's Revenue project is considering the accounting treatment of taxation revenue with long settlement dates. Might be appropriate to focus on taxation issues with impact on financial statements in 2019–2023 Work Plan, prior to reconsidering a project on Tax Expenditures as part of a review of RPG 2, *Financial Statement Discussion and Analysis*.	No

Potential Projects	Prevalence	Consequences	Urgency	Technical and Resource Considerations	Prioritized for Inclusion in the Work Plan 2019-2023
Asset Retirement Obligations (AROs)	Impact limited to those entities which engage in activities that impact the environment or are engaged in the management of assets, which will give rise to future remediation activities related to the asset or the natural environment in which the asset is operated.	If current IPSAS are applied AROs would be faithfully represented in the financial statements.	IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, which is primarily drawn from IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, provides requirements and guidance on the recognition of liabilities related to environmental remediation and decommissioning obligations. The Conceptual Framework may have significant implications for the recognition requirements in IPSAS 19, but there are no indications that there are flaws in current IPSAS 19 related to accounting for AROs.	Some standard setters have developed specific guidance for AROs. More specific guidance is feasible to develop, however, it is questionable if additional guidance is needed.	No

Potential Projects	Prevalence	Consequences	Urgency	Technical and Resource Considerations	Prioritized for Inclusion in the Work Plan 2019-2023
IPSAS 22, *Disclosure of Financial Information about the General Government Sector*	Reporting on the General Government Sector (GGS) is a key characteristic of the public sector. However, the low rate of adoption of this standard may question if this is a prevalent issue in a financial reporting context.	IPSAS 22 does provide additional information but its limited adoption does not appear to impair the use of financial statements for decision making.	Information on general government sector available through reporting outside the financial statements. The project to revise IPSAS 18, *Segment Reporting* may also address this.	IPSASB could draw upon current statistical guidance to review IPSAS 22.	No
Theme B – Maintaining IFRS convergence					
Update of IPSAS 18, *Segment Reporting*	Expected to impact entities widely.	IPSAS 18 is based on an old IASB standard. Indications received from preparers and IPSASB partners engaged in IPSAS implementation, are that IPSAS 18 does not provide useful information and is difficult to apply.	IPSAS 18 currently addresses segment reporting. However, in jurisdictions where IPSAS adopters also require for profit entities to apply IFRS, have identified a need for consistency between the public and private sectors.	The principles in IFRS 8, *Operating Segments* could be readily adapted through a convergence project for the public sector.	Yes

Potential Projects	Prevalence	Consequences	Urgency	Technical and Resource Considerations	Prioritized for Inclusion in the Work Plan 2019-2023
IPSAS 1, *Presentation of Financial Statements*	Expected to impact entities widely.	The current IPSAS 1 is based on a superseded version of IAS 1. In addition IPSAS 1 has been only partially updated to reflect all changes arising from the Conceptual Framework.	IPSAS 1 addresses presentation of financial statements. However, recent IASB developments and the IPSASB Conceptual Framework have introduced new concepts and ideas which may improve communication through financial statements.	Developments related to IAS 1, may depend on the IASB's ongoing communication initiative, which when completed can be considered for its applicability to the public sector. A significant change to IAS 1 was the introduction of "other comprehensive income", a component of income outside profit or loss. The IPSASB examined this component of income in the development of its Conceptual Framework and concluded that it was inappropriate in the public sector.	No

Potential Projects	Prevalence	Consequences	Urgency	Technical and Resource Considerations	Prioritized for Inclusion in the Work Plan 2019-2023
IPSAS 20, *Related Party Transactions*	Expected to impact entities widely.	IPSAS 20 is based on an old IASB standard. Revising or replacing IPSAS 20 to reflect the revised IAS 24, *Related Party Disclosures*, may provide more useful information.	IPSAS 20 addresses related party transactions, but is based on superseded IASB standard. IPSAS adopters where, for profit entities apply IFRS, identify a need for consistency between the public and private sectors.	A project to replace or update IPSAS 20 could proceed without reliance on other projects.	No
IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations*	Limited, would impact only public sector entities with assets held for sale.	Currently the lack of guidance impairs transparency and decision making related to sales of non-current assets in the public sector.	Some argue it is not a relevant issue in the public sector. However, others note that accountability related to asset management requires greater transparency, especially for assets held for sale.	Appropriate measurement basis for assets held for sale will be considered in the ongoing Measurement Project, so there is a risk of duplication if a separate project is initiated.	No

Potential Projects	Prevalence	Consequences	Urgency	Technical and Resource Considerations	Prioritized for Inclusion in the Work Plan 2019-2023
IFRS 6, *Exploration for and Evaluation of Mineral Resources*	An increasingly prominent issue in jurisdictions with mineral and resource based economies, where IPSAS adoption and implementation is increasing.	Currently the lack of guidance in this area impairs decision making.	As more jurisdictions in mineral and resource based economies adopt IPSAS.	This project would be in the same area as the proposed Natural Resources project. Further, IFRS 6 is an interim pronouncement that permits the retention of pre-IFRS adoption accounting policies, although IASB has no current plans to replace it. IFRS does not have a focus that addresses key public sector issues.	No

Potential Projects	Prevalence	Consequences	Urgency	Technical and Resource Considerations	Prioritized for Inclusion in the Work Plan 2019-2023
IFRS 14, *Regulatory Deferral Accounts*	Issue is limited to rate regulated industries (such as electric or gas utilities), and potentially regulatory entities. Likely that most entities affected by rate regulation are profit seeking entities that are reporting under IFRS or national for-profit standards. Any IPSASB project should therefore focus on regulators.	Entities such as utilities which operate in regulated industries are likely applying IFRS or national for-profit standards entities. IPSAS are not primarily designed for such entities.	Not an emerging issue in the public sector.	Regardless of its limited relevance for non-commercial public sector entities, IFRS 14, which allows entities adopting IFRS to continue previous accounting policies would not form an appropriate basis for an IPSAS. The IASB has an active project considering accounting for rate regulated activities. The IPSASB should not progress this project until the IASB work is complete. Any IPSASB project should focus on regulators.	No
IFRS 17, *Insurance Contracts*	Relevant to entities issuing insurance contracts (limited in the public sector).	The hierarchy in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, directs users to IFRS 17, so the absence of an IPSAS on insurance accounting does not appear to have detrimental effects.	Not an emerging issue in the public sector.	IFRS 17 is a high-quality standard that could provide a sound basis for development of an IPSAS.	No

Potential Projects	Prevalence	Consequences	Urgency	Technical and Resource Considerations	Prioritized for Inclusion in the Work Plan 2019-2023
IAS 34, *Interim Financial Reporting*	Only relevant for entities in jurisdictions where interim reporting is a feature of the reporting framework.	The lack of an IPSAS on interim financial reporting drawn from IAS 34 is not preventing entities from developing interim financial reports.	Not an emerging issue in the public sector.	IAS 34 would provide a sound basis for development of an IPSAS.	No
Theme C – Developing guidance to meeting users' broader financial reporting needs					
Revising RPG 1, *Reporting on the Long-Term Sustainability of an Entity's Finances*	Limited to higher levels of government, where a macro view of future resource inflows and outflows can be assessed for sustainability reporting (such as the whole of government level).	No impact on general purpose financial statements. However, information on the sustainability of an entities finances is useful to users and complements GPFSs.	The IPSASB has noted a potential need to revise RPG 1 in ED 63, *Social Benefits.*	Before RPG 1 was revised, the IPSASB would need to consider the responses to ED 63 and complete the development of a social benefits standard. Revisions to RPG 1 will need to complement that standard.	No
IASB Initiative-Better Communication in Financial Reporting	Expected to impact entities widely.	Improvements to financial reporting communication may make financial statements more meaningful and useful to users.	IPSAS 1 addresses presentation of financial statements. However, recent IASB developments may improve financial reporting and information communicated to users.	The IASB initiative related to better communication is still ongoing and the IPSASB should continue to monitor developments.	No

Potential Projects	Prevalence	Consequences	Urgency	Technical and Resource Considerations	Prioritized for Inclusion in the Work Plan 2019-2023
Defining Public Sector Key Financial Performance Indicators	Expected to impact entities widely.	The lack of defined public sector key financial performance indicators limits the power of accrual accounting for decision making in jurisdictions which have adopted IPSAS.	In some jurisdictions accrual financial reports are produced, but not used for decision-making purposes. Defining key financial performance indicators for the public sector would enhance the value of accrual accounting.	Developing guidance on key financial performance indicators for public sector entities is feasible. However, the selection of such indicators may reflect need to jurisdictional factors. There is also a risk that such a project might be over granular.	No
Public Sector Guidance for Cost Accounting	Does not directly relate to financial reporting for public sector entities.	The lack of public sector cost accounting guidance does not directly and adversely impact IPSAS financial reporting.	Developing guidance for cost accounting may be useful, however, it is questionable if developing such guidance is within the IPSASB's core remit.	Developing guidance for cost accounting is feasible, but questionable whether the IPSASB is best positioned to undertake such a project.	No

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IFRS® Conceptual Framework
Project Summary

Conceptual Framework for Financial Reporting

Conceptual Framework at a glance

Introduction

The International Accounting Standards Board (Board) issued the revised *Conceptual Framework for Financial Reporting* (*Conceptual Framework*), a comprehensive set of concepts for financial reporting, in March 2018.

It sets out:

- the objective of financial reporting
- the qualitative characteristics of useful financial information
- a description of the reporting entity and its boundary
- definitions of an asset, a liability, equity, income and expenses
- criteria for including assets and liabilities in financial statements (recognition) and guidance on when to remove them (derecognition)
- measurement bases and guidance on when to use them
- concepts and guidance on presentation and disclosure

This Project Summary summarises:

- why the Board revised the *Conceptual Framework*
- the main changes from the previous *Conceptual Framework*
- the main concepts and guidance in each chapter of the *Conceptual Framework*

Purpose

- to assist the Board to develop IFRS Standards (Standards) based on consistent concepts, resulting in financial information that is useful to investors, lenders and other creditors
- to assist preparers of financial reports to develop consistent accounting policies for transactions or other events when no Standard applies or a Standard allows a choice of accounting policies
- to assist all parties to understand and interpret Standards

Status

- provides concepts and guidance that underpin the decisions the Board makes when developing Standards
- not a Standard
- does not override any Standard or any requirement in a Standard

Effective date

- immediately for the Board and the IFRS Interpretations Committee
- annual periods beginning on or after 1 January 2020 for preparers who develop an accounting policy based on the *Conceptual Framework*

Why have we revised the *Conceptual Framework*?

Previous *Conceptual Framework*

- issued in 1989 and partly revised in 2010
- useful, but incomplete and needed improvement

Priority
identified as a priority by stakeholders in the 2011 Agenda Consultation

Filling gaps
for example, guidance on measurement, presentation and disclosure

Updating
for example, the definitions of an asset and a liability

Clarifying
for example, the role of measurement uncertainty

Revised *Conceptual Framework*

- a comprehensive set of concepts for financial reporting

Approach

In revising the *Conceptual Framework*, the Board sought a balance between providing high-level concepts and providing enough detail for the *Conceptual Framework* to be useful to the Board and others.

The Board views the *Conceptual Framework* as a practical tool to help it develop Standards. Hence, the *Conceptual Framework* includes concepts that help the Board develop Standards and also discusses the factors the Board needs to consider in making judgements when application of the concepts does not lead to a single answer.

Main changes

The revised *Conceptual Framework* introduces the following main improvements:

New

Measurement	concepts on measurement, including factors to be considered when selecting a measurement basis
Presentation and disclosure	concepts on presentation and disclosure, including when to classify income and expenses in other comprehensive income
Derecognition	guidance on when assets and liabilities are removed from financial statements

Updated

Definitions	definitions of an asset and a liability
Recognition	criteria for including assets and liabilities in financial statements

Clarified

Prudence	**Stewardship**	**Measurement uncertainty**	**Substance over form**

Chapter 1—The objective of financial reporting

This chapter sets out the objective of general purpose financial reporting (financial reporting), what information is needed to achieve that objective and who the primary users (users) of financial reports are.

Objective of financial reporting

To provide financial information that is useful to users in making decisions relating to providing resources to the entity

Users' decisions involve decisions about

- buying, selling or holding equity or debt instruments
- providing or settling loans and other forms of credit
- voting, or otherwise influencing management's actions

To make these decisions, users assess

- prospects for future net cash inflows to the entity
- management's stewardship of the entity's economic resources

To make both these assessments, users need information about both

- the entity's economic resources, claims against the entity and changes in those resources and claims
- how efficiently and effectively management has discharged its responsibilities to use the entity's economic resources

Summary of changes

This chapter was issued in 2010 and went through extensive due process at that time. Therefore, in revising the *Conceptual Framework*, the Board did not fundamentally reconsider this chapter. However, it clarified why information used in assessing stewardship is needed to achieve the objective of financial reporting.

Stewardship

Users of financial reports need information to help them assess management's stewardship. The *Conceptual Framework* explicitly discusses this need as well as the need for information that helps users assess the prospects for future net cash inflows to the entity.

Users of financial reports

Users of financial reports are an entity's existing and potential investors, lenders and other creditors. Those users must rely on financial reports for much of the financial information they need.

Chapter 2—Qualitative characteristics of useful financial information

This chapter discusses what makes financial information useful.

For information to be useful it must both be **relevant** and provide a **faithful representation** of what it purports to represent. **Relevance** and **faithful representation** are the fundamental qualitative characteristics of useful financial information, and the guiding concepts that apply throughout the revised *Conceptual Framework*.

Fundamental qualitative characteristics

Relevance

- information is **relevant** if it is capable of making a difference to the decisions made by users
- financial information is capable of making a difference in decisions if it has predictive value or confirmatory value

Faithful representation

- information must **faithfully represent** the substance of what it purports to represent
- a faithful representation is, to the maximum extent possible, complete, neutral and free from error
- a faithful representation is affected by level of measurement uncertainty

Enhancing qualitative characteristics

Comparability | Verifiability | Timeliness | Understandability

- these four qualitative characteristics enhance the usefulness of information
- but they cannot make non-useful information useful

Cost constraint

- the benefit of providing the information needs to justify the cost of providing and using the information

Summary of changes

This chapter was issued in 2010 and went through extensive due process at that time. Therefore, in revising the *Conceptual Framework* the Board did not fundamentally reconsider this chapter. However, the Board clarified the roles of prudence, measurement uncertainty and substance over form in assessing whether information is useful.

Prudence

Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty. Prudence does not allow for overstatement or understatement of assets, liabilities, income or expenses.

Measurement uncertainty

Measurement uncertainty does not prevent information from being useful. However, in some cases the most relevant information may have such a high level of measurement uncertainty that the most useful information is information that is slightly less relevant but is subject to lower measurement uncertainty.

Chapter 3—Financial statements and the reporting entity

This chapter describes the objective and scope of financial statements and provides a description of the reporting entity.

Reporting entity

- an entity that is required, or chooses, to prepare financial statements
- not necessarily a legal entity—could be a portion of an entity or comprise more than one entity

Financial statements

a particular form of financial reports that provide information about the reporting entity's assets, liabilities, equity, income and expenses

Consolidated financial statements	Unconsolidated financial statements	Combined financial statements
provide information about assets, liabilities, equity, income and expenses of both the parent and its subsidiaries as a single reporting entity	provide information about assets, liabilities, equity, income and expenses of the parent only	provide information about assets, liabilities, equity, income and expenses of two or more entities that are not all linked by a parent-subsidiary relationship

Summary of changes

This chapter is new.

Boundary of a reporting entity

Determining the appropriate boundary of a reporting entity can be difficult if, for example, the entity is not a legal entity. In such cases, the boundary is determined by considering the information needs of the users of the entity's financial statements. Those users need information that is **relevant** and that **faithfully represents** what it purports to represent. A reporting entity does not comprise an arbitrary or incomplete collection of assets, liabilities, equity, income and expenses.

Chapter 4—The elements of financial statements

This chapter defines the five elements of financial statements—an asset, a liability, equity, income and expenses.

Previous definition of an asset	Revised definition of an asset
A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity	A present economic resource controlled by the entity as a result of past events An economic resource is a right that has the potential to produce economic benefits

Main changes in the definition of an asset

- separate definition of an economic resource—to clarify that an asset is the economic resource, not the ultimate inflow of economic benefits
- deletion of 'expected flow'—it does not need to be certain, or even likely, that economic benefits will arise
- a low probability of economic benefits might affect recognition decisions and the measurement of the asset

Previous definition of a liability	Revised definition of a liability
A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits	A present obligation of the entity to transfer an economic resource as a result of past events An obligation is a duty or responsibility that the entity has no practical ability to avoid

Main changes in the definition of a liability

- separate definition of an economic resource—to clarify that a liability is the obligation to transfer the economic resource, not the ultimate outflow of economic benefits
- deletion of 'expected flow'—with the same implications as set out above for an asset
- introduction of the 'no practical ability to avoid' criterion to the definition of obligation

Summary of changes

The definitions of an asset and a liability have been refined and the definitions of income and expenses have been updated only to reflect that refinement.

The definition of equity as the residual interest in the assets of the entity after deducting all its liabilities is unchanged. The Board's research project on Financial Instruments with Characteristics of Equity is exploring the distinction between liabilities and equity.

No practical ability to avoid

The revised *Conceptual Framework* discusses how the 'no practical ability to avoid' criterion is applied in the following circumstances:

(a) if a duty or responsibility arises from the entity's customary practices, published policies or specific statements—the entity has an obligation if it has no practical ability to act in a manner inconsistent with those practices, policies or statements.

(b) if a duty or responsibility is conditional on a particular future action that the entity itself may take—the entity has an obligation if it has no practical ability to avoid taking that action.

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Unit of account: the right(s) or obligation(s), or group of rights and obligations, to which recognition criteria and measurement concepts are applied

Selecting the unit of account

Relevance	Faithful representation
• a unit of account is selected to provide **relevant** information about the asset or liability and any related income and expenses	• a unit of account is selected to provide a **faithful representation** of the substance of the transaction or other event from which the asset, liability and any related income or expenses have arisen

Executory contract

An executory contract is a contract that is equally unperformed. It establishes a single asset or liability for the inseparable combined right and obligation to exchange economic resources.

Substance of contracts

To represent contractual rights and obligations faithfully, financial statements must report their substance. In some cases, the substance of such rights and obligations is clear from a contract's legal form. But, in other cases, the terms of the contract, or of a group or series of contracts, may require analysis to identify the substance of the rights and obligations.

Revised definition of income

Increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims

Revised definition of expenses

Decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims

Although income and expenses are defined in terms of changes in assets and liabilities, information about income and expenses is just as important as information about assets and liabilities.

Chapter 5—Recognition and derecognition

This chapter discusses criteria for including assets and liabilities in financial statements (recognition) and guidance on when to remove them (derecognition).

Recognition	The process of capturing for inclusion in the statement of financial position or the statement(s) of financial performance an item that meets the definition of an asset, a liability, equity, income or expenses

Recognition is appropriate if it results in both **relevant** information about assets, liabilities, equity, income and expenses and a **faithful representation** of those items, because the aim is to provide information that is useful to investors, lenders and other creditors

Recognition criteria

Relevance	**Faithful representation**
• whether recognition of an item results in **relevant** information may be affected by, for example:	• whether recognition of an item results in a **faithful representation** may be affected by, for example:
low probability of a flow of economic benefits	measurement uncertainty
existence uncertainty	recognition inconsistency (accounting mismatch)
	presentation and disclosure

Cost constraint

Cost constrains recognition decisions, just as it constrains other financial reporting decisions

Summary of changes

The previous recognition criteria were that an entity should recognise an item that met the definition of an element if it was probable that economic benefits would flow to the entity and if the item had a cost or value that could be determined reliably.

The revised recognition criteria refer explicitly to the qualitative characteristics of useful information.

The Board's aim was to develop a more coherent set of concepts, not to increase or decrease the range of assets and liabilities recognised.

Why recognition is important

Recognising assets, liabilities, equity, income and expenses depicts an entity's financial position and financial performance in structured summaries (the statements of financial position and financial performance). The amounts recognised in a statement are included in the totals and, if applicable, subtotals, in the statement. The statements are linked because income and expenses are linked to changes in assets and liabilities.

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Derecognition	The removal of all or part of a recognised asset or liability from an entity's statement of financial position

Derecognition normally occurs

For an asset	For a liability
when the entity loses control of all or part of the recognised asset	when the entity no longer has a present obligation for all or part of the recognised liability

Derecognition aims to faithfully represent both

- any assets and liabilities retained after the transaction that led to the derecognition
- the change in the entity's assets and liabilities as a result of that transaction

Summary of changes

The guidance on derecognition is new.

Derecognition resulting from a transfer

Normally, a faithful representation of a transfer of an asset or liability is achieved by derecognition of the asset or liability with appropriate presentation and disclosure.

However, in limited cases, it may be necessary to continue to recognise a transferred component of an asset or liability together with a liability or asset for the proceeds received or paid, with appropriate presentation and disclosure.

Chapter 6—Measurement

This chapter describes various measurement bases and discusses factors to be considered when selecting a measurement basis.

Historical cost measurement bases

- historical cost provides information derived, at least in part, from the price of the transaction or other event that gave rise to the item being measured
- historical cost of assets is reduced if they become impaired and historical cost of liabilities is increased if they become onerous
- one way to apply a historical cost measurement basis to financial assets and financial liabilities is to measure them at amortised cost

Current value measurement bases

- current value provides information updated to reflect conditions at the measurement date
- current value measurement bases include:

fair value	• the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date • reflects market participants' current expectations about the amount, timing and uncertainty of future cash flows
value in use (for assets) fulfilment value (for liabilities)	• reflects entity-specific current expectations about the amount, timing and uncertainty of future cash flows
current cost	• reflects the current amount that would be: ▪ paid to acquire an equivalent asset ▪ received to take on an equivalent liability

Summary of changes

The previous version of the *Conceptual Framework* included little guidance on measurement. The revised *Conceptual Framework* describes what information measurement bases provide and explains the factors to consider when selecting a measurement basis.

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The factors to be considered when selecting a measurement basis are **relevance** and **faithful representation**, because the aim is to provide information that is useful to investors, lenders and other creditors

Factors to consider in selecting a measurement basis

Relevance

Relevance of information provided by a measurement basis is affected by:

characteristics of the asset or liability	contribution to future cash flows
• the variability of cash flows • sensitivity of the value to market factors or other risks • for example, amortised cost cannot provide relevant information about a deriviative	• whether cash flows are produced directly or indirectly in combination with other economic resources • the nature of the entity's business activities • for example, if assets are used in combination to produce goods or services, historical cost can provide relevant information about margins achieved in a period

Faithful representation

Whether a measurement basis can provide a **faithful representation** is affected by:

measurement inconsistency	measurement uncertainty
• if financial statements contain measurement inconsistencies (accounting mismatch), those financial statements may not faithfully represent some aspects of the entity's financial position and financial performance	• does not necessarily prevent the use of a measurement basis that provides relevant information • but if too high might make it necessary to consider selecting a different measurement basis

Cost constraint

Cost constrains the selection of a measurement basis, just as it constrains other financial reporting decisions

Selecting a measurement basis

In selecting a measurement basis, it is necessary to consider the nature of the information in both the statement of financial position and the statement(s) of financial performance.

The relative importance of each factor to be considered (see boxes) depends upon the facts and circumstances of individual cases.

Consideration of the factors and the cost constraint is likely to result in the selection of different measurement bases for different assets, liabilities, income and expenses.

Chapter 7—Presentation and disclosure

This chapter includes concepts on presentation and disclosure and guidance on including income and expenses in the statement of profit or loss and other comprehensive income.

The statement of profit or loss

- The statement of profit or loss is the primary source of information about an entity's financial performance for the reporting period
- Profit or loss could be a section of a single statement of financial performance or a separate statement
- The statement(s) of financial performance include(s) a total (subtotal) for profit or loss
- In principle, all income and expenses are classified and included in the statement of profit or loss

Other comprehensive income

- In exceptional circumstances, the Board may decide to exclude from the statement of profit or loss income or expenses arising from a change in current value of an asset or liability and include those income and expenses in other comprehensive income
- The Board may make such a decision when doing so would result in the statement of profit or loss providing more **relevant** information or a more **faithful representation**

Recycling

- In principle, income and expenses included in other comprehensive income in one period are recycled to the statement of profit or loss in a future period when doing so results in the statement of profit or loss providing more **relevant** information or a more **faithful representation**
- When recycling does not result in the statement of profit or loss providing more **relevant** information or a more **faithful representation**, the Board may decide income and expenses included in other comprehensive income are not to be subsequently recycled

Summary of changes

This chapter is new.

Better Communication

Information about assets, liabilities, equity, income and expenses is communicated through presentation and disclosure in the financial statements.

Effective communication of information in financial statements makes that information more relevant and contributes to a faithful representation of an entity's assets, liabilities, equity, income and expenses.

The revised *Conceptual Framework* includes concepts that describe how information should be presented and disclosed in financial statements.

The Board is also working on several projects on the theme of Better Communication to make financial information more useful to investors, lenders and other creditors and to improve the communication of that information.

Amendments to References to the Conceptual Framework in IFRS Standards—a separate accompanying document

That document sets out amendments to Standards to update references to the *Conceptual Framework*.

Objective of the amendments	• Some Standards include explicit references to previous versions of the *Conceptual Framework* • These amendments update those references so they refer to the revised *Conceptual Framework*
Effects	• The Board expects the amendments to references to the *Conceptual Framework* in Standards will not have a significant effect on users and preparers of financial statements
Effective date and transition	• The amendments are effective for annual periods beginning on or after 1 January 2020, with earlier application permitted • The amendments should be applied retrospectively unless retrospective application would be impracticable or involve undue cost or effort

Exemptions

- IFRS 3 *Business Combinations*

To avoid unintended consequences, acquirers are required to apply the definitions of an asset and a liability and supporting concepts in the previous, rather than the revised, *Conceptual Framework*. The Board plans to assess how IFRS 3 can be updated without unintended consequences.

- Regulatory account balances

When developing accounting policies for regulatory account balances applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, entities are required to refer to the previous, rather than the revised, *Conceptual Framework*. This avoids entities revising those accounting policies twice within a short period: once for the revised *Conceptual Framework* and again when a revised Standard on rate-regulated activities is issued.

Important information

This Project Summary has been compiled by the staff of the IFRS Foundation for the convenience of interested parties. The views within this document are those of the staff who prepared this document and do not necessarily reflect the views or the opinions of the Board. The content of this Project Summary does not constitute any advice and is not to be considered as an authoritative document issued by the Board.

Official pronouncements of the Board are available in electronic format to eIFRS subscribers. Publications are available for ordering from the IFRS Foundation website at www.ifrs.org.

Other relevant documents

Conceptual Framework for Financial Reporting—describes the objective of, and the concepts for, general purpose financial reporting.

Basis for Conclusions on the Conceptual Framework for Financial Reporting—summarises the Board's considerations in developing the *Conceptual Framework*.

Amendments to References to the Conceptual Framework in IFRS Standards—sets out amendments to Standards, their accompanying documents and IFRS practice statements.

Feedback Statement—summarises the feedback on the proposals that led to the revised *Conceptual Framework.*

Notes

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IFRS® Conceptual Framework
Feedback Statement

Conceptual Framework for Financial Reporting

Introduction

The International Accounting Standards Board (Board) issued the *Conceptual Framework for Financial Reporting* in 2018 (2018 *Conceptual Framework*). This version replaces the *Conceptual Framework* issued in 2010 (2010 *Conceptual Framework*).

The Board and the IFRS Interpretations Committee started using the 2018 *Conceptual Framework* immediately after it was issued.

To achieve transition for preparers who develop accounting policies by reference to the *Conceptual Framework*, the Board also issued *Amendments to References to the Conceptual Framework in IFRS Standards* in 2018. That document updates references to previous versions of the *Conceptual Framework* in IFRS Standards (Standards), their accompanying documents and IFRS practice statements.

Those updated references are effective for annual periods beginning on or after 1 January 2020.

Part 1 of this Feedback Statement summarises the feedback on the proposals that preceded the 2018 *Conceptual Framework* and the Board's response to that feedback. It focuses on the more significant matters that prompted the most feedback from stakeholders.

Part 2 of this Feedback Statement summarises the feedback on the proposals that preceded *Amendments to References to the Conceptual Framework in IFRS Standards* and the Board's response to that feedback.

Consultation and testing

The Board consulted extensively with the public while developing the 2018 *Conceptual Framework* and *Amendments to References to the Conceptual Framework in IFRS Standards*.

Publications

The Board published the following proposals over the course of the project:

(a) a Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* in 2013 (2013 Discussion Paper);

(b) an Exposure Draft *Conceptual Framework for Financial Reporting* in 2015 (2015 Exposure Draft); and

(c) an Exposure Draft *Updating References to the Conceptual Framework* in 2015.

The Board received 228 comment letters on the 2013 Discussion Paper, 233 comment letters on the 2015 Exposure Draft and 40 comment letters on the Exposure Draft *Updating References to the Conceptual Framework*. The Board considered this feedback in finalising the 2018 *Conceptual Framework* and *Amendments to References to the Conceptual Framework in IFRS Standards*.

Outreach

The Board conducted extensive outreach with stakeholders from various jurisdictions and various backgrounds, including investors and analysts, preparers of financial statements, regulators, standard-setters, professional accountancy bodies, accounting firms and academics. The Board held 230 meetings with stakeholders and considered their feedback in finalising the 2018 *Conceptual Framework*.

The Board also conducted outreach with preparers of financial statements and accounting firms to ensure it had a good understanding of whether and when in practice entities develop their accounting policies by reference to the *Conceptual Framework*. The Board used their feedback in finalising *Amendments to References to the Conceptual Framework in IFRS Standards*.

Consultative group

The Board used the Accounting Standard Advisory Forum (ASAF) as its consultative group for the Conceptual Framework project. ASAF is an advisory group to the Board. It comprises national accounting standard-setters and regional bodies with an interest in financial reporting. The Board discussed a wide range of topics with ASAF during the development of the 2018 *Conceptual Framework*.

Testing

The Board tested the proposed revised definitions of an asset and a liability and the guidance supporting those definitions. The aim of this test was:

(a) to enable both the Board and stakeholders to assess implications of the proposals for future Standards; and

(b) to assess whether the proposed definitions and supporting guidance would cause any problems.

Part of the testing included discussions and case studies at the World Standard-setters Conference in 2016.

Part 1—The 2018 *Conceptual Framework*

Project proposals	Feedback	The Board's response
Approach to the project		
In the 2011 Agenda Consultation stakeholders identified revision of the *Conceptual Framework* as a priority project for the Board. To achieve a timely revision, the 2013 Discussion Paper and the 2015 Exposure Draft proposed an approach that focused on updating, clarifying and filling in gaps in the 2010 *Conceptual Framework* instead of fundamentally reconsidering all of its aspects.	Many stakeholders supported the Board's decision to focus on updating, clarifying and filling in gaps in the 2010 *Conceptual Framework* instead of fundamentally reconsidering all of its aspects. Some stakeholders questioned this approach and thought the proposals were not sufficiently aspirational.	The Board confirmed its approach to focus on updating, clarifying and filling in gaps in the 2010 *Conceptual Framework*. The Board views the *Conceptual Framework* as a practical tool to help it develop Standards. Hence, the *Conceptual Framework* describes concepts and explains factors the Board needs to consider in applying those concepts.
Purpose of the *Conceptual Framework*		
The 2013 Discussion Paper proposed identifying the Board as the primary user of the *Conceptual Framework*. However, the Board was persuaded by feedback to extend the proposed purpose of the *Conceptual Framework* in the 2015 Exposure Draft to be: (a) to assist the Board to develop Standards that are based on consistent concepts; (b) to assist preparers to develop consistent accounting policies when no Standard specifically applies to a transaction or other event or when a Standard allows a choice of accounting policy; and (c) to assist all parties to understand and interpret Standards.	Many stakeholders agreed with the proposals in the 2015 Exposure Draft. However, a few stakeholders continued to suggest that the primary purpose of the *Conceptual Framework* should be to help the Board when developing Standards.	The Board confirmed the purpose of the *Conceptual Framework* as proposed in the 2015 Exposure Draft. The Board concluded it was important to acknowledge the role of the *Conceptual Framework* for parties other than the Board.

Project proposals	Feedback	The Board's response
Status of the *Conceptual Framework*		
The *Conceptual Framework* is a set of concepts and accompanying guidance. It is not a Standard and does not override any Standard. The Board proposed that this should remain the case. The Board also proposed that it should be able to depart from aspects of the *Conceptual Framework* if it needs to do so to meet the objective of financial reporting. The Board envisaged that such a need would arise only in a limited number of cases.	Some stakeholders supported these proposals. However, other stakeholders suggested that the *Conceptual Framework* should override the requirements of Standards, or that the Board should never be allowed to depart from aspects of the *Conceptual Framework*.	The Board confirmed the status as proposed. The *Conceptual Framework*'s existing status, as not being a Standard and not overriding Standards, has worked well in practice. The Board also concluded that, in some circumstances, it might need to depart from aspects of the *Conceptual Framework* to meet the objective of financial reporting. It is helpful for the *Conceptual Framework* to acknowledge this, and to specify that such departures are appropriate only if needed to meet that objective. That need might arise because conceptual thinking or the economic environment may change, and new or revised Standards might need to reflect these changes. If the Board does depart from aspects of the *Conceptual Framework* when setting a Standard, it will explain the departure in the Basis for Conclusions on that Standard.

Project proposals	Feedback	The Board's response
Effects of the 2018 *Conceptual Framework*		
New Standards and IFRS Interpretations The Board proposed using the 2018 *Conceptual Framework* for standard-setting immediately after it is issued. **Existing Standards** The Board also proposed that changes in the *Conceptual Framework* would not automatically lead to changes in Standards. The Board proposed considering any potential changes to Standards arising from changes in the *Conceptual Framework* in the light of other priorities when developing its work plan. **Accounting policies developed by preparers** Preparers of financial statements can be directly affected by the changes if they use the *Conceptual Framework* to develop or select accounting policies when no Standard specifically applies to a transaction or other event. To achieve transition to the 2018 *Conceptual Framework* for such entities, the Board proposed amendments to Standards that update references to the previous versions of the *Conceptual Framework*. Feedback on these proposals is given in Part 2 of this document.	**New Standards and IFRS Interpretations** Some stakeholders expressed concerns about the implications of the proposed changes to the *Conceptual Framework* for future Standards, in particular the proposed changes to the definitions of an asset and a liability, and encouraged the Board to conduct an effect analysis. Some stakeholders also expressed a concern that the general approach in the 2015 Exposure Draft of using the fundamental qualitative characteristics of relevance and faithful representation as the basis for recognition, measurement and presentation decisions would not provide enough direction for the Board. They thought this approach was too abstract and subjective. These stakeholders suggested that the Board introduce more concrete and robust criteria to ensure it develops Standards with consistent requirements that result in useful information. **Existing Standards** Most stakeholders agreed that changes in the *Conceptual Framework* should not automatically lead to changes in Standards. However, some stakeholders were concerned about the possibility of Standards being inconsistent with the 2018 *Conceptual Framework*.	In response to the feedback, the Board performed an extensive analysis of the possible effects on future Standards of the proposed definitions of an asset and a liability, the concepts supporting those definitions and the recognition criteria. In addition, the Board tested for inconsistencies between the revised concepts and existing Standards. The analysis indicated a few areas where further guidance would be helpful, and the Board considered these areas during its deliberations. The Board also concluded that more rigid criteria would not improve its ability to set Standards that result in useful information. In addition, the analysis demonstrated that the requirements of existing Standards were often consistent with potential outcomes of applying the proposed definitions and supporting guidance. The analysis identified an inconsistency between the *Conceptual Framework* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* as interpreted by IFRIC 21 *Levies*. Applying IFRIC 21, liabilities for levies are identified only when all conditions for the payment of the levies are met. If the definition in the *Conceptual Framework* were applied, liabilities for levies might be identified before all those conditions have been met. However, the publication of the *Conceptual Framework* does not change the accounting requirements for levies—the *Conceptual Framework* does not override IAS 37 or IFRIC 21. Any decision to amend an existing Standard would require the Board to go through its due process.

Project proposals	Feedback	The Board's response
Primary users of general purpose financial reporting Throughout the project, the Board proposed that the *Conceptual Framework* should continue to define the primary users (users) of general purpose financial reporting (financial reporting) as the existing and potential investors, lenders and other creditors.	Although some stakeholders agreed with the proposal, some argued that the proposed primary user group is defined too narrowly and that it should be expanded to include, for example, employees, customers, suppliers, regulators and others. In contrast, others argued that the proposed primary user group is defined too broadly and that the Board should describe primary users as existing holders of equity claims against the entity.	The Board confirmed the proposal. It concluded that: (a) existing and potential investors, lenders and other creditors have the most critical and immediate need for the information in financial reports and many cannot require the entity to provide the information to them directly. (b) the *Conceptual Framework* contributes to the stated mission of the IFRS Foundation to develop Standards that bring transparency, accountability and efficiency to financial markets around the world. Participants in financial markets include not only existing investors but also potential investors and existing and potential lenders and other creditors. (c) information that meets the needs of the specified primary users is likely to meet the needs of other users. (d) focusing on the common information needs of the primary users does not prevent a reporting entity from including additional information that is more useful to a particular subset of primary users.

Project proposals	Feedback	The Board's response
Stewardship The Board removed the term 'stewardship' from the *Conceptual Framework* in 2010 because of translation difficulties. Instead, it sought to describe the concept underlying the previous use of the term. When the Board restarted its work on the *Conceptual Framework* in 2012, it proposed that it would not reconsider fundamentally the chapter on the objective of financial reporting, and thus the 2013 Discussion Paper did not propose to reintroduce the term 'stewardship'. In response to feedback, in the 2015 Exposure Draft the Board proposed to reintroduce the term 'stewardship' with an explanation of how the term is used, and to give more prominence to stewardship in describing the objective of financial reporting.	Many stakeholders disagreed with the Board's original proposal not to reintroduce the term 'stewardship'. They argued for an explicit acknowledgement that the assessment of management's stewardship was part of the objective of financial reporting. Many stakeholders supported the proposed reintroduction of the term 'stewardship' and the concept's greater prominence in the 2015 Exposure Draft. However, some stakeholders suggested that stewardship should be an additional objective of financial reporting instead of part of the objective of providing information that is useful for making decisions relating to providing resources to the entity (resource allocation decisions).	In the 2018 *Conceptual Framework* the Board confirmed the approach proposed in the 2015 Exposure Draft. Hence, the 2018 *Conceptual Framework* explicitly discusses information needed to assess management's stewardship as well as information needed to help users assess the prospects for future net cash inflows to the entity. Both types of information are needed to meet the objective of financial reporting—that is to provide information that is useful for making resource allocation decisions. The Board also clarified that resource allocation decisions involve decisions about exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources (as well as decisions about buying, selling or holding equity and debt instruments and providing or settling loans and other forms of credit).

Project proposals	Feedback	The Board's response
Business activities		
In both the 2013 Discussion Paper and the 2015 Exposure Draft, the Board explained that the nature of an entity's business activities can affect the relevance of some types of financial information and the Board may need to consider that factor when developing Standards. Specifically, in the 2015 Exposure Draft the Board proposed to include a discussion of business activities in each chapter of the *Conceptual Framework* where this concept plays a role.	Throughout the project, some stakeholders suggested that the *Conceptual Framework* should give more prominence to the notion of a business model and suggested the Board should define or provide additional guidance on the business model. Other stakeholders did not support including a discussion of business activities in the *Conceptual Framework* because they think considering the nature of an entity's business activities necessarily leads to subjectivity and impairs comparability of financial statements.	The Board confirmed the approach proposed in the 2015 Exposure Draft. The Board concluded that: (a) the nature of an entity's business activities does not affect all areas of financial reporting in the same way and to the same extent, and concluded that it should not be included as an overarching concept. Instead, the 2018 *Conceptual Framework* discusses business activities separately for each affected area. (b) using the term 'business model' would be confusing, because organisations define the term in varied ways. The Board decided therefore, to use the term 'business activities' in the 2018 *Conceptual Framework*. (c) an entity's business activities are a matter of fact that in most cases can be determined objectively.

Project proposals	Feedback	The Board's response
Long-term investment Throughout the project, the Board expressed the view that a specific discussion of the following topics in the *Conceptual Framework* was unnecessary: (a) long-term investment by the reporting entity; and (b) the information needs of long-term investors in the reporting entity. The Board suggested that the concepts proposed for the *Conceptual Framework* will be sufficient to enable the Board to reach appropriate conclusions in setting Standards.	Many stakeholders broadly agreed that a specific discussion of these issues was not necessary. Some stakeholders suggested that the Board should identify long-term investment as a particular type of business activity and develop specific measurement and presentation and disclosure requirements for entities conducting that business activity. Some stakeholders also suggested that the *Conceptual Framework* should emphasise the information needs of long-term investors in a reporting entity, and that their information needs may differ from those of short-term investors.	The Board concluded that the 2018 *Conceptual Framework*: (a) contains sufficient and appropriate discussion of recognition, measurement, presentation and disclosure to enable the Board to reach appropriate decisions on how a reporting entity should account for long-term investments; (b) should not refer explicitly to the business activity of long-term investment, because the *Conceptual Framework* does not refer to any other business activity and because adding such a reference would embed excessive and unnecessary detail in the *Conceptual Framework*; and (c) contains sufficient and appropriate discussion of primary users and their information needs, and of the objective of financial reporting, to address appropriately the needs of long-term investors. A presentation discussing the *Conceptual Framework* and long-term investment in more detail is available here: www.ifrs.org/about-us/the-public-interest/

Project proposals	Feedback	The Board's response
Measurement uncertainty and reliability		
The 2010 *Conceptual Framework* used the term 'faithful representation' to refer to the qualitative characteristic that the previous framework called 'reliability'. It also included in the discussion of the other fundamental qualitative characteristic, relevance, a brief discussion of measurement uncertainty. The Board originally proposed not to reconsider fundamentally the chapter on the qualitative characteristics of useful financial information, and to retain the approach used in the 2010 *Conceptual Framework*. The Board received feedback that the 2010 *Conceptual Framework* did not adequately discuss the role of measurement uncertainty in financial reporting. Hence, in the 2015 Exposure Draft the Board proposed to expand the discussion of the effect of measurement uncertainty on the relevance of financial information and the role of measurement uncertainty in decisions about recognition and measurement. This discussion included an explicit reference to a trade-off between the level of measurement uncertainty and other factors that make information relevant.	Many stakeholders agreed that faithful representation should continue to be identified as one of the two fundamental qualitative characteristics of useful financial information. However, some stakeholders argued that the term 'reliability' should be reintroduced and expressed the following views: (a) 'reliability' is clearer and better understood. (b) faithful representation does not act as an effective filter when identifying the types of information to be included in financial statements, because it allows the recognition of items that cannot be measured reliably. (c) the framework before 2010 acknowledged a trade-off between the qualitative characteristics of relevance and reliability—more relevant information may lack reliability and more reliable information may lack relevance. This idea was lost when reliability was replaced with faithful representation. Many stakeholders welcomed the expanded discussion on measurement uncertainty in the 2015 Exposure Draft. However, they observed that it was more intuitive to include measurement uncertainty as a factor affecting faithful representation, rather than as a factor affecting relevance. Doing so would also make it easier to explain the idea of a trade-off between the level of measurement uncertainty and other factors.	The Board observed that the term 'reliability' is used by some stakeholders in ways that differ from the description in the framework before 2010. Further, many of the concerns about the removal of the term 'reliability' related to measurement uncertainty. The Board therefore concluded it should continue to use the term 'faithful representation' to avoid confusion, but should clarify the role of measurement uncertainty. The Board was persuaded by the view that measurement uncertainty is a factor that fits better in faithful representation than relevance. Accordingly, the 2018 *Conceptual Framework* explains that measurement uncertainty is one factor that can affect the possibility of providing a faithful representation, and that in some cases there could be a trade-off between relevance and faithful representation. The *Conceptual Framework* gives as an example of such a trade off the situation where the level of measurement uncertainty involved in making an estimate may be so high that it may be questionable whether the estimate would provide a sufficiently faithful representation.

Project proposals	Feedback	The Board's response
Prudence		
The framework before 2010 identified the exercise of 'prudence' as a factor that can make financial information useful. Prudence was described as the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty. However, the term was interpreted in different ways by users of that framework. The 2010 *Conceptual Framework* removed the term 'prudence' because the Board feared that a reference to prudence would be understood in a way that is inconsistent with neutrality. The Board proposed in the 2013 Discussion Paper not to reconsider fundamentally the chapter on the qualitative characteristics of useful information, and thus did not propose to reintroduce the term. However, the Board was persuaded by those who argued that prudence, defined as the exercise of caution, can help achieve neutrality in selecting and applying accounting policies. Hence, in the 2015 Exposure Draft the Board proposed to reintroduce the term 'prudence', defined as the exercise of caution when making judgements under conditions of uncertainty.	Many stakeholders supported the proposals in the 2015 Exposure Draft to reintroduce the term 'prudence'. Other stakeholders argued for the introduction of an asymmetric form of prudence that requires more persuasive evidence to support the recognition of income or assets than of expenses or liabilities, or the selection of measurement bases that recognise losses at an earlier stage than gains.	The Board confirmed the proposals in the 2015 Exposure Draft. The Board observed that the removal of the term 'prudence' in the 2010 revisions had led to confusion and concluded that reintroducing the term with a clear explanation would bring clarity. The Board did not incorporate an asymmetric form of prudence in the 2018 *Conceptual Framework* because that notion could sometimes conflict with the need for financial information to be relevant and provide a faithful representation. However, the Board observed that not all asymmetry is inconsistent with neutrality, and that Standards may contain asymmetric requirements if those requirements result in useful information.

Project proposals	Feedback	The Board’s response
Definition of an asset and a liability		
In the 2013 Discussion Paper, the Board proposed revised definitions of an asset and a liability, which removed the notion of an expected flow from the definitions and moved the reference to future flows of economic benefits into the supporting definition of an economic resource. In the 2015 Exposure Draft, the Board proposed to refine the definitions of an asset and a liability as follows: (a) an asset is a present economic resource controlled by the entity as a result of past events; (b) an economic resource is a right that has the potential to produce economic benefits; and (c) a liability is a present obligation of the entity to transfer an economic resource as a result of past event.	Many stakeholders broadly supported the definitions of an asset and a liability proposed in 2015 Exposure Draft. However, some stakeholders disagreed with the proposed definitions. The main concern of those who disagreed was the proposal to replace the notion of an expected flow in the existing definitions with the concept that an asset or liability ‘has the potential to produce economic benefits’. Some stakeholders argued that the proposed definitions would considerably widen the range of items identified as assets and liabilities.	The Board confirmed the proposed definitions of an asset and a liability. Retaining a notion of an expected flow would exclude many items that are clearly assets and liabilities. The Board concluded that uncertainty about the flow of economic benefits is best dealt with in recognition criteria or measurement, instead of within the definitions of an asset and a liability. The Board does not expect the combined effect of the definitions and recognition criteria to either broaden or narrow the range of items recognised.

Project proposals	Feedback	The Board's response
Present obligation		
In the 2013 Discussion Paper the Board discussed three approaches to identify a present obligation, each reflecting a different criterion for the extent of an entity's ability to avoid a future transfer of economic benefits. In the 2015 Exposure Draft, the Board proposed that an entity has a present obligation to transfer an economic resource if both: (a) the entity has no practical ability to avoid the transfer; and (b) the obligation is a result of past events.	Many stakeholders expressed general agreement with the proposed criteria for identifying a present obligation. Other stakeholders disagreed with the criteria. Those stakeholders suggested various alternatives—some suggested criteria that would lead to a narrower description of a present obligation, while others suggested criteria that would lead to a broader description. Some stakeholders, including some who broadly agreed with the proposed criteria, were concerned about difficulties in interpreting the criteria 'no practical ability to avoid' or 'result of past events', and about the possible implications of the proposed criteria for future Standards. They asked the Board to test the implications of the criteria and provide more guidance on their application.	The two criteria proposed—the 'no practical ability to avoid' criterion and the 'result of past events' criterion—continue to be identified as necessary characteristics of a liability in the 2018 *Conceptual Framework*. To address stakeholders' concerns about difficulties in interpreting the 'result of past events' criterion the Board refined and expanded the guidance proposed in the 2015 Exposure Draft. To address stakeholders' other concerns about interpreting the criteria, and about the possible implications of the criteria for future Standards, the Board developed case studies in which it applied the criteria to a range of transactions. The types of transactions covered by the case studies included those about which stakeholders had specifically raised concerns. The case studies demonstrated how and why for many of those transactions the results of applying the proposed criteria could be the same as existing IFRS requirements. The Board discussed the case studies with participants at the World Standard-setters conference in 2016. As a result of this outreach, the Board concluded no further guidance was needed.
Distinction between liabilities and equity		
The Board proposed not to make any changes to the definitions of a liability, or of equity, to address the classification of financial instruments with characteristics of both liabilities and equity. The Board also proposed not to include in the 2018 *Conceptual Framework* discussion on presentation or disclosure about classes of equity claims, measurement of equity claims, or the use of a statement of changes in equity.	Some stakeholders argued that the Board should address the distinction between liabilities and equity in the Conceptual Framework project. Others expressed the view that the Board should not make any changes to the liability definition until it has completed its project on Financial Instruments with Characteristics of Equity.	The *Conceptual Framework* retains a binary distinction between liabilities and equity. The Board decided not to address in the 2018 *Conceptual Framework* the classification of financial instruments with characteristics of both liabilities and equity, so as not to delay other much-needed improvements to the *Conceptual Framework*. If necessary, the *Conceptual Framework* will be updated as one possible outcome of the Board's project on Financial Instruments with Characteristics of Equity.

Project proposals	Feedback	The Board's response
Definition of income and expenses		
Throughout the project, the Board proposed not to change the definitions of income and expenses, except to align them with the revised definitions of an asset and a liability. In particular, the Board proposed to continue to define income and expenses in terms of changes in assets and liabilities. This does not mean the Board focuses solely or primarily on the statement of financial position. The Board and other standard-setters have found over many years that it is more effective, efficient and rigorous to define assets and liabilities first and to define income and expenses as changes in assets and liabilities, instead of trying to define income and expenses first and then describe assets and liabilities as by-products of the recognition of income and expenses.	Many stakeholders supported the proposals. However, some stakeholders disagreed with the proposals and argued that they give undue primacy to the statement of financial position over the statement(s) of financial performance, and insufficiently acknowledge the importance of accounting for transactions in the statement(s) of financial performance or of matching income and expenses.	The Board confirmed the proposals, noting that no major problems have been identified with the definitions of income and expenses. To demonstrate its equal focus on the statements of financial position and financial performance, the Board included in the 2018 *Conceptual Framework* a statement that information about income and expenses is just as important as information about assets and liabilities. The 2018 *Conceptual Framework* also reiterates in the recognition criteria (Chapter 5) and in the guidance on measurement (Chapter 6) that it is important to consider the nature of the information in both the statement of financial position and the statement(s) of financial performance. The Board agrees that information about transactions is relevant to users of financial statements. Hence, much of financial reporting is currently based on transactions and will continue to be so. The Board also observed that the recognition of assets and liabilities will often result in the simultaneous recognition of income and expenses if income and expenses both arise from transactions that create assets and liabilities.

Project proposals	Feedback	The Board's response
Recognition		
In the 2013 Discussion Paper, the Board proposed an overarching principle that an entity should recognise all its assets and liabilities, unless the Board decides when developing Standards that an entity need not, or should not, recognise an asset or liability because recognition would not provide sufficiently useful information to justify the cost (the cost constraint). In the 2015 Exposure Draft, the Board proposed recognition criteria based on the qualitative characteristics of useful financial information, that is, relevance and faithful representation, and the cost constraint.	Throughout the project stakeholders have expressed different views on: (a) whether there should be a presumption that all assets and liabilities should be recognised, with exceptions, or an underlying assumption that assets and liabilities should be recognised only if they meet specified criteria; and (b) the extent to which recognition requirements should be principle-based, requiring the Board to exercise significant judgement when developing Standards, or more concrete and robust, thereby imposing more restrictions on future Board decisions.	The Board confirmed the approach proposed in the 2015 Exposure Draft. The Board concluded that setting more rigid recognition criteria in the *Conceptual Framework* would not help the Board set recognition requirements in individual Standards. For example, the Board concluded the *Conceptual Framework* should not include a probability threshold for recognition. Instead, low probability of a flow of economic benefits is noted as an indicator that in particular cases recognition of an asset or liability may not provide relevant information. The 2018 *Conceptual Framework* also explains that cost constrains recognition decisions just as it constrains other financial reporting decisions.

Project proposals	Feedback	The Board's response
Derecognition		
In the 2013 Discussion Paper, the Board proposed that an entity should derecognise an asset or liability when it no longer meets the recognition criteria. In the 2015 Exposure Draft, the Board proposed that decisions about whether to derecognise an asset or liability should aim to result in a faithful representation of both: (a) the assets and liabilities retained by the entity; and (b) the changes in the entity's assets and liabilities.	Throughout the project, some stakeholders expressed a preference for either a control approach or a risks-and-rewards approach to derecognition. Other stakeholders agreed with the proposed guidance in the 2015 Exposure Draft.	The Board confirmed the proposed guidance in the 2015 Exposure Draft. In the Board's view, the control approach focuses more on the assets and liabilities retained after the transaction or other event and the risks-and-rewards approach focuses more on the changes in the assets and liabilities. The Board thought a focus on both was valid. Accordingly, the 2018 *Conceptual Framework* does not specify the use of the control approach or the risks-and-rewards approach. It explains how to approach decisions about derecognition in the minority of cases when it is difficult to achieve a faithful representation of both the assets and liabilities, and the changes in them.
Measurement		
Throughout the project the Board indicated that identifying which measurement bases would provide useful information and considering the cost constraint is likely to result in the selection of different measurement bases for different assets, liabilities, income and expenses (a mixed measurement model). In the 2013 Discussion Paper, the Board included detailed discussion about measurement, which some stakeholders thought was too detailed for the *Conceptual Framework*. In the 2015 Exposure Draft, the Board focused on: (a) measurement bases, the information that they provide and their advantages and disadvantages; and (b) the factors to consider when selecting a measurement basis.	Nearly all who commented on this topic agreed that a mixed measurement model would provide the most useful information. Throughout the project, some stakeholders suggested that the proposed guidance would be insufficient, and the Board should either delay issuing a revised *Conceptual Framework* or issue a revised *Conceptual Framework* without a measurement chapter whilst developing further guidance. However, many stakeholders agreed with the overall approach to measurement in the 2015 Exposure Draft, although some stakeholders expressed concerns about specific aspects of the proposals.	The lack of guidance on measurement was a serious gap in the previous *Conceptual Framework*. Accordingly, the Board rejected the suggestions to delay issuing a revised *Conceptual Framework* or to issue a revised *Conceptual Framework* without a measurement chapter. The 2018 *Conceptual Framework* discusses measurement bases and factors that will help the Board to develop measurement requirements in Standards. It does not specify definitively when a particular measurement basis would be appropriate.

Project proposals	Feedback	The Board's response
Profit or loss and other comprehensive income		
In the 2013 Discussion Paper, the Board included a discussion of the classification of income and expenses in profit or loss or other comprehensive income. In response to feedback the Board refined the discussion and proposed in the 2015 Exposure Draft: (a) a description of the statement of profit or loss as the primary source of information about an entity's financial performance for the period; and (b) a presumption that all income and expenses would be included in the statement of profit or loss unless specified conditions are met, in which case the Board could decide income and expenses would be included in other comprehensive income. The Board did not propose to define profit or loss.	Throughout the project, some stakeholders stated that the proposals were insufficient and would not provide the Board with a clear basis for making standard-setting decisions. They asked the Board to perform further work on reporting financial performance. Some stakeholders asked the Board to define profit or loss. A few stakeholders provided suggestions for how to develop a definition of profit or loss, or for distinguishing income or expenses to be included in the statement of profit or loss from income or expenses to be included in other comprehensive income. However, no consensus on a viable approach emerged. Some stakeholders broadly supported the proposals in the 2015 Exposure Draft.	The Board confirmed the approach in the 2015 Exposure Draft. The Board concluded on the basis of this project and its extensive previous work that it is not possible to produce a robust conceptual definition of profit or loss. The Board also concluded guidance on the use of other comprehensive income is urgently needed, and should not be delayed for further work. Accordingly, the 2018 *Conceptual Framework* includes a principle that all income and expenses are included in the statement of profit or loss. However, in exceptional circumstances the Board may require or permit income and expenses to be excluded from the statement of profit or loss and included instead in other comprehensive income. The Board may make such a decision if doing so would result in the statement of profit or loss providing more relevant information or providing a more faithful representation of an entity's financial performance for the period.

Project proposals	Feedback	The Board’s response
Recycling		
The 2013 Discussion Paper suggested requiring or permitting at least some income or expenses included in other comprehensive income to be reclassified subsequently (‘recycled’) into the statement of profit or loss. The 2015 Exposure Draft proposed a rebuttable presumption that income and expenses included in other comprehensive income would subsequently be recycled to profit or loss.	Some stakeholders supported the proposal in the 2015 Exposure Draft. Some stakeholders argued that all income and expenses included in other comprehensive income should be recycled. Others argued that income and expenses included in other comprehensive income should never be recycled.	In response to feedback the 2018 *Conceptual Framework* includes a principle that income and expenses included in other comprehensive income are recycled in the period when doing so results in the statement of profit or loss providing more relevant information, or providing a more faithful representation of the entity’s financial performance for that period. However, the Board may decide to prohibit recycling, or not to require it, if, for example, it is not possible to identify any period when reclassifying income and expenses into the statement of profit or loss would result in the statement of profit or loss providing more relevant information, or providing a more faithful representation of the entity’s financial performance.
Capital maintenance		
The Board proposed to retain the existing discussion of capital and capital maintenance in the 2010 *Conceptual Framework*.	Most stakeholders did not comment on the discussion of capital and capital maintenance. Most of those who commented suggested that the existing discussion of capital and capital maintenance was not satisfactory. However, they expressed diverse views on whether and how the discussion should be improved.	The 2018 *Conceptual Framework* explains that the discussion of capital and capital maintenance has been carried forward unchanged from the 2010 *Conceptual Framework*. The Board may decide to revisit the discussion of capital and capital maintenance in the future if it considers such a revision necessary.

Part 2—*Amendments to References to the Conceptual Framework in IFRS Standards*

Project proposals	Feedback	The Board's response
Preparers of financial statements can be affected by the changes to the *Conceptual Framework* if they use it to develop or select accounting policies when no Standard specifically applies to a transaction or other event. To achieve transition to the 2018 *Conceptual Framework* for such entities, the Board proposed amendments to Standards that update references to previous versions of the *Conceptual Framework*.	Most stakeholders supported the proposal to replace references to previous versions of the *Conceptual Framework* in principle. However, some stakeholders expressed concerns about potential unintended consequences of the proposals relating to paragraph 11 of IFRS 3 *Business Combinations* and paragraph 11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.	In response to feedback, the Board updated references to previous versions of the *Conceptual Framework* in Standards apart from the reference to a previous version of the *Conceptual Framework* in paragraph 11 of IFRS 3. The Board decided to retain this reference and undertake an analysis of the possible consequences of replacing the reference. Once that analysis is complete, the Board intends to amend IFRS 3 in a way that avoids unintended consequences. The Board also decided that although the reference to the previous version of the *Conceptual Framework* will be replaced in paragraph 11 of IAS 8, the replacement will not apply to accounting policies for regulatory account balances. This avoids entities revising those accounting policies twice within a short period: once for the revised *Conceptual Framework* and again when a revised Standard on rate-regulated activities is issued. The Board concluded that the other proposed amendments would not have a significant effect. However, in order to keep disruption for preparers and users to a minimum, the Board decided not to require retrospective application of an amendment if it would be impracticable or if doing so would require undue cost or effort.

Important information

This Feedback Statement has been compiled by the staff of the IFRS Foundation for the convenience of interested parties. The views expressed in this document are those of the staff who prepared the document and are not the views or the opinions of the Board and should not be considered authoritative in any way. The content of this Feedback Statement does not constitute any advice.

Official pronouncements of the Board are available in electronic format to eIFRS subscribers. Publications are available for ordering from our website at www.ifrs.org.

Other relevant documents

Conceptual Framework for Financial Reporting—describes the objective of, and the concepts for, general purpose financial reporting.

Basis for Conclusions on the Conceptual Framework for Financial Reporting—summarises the Board's considerations in developing the *Conceptual Framework*.

Amendments to References to the Conceptual Framework in IFRS Standards—sets out amendments to Standards, their accompanying documents and IFRS practice statements.

Project Summary—provides an overview of the 2018 *Conceptual Framework.*

Notes

Notes

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STANDARDS
BOARD

19 November 2015

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Dear Hans

IASB Exposure Drafts ED/2015/3 *Conceptual Framework for Financial Reporting* and ED/2015/4 *Updating References to the Conceptual Framework*

The New Zealand Accounting Standards Board (NZASB) is pleased to submit its comments on the International Accounting Standards Board's (IASB's) Exposure Drafts ED/2015/3 *Conceptual Framework for Financial Reporting* and ED/2015/4 *Updating References to the Conceptual Framework*.

We set out below some general comments, followed by some more specific comments on particular aspects of the proposals.

General comments

We remain supportive of the conceptual framework project. We also appreciate the difficulty of developing a robust conceptual framework within a reasonable period of time, particularly given the gaps in the existing framework, the complexity of the matters involved and the wide diversity of views on how those matters should be addressed.

Overall, we consider that some of the proposals in the Exposure Draft are an improvement on the Discussion Paper. However, we consider that aspects of the proposals require further development. This further development is necessary to ensure that the *Conceptual Framework* continues to serve its role as a framework of accounting concepts that reflect real world economic phenomena, which therefore excludes accounting conventions, methods, or practical expedients. A conceptual framework needs to provide a conceptual basis for accounting standards and support the evolution of financial reporting.

Ideally, we would prefer that the IASB took more time to develop robust concepts for those parts of the *Conceptual Framework* where there are currently gaps, such as measurement and reporting financial performance. However, if the IASB continues with its plan to complete the conceptual framework project in 2016, our preference is for the revised *Conceptual Framework* to provide limited guidance on those matters. This approach would reduce the risk of including guidance or rules in the *Conceptual Framework* that entrench current practice, which may not have a conceptual basis, and/or inadvertently limit the further development and evolution of accounting. We discuss this point further in our responses to specific questions.

Summary of our main comments

In our view, a number of areas in the *Conceptual Framework* require further development. The main areas that we have identified as needing further development are:

(a) The definition of a liability. In particular, we consider that the description of a present obligation and its accompanying guidance need further work. We consider that liabilities should represent present claims against the entity at the reporting date. The definition of a liability should clearly distinguish between present claims that result in future outflows of economic resources and future outflows of economic resources that arise from future obligations that must be incurred to continue operating. The proposed guidance results in the proposed definition being too broad.

(b) The chapter on measurement. We consider that:

  (i) the objective of the chapter remains unclear;

  (ii) to be useful in filling the gap in the existing *Conceptual Framework,* the discussion of each measurement basis needs to include the conceptual rationale for each measurement basis, including how each measurement basis could meet user needs and contribute to achieving the qualitative characteristics of financial reporting;

  (iii) the information value of current measurements has not been adequately captured; and

  (iv) the categories or classification of measurement bases needs to be revised.

(c) The meaning of 'financial performance' and the distinction between profit or loss and other comprehensive income (OCI). This is one area where we strongly encourage the IASB to undertake further work. Alternatively, given the timeframe the IASB is working to, which may preclude that further work, care must be taken not to prejudge the outcome of the IASB's performance reporting project or create barriers preventing further progress in this area.

We have focused our attention on these main areas in considering the proposals in ED/2015/3.

Furthermore, we disagree with the reintroduction of the term 'prudence'. The term 'prudence' is interpreted and applied differently in different jurisdictions. Given the danger of misinterpretation and misapplication, we do not support prudence being reintroduced into the *Conceptual Framework*.

Responses to specific questions for respondents

Our responses to the specific questions for respondents to ED/2015/3 are provided in Appendix A to this letter.

Our responses to the specific questions for respondents to ED/2015/4 are provided in Appendix B to this letter.

If you have any queries or require clarification of any matters in this submission, please contact Joanne Scott (joanne.scott@xrb.govt.nz) or me.

Yours sincerely

Kimberley Crook
Chair – New Zealand Accounting Standards Board

Appendix A Responses to specific questions for respondents to ED/2015/3 *Conceptual Framework for Financial Reporting*

Chapters 1 and 2—The objective of general purpose financial reporting and the qualitative characteristics of useful financial information

Question 1—Proposed changes to Chapters 1 and 2

Do you support the proposals:

(a) to give more prominence, within the objective of financial reporting, to the importance of providing information needed to assess management's stewardship of the entity's resources;

(b) to reintroduce an explicit reference to the notion of prudence (described as caution when making judgements under conditions of uncertainty) and to state that prudence is important in achieving neutrality:

(c) to state explicitly that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form;

(d) to clarify that measurement uncertainty is one factor that can make financial information less relevant, and that there is a trade-off between the level of measurement uncertainty and other factors that make information relevant; and

(e) to continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information?

Why or why not?

Assessing stewardship of management

We agree with the proposal to give more prominence, within the objective of financial reporting, to the importance of providing information needed to assess the efficient and effective management of the entity's resources.

Holding management to account remains integral to the purpose of financial reporting. This should be clearly established in the discussion of the objective of financial reporting in the *Conceptual Framework*.

Although we support giving more prominence to stewardship, we do not necessarily share all the views of those who support giving more prominence to stewardship. We are aware of views that support a more traditional approach to 'stewardship' that implies the use of historical cost as the preferred measurement basis. We do not agree with that approach and would be concerned if the greater prominence given to stewardship could be interpreted in that way. In our view, although historical cost measures can be useful, there are also many instances in which the selection of information that is useful for assessing the efficient and effective management of the entity's resources is likely to imply the use of current measurements. We comment further on this point in our response to the questions on measurement.

Reintroduction of prudence

We disagree with the reintroduction of the term 'prudence'. The term 'prudence' is interpreted and applied differently in different jurisdictions. Given the danger of misinterpretation and misapplication, we do not support prudence being reintroduced into the *Conceptual Framework*. In this regard, we support the alternative view of Patrick Finnegan in paragraph AV16 of the Exposure Draft, and in particular, his concerns about the introduction of prudence leading to bias and potential confusion about when and how prudence should be applied.

However, if the IASB proceeds with the reintroduction of prudence, it is essential that the particular meaning of prudence that has been adopted is clearly explained. It must be clear that prudence is there only to support neutrality and that prudence is not asymmetric.

If prudence were to be defined in such a way that it allowed bias or asymmetry, it would be inconsistent with neutrality. In order for information reported to be a faithful representation, it must be complete, neutral and free from error. If prudence were to be defined in such a way that it did not simply support neutrality but potentially led to bias or asymmetry, it would undermine faithful representation. Asymmetric prudence results in financial statements that are less transparent, and potentially misleading. Hence, asymmetric prudence is not consistent with the objective of financial reporting.

To clarify that prudence is there only to support neutrality and does not lead to bias or asymmetry, we recommend that the description of prudence be revised as follows:

> Neutrality is supported by the exercise of prudence. Prudence is the exercise of giving careful consideration to all relevant facts and circumstances in a balanced manner when making judgements under conditions of uncertainty and means that assets, liabilities, income and expenses are not overstated or understated.

In addition, within the discussion of faithful representation, care must be taken not to inadvertently elevate prudence to the same status as a qualitative characteristic.

Faithful representation represents substance over form

We agree with the proposals to state explicitly that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form. Substance over form remains a key principle that must be applied in preparing general purpose financial reports.

Measurement uncertainty is one factor that can make financial information less relevant

We support the clarification that measurement uncertainty is a factor to consider in assessing whether information is *useful*. However, we consider that measurement uncertainty should be discussed as part of faithful representation rather than as part of relevance, that is, as a factor that impacts on faithful representation and therefore can make information less useful. The recognition of amounts where measurement is very uncertain could potentially result in financial statements that are no longer a faithful representation. The information provided could even be misleading. For example, users could be misled by the 'illusion of precision' if a single figure is used to represent a wide range of possible outcomes. In such cases, it may be more appropriate from a user perspective, to disclose, rather than recognise an item.

We understand that the positioning of measurement uncertainty as part of the discussion of relevance results from the discussion in paragraph 2.19 of the Exposure Draft on estimates (and the additional text in paragraph 2.20 of the Exposure Draft). However, we do not consider the discussion (particularly the last part of paragraph 2.19 and the new text in 2.20) to be a helpful way of describing faithful representation. An estimate of an unobservable price or value is a means to an end, not the end itself. For example, for assets measured at fair value, the objective is to measure the fair value of the asset. If there are no observable prices, fair value must be estimated. The fact that an estimate is necessary does not change the measurement objective.

In our view, it would be preferable to explain that, although an estimated price or value might not be verifiable directly (in the absence of observable prices), an assessment of whether the element concerned (for example, an asset) is capable of being faithfully represented using such an estimate involves considering a range of factors that includes, but is not limited to, measurement uncertainty.

In addition, discussing measurement uncertainty as an aspect of faithful representation may assist the IASB in responding to those who support reintroducing reliability as a qualitative characteristic of useful financial information.

Relevance and faithful representation as fundamental qualitative characteristics

We agree with the proposal to continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information. If information reported were not relevant and a faithful representation of what it purports to represent, it would not be useful for decision making.

'Reliability' should not be reintroduced as a qualitative characteristic of useful financial information. The term 'reliability' can be misunderstood and is often associated with measurement only. 'Faithful representation' is a broader concept and the term more clearly encompasses what is intended by the qualitative characteristic.

<u>Other comments</u>

Completeness

The description of completeness suggests that providing more detailed and extensive disclosure is preferable to providing more concise disclosure. However, disclosure of too much detailed information could obscure useful information and result in financial statements being less understandable. We therefore recommend that the discussion of completeness draw on the work being done in the IASB's Disclosure Initiative.

For example, within the discussion of completeness in paragraph 2.16 of the Exposure Draft, the use of the phrase '…would include, as a minimum,..' suggests both that the listed information must always be provided, and that it would be incomplete without more detailed information.

Primary users

We note that some commentators are urging the IASB to revise the list of primary users. We consider that the list of users is sufficiently broad and should not be narrowed. 'Existing and potential investors' as well as 'lenders and other creditors' appropriately capture a wide range of users, including customers and appropriate parts of the general public. The government, regulators and management should not be listed as primary users as they typically have the power to obtain specific information about the reporting entity and, as such do not need to rely on general purpose financial statements and should not be part of the primary audience considered in setting standards for general purpose financial reporting.

The list of primary users is already narrower than the list in the previous *Conceptual Framework*. Narrowing the list any further would inappropriately exclude users of general purpose financial reports.

Chapter 3—Financial statements and the reporting entity

Question 2—Description and boundary of a reporting entity

Do you agree with:

(a) the proposed description of a reporting entity in paragraphs 3.11–3.12 of the Exposure Draft; and

(b) the discussion of the boundary of a reporting entity in paragraphs 3.13–3.25 of the Exposure Draft?

Why or why not?

Description of a reporting entity

We agree that the *Conceptual Framework* should continue to broadly describe, rather than precisely define, a reporting entity. It is not the role of an international standard setter to specify the types of entities that should apply its standards. The responsibility for determining which organisations are reporting entities, and whether or not they are required to apply a particular set of accounting standards, rests with the regulators in individual jurisdictions. What an international standard setter can do is identify the types of entities that it has in mind when it develops its standards and the circumstances in which it considers the use of its standards is likely to be appropriate. The regulators in individual jurisdictions can then use this information to assist them in determining which entities should be required to apply those standards by, for example, considering the needs of stakeholders of the organisations within a specific jurisdiction.

We agree that what constitutes a reporting entity should not be limited to business activities that are structured as legal entities. Neither should the constituent parts of a reporting entity be limited to legal entities. Whether an entity is a legal entity depends on legislation in particular jurisdictions. Limiting reporting entities to legal entities would place undue emphasis on legal form, could result in financial reporting failing to reflect economic substance and, accordingly, could result in inconsistent reporting between jurisdictions simply by virtue of legislative differences.

The boundary of a reporting entity

We consider that the discussion of the boundary of a reporting entity requires further clarification. Our comments on aspects of the discussion that were unclear to us are set out below.

The boundary of a reporting entity should be determined based on control. It is unclear how the discussion of the boundary of the reporting entity in the Exposure Draft is consistent with the concept of control and the definition of an asset (which also uses the concept of control). An entity either controls, or does not control, something. The concept of control and the definition of an asset do not distinguish between direct and indirect control.

Furthermore, it is unclear how the discussion of the boundary of a reporting entity is consistent with the preparation of financial statements from the perspective of the entity as a whole (the economic entity perspective) and substance over form. The boundary of the reporting entity should not change depending on whether subsidiary operations are incorporated legal entities or unincorporated.

In addition, the discussion of control and indirect control, and of consolidated and unconsolidated financial statements, does not make it clear whether the *Conceptual Framework* has adopted the economic entity perspective or parent/proprietary perspective. Indeed, this discussion could imply that both perspectives have been adopted. However, the perspective from which group financial statements are prepared can lead to different accounting treatments in various circumstances, such as step acquisitions and changes in ownership interests without a loss of control. We therefore consider that the *Conceptual Framework* should be clear about which perspective has been adopted.

The discussion of unconsolidated (parent-only) financial statements implies that consolidated financial statements should be prepared. We consider that the *Conceptual Framework* should be explicit about this. Also, whilst we agree that the reporting entity providing unconsolidated financial statements should be required to disclose where consolidated financial statements can be obtained, this is a requirement that belongs in a Standard, not in the *Conceptual Framework.*

Chapter 4—The elements of financial statements

Question 3—Definitions of elements

Do you agree with the proposed definitions of elements (excluding issues relating to the distinction between liabilities and equity):

(a) an asset, and the related definition of an economic resource;

(b) a liability;

(c) equity;

(d) income; and

(e) expenses?

Why or why not? If you disagree with the proposed definitions, what alternative definitions do you suggest and why?

Definition of an asset and an economic resource

We agree with the proposed definition of an asset and the proposed definition of an economic resource. We consider the definitions to be an improvement on the existing definitions. In particular, removal of the word 'expected' from the definition of an asset appropriately focuses the definition on the resource and resource capacity (rather than future expectations). Also, although, in our view, the identification of a past event is not necessary in order to determine whether or not an asset exists, identifying that event helps to determine whether or not an asset exists and the nature of that asset.

We also support the discussion of economic resources as being a right or a bundle of rights. However, we consider that the *Conceptual Framework* needs more consideration of the accounting implications of assets being viewed as bundles of rights. For example, the relationship between the concept of an asset being a right or a bundle of rights under the entity's control and the concept of joint control should be clarified (as explained further below).

We consider that the relationship between assets as a bundle of rights and: (i) the unit of account; (ii) recognition and derecognition; and (iii) the implications for measurement, should be clarified at a conceptual level.

For example, paragraph 4.12 of the Exposure Draft implies that the bundle of rights making up an asset (when viewed collectively as a whole) can never be different to the sum of the individual rights that make up the bundle. This implies that each individual right is identifiable, potentially separable, and independent of the other rights in the bundle. However, the discussion of the unit of account, especially paragraph 4.62 of the Exposure Draft, acknowledges that this may not be the case.

If an entity divides the bundle of rights (for example, by a change from control to joint control of an item of property, plant and equipment), it is not clear whether the entity has:

(a) disposed of one or more rights while retaining some rights; or

(b) exchanged one bundle of rights for another (different) bundle of rights.

Paragraph 4.63 of the Exposure Draft (in the discussion of unit of account) acknowledges this issue and refers to the discussion on derecognition in paragraphs 5.25–5.32 of the Exposure Draft. However, that discussion does not clearly address this issue, which is different to the issues acknowledged in paragraph 5.30 of the Exposure Draft.

Currently, there are different views applied in International Financial Reporting Standards (IFRS) for asset transfers with some retained interest. For example, there are differences in the treatment of a transfer of assets to an associate or joint venture depending on whether or not the assets are part of a transfer of a business (according to the recently issued amendments to IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*). Although this difference in IFRS results from differences in current accounting standards (IFRS 10 and IAS 28), on a conceptual level, it is not clear why there should be a difference in treatment based on whether or not the assets are part of a business transferred. In both cases, the entity loses control of the physical objects but continues to have joint control of the physical objects. If assets are viewed as being rights (according to paragraphs 4.8–4.12 of the Exposure Draft), and given the economic differences between rights of the entity in the case of control compared with joint control (as acknowledged in paragraph 4.17 of the Exposure Draft), the question that arises is whether this type of transaction represents the division of the original bundle of rights into two parts (with one part retained and the other transferred) or the exchange of one bundle of rights for another (different) bundle of rights? In our view, the latter view is more consistent with the concept of control and of viewing economic resources as rights.

Furthermore, paragraph 4.17 of the Exposure Draft explains that a right to a proportionate share in a physical object (property) is a different asset to control of the physical object. It is unclear how this thinking would apply to situations where the physical object is the subject of joint control by the entity and one or more other parties, or situations where the entity controls the physical object but has a minority interest in the economic benefits flowing from that asset.

We therefore recommend considering these issues further and ensuring the discussion in the *Conceptual Framework* is clear and consistent. In particular, this is likely to include considering further the link between control and the economic resource in question. For example, a distinction could be drawn between the following two scenarios involving the division of a bundle of rights:

(a) the entity continues to control one or more rights in the bundle, while losing control of the rest of the bundle. This might occur when an entity leases a physical object to another entity, thereby losing control of the right to use the physical object during the lease term, while retaining control of the right to use the physical object for the remainder of its useful life (after the lease ends) and other rights, such as the right to the economic benefits from its sale; and

(b) the entity loses control of all rights in the bundle but retains an interest in the economic benefits arising from the previously held rights by obtaining control of a different set of rights. This might occur when an entity transfers property to a joint arrangement or associate.

We also note that the discussion in the Exposure Draft switches between discussing assets as bundles of rights and discussing assets as the physical object in question. The discussion needs to be revised to be consistent with proposed definitions.

Definition of a liability

Subject to our comments on the meaning of 'present obligation' in our response to Question 4 below, we agree with the proposed definition of a liability.

Consistent with our comments above on the proposed definition of an asset, we consider the definition to be an improvement on the existing definition. In particular, removal of the word 'expected' from the definition of a liability appropriately focuses the definition on the resource and resource capacity (rather than future expectations). Also, although, in our view, the identification of a past event is not necessary in order to determine whether or not a liability exists, identifying that event helps to determine whether or not a liability exists and the nature of that liability.

Definition of equity

We agree with the proposal to retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.

Definitions of income and expense

We agree with the proposal to retain the existing definitions of income and expense.

Question 4—Present obligation

Do you agree with the proposed description of a present obligation and the proposed guidance to support that description? Why or why not?

Question 5—Other guidance on the elements

Do you have any comments on the proposed guidance?

Do you believe that additional guidance is needed? If so, please specify what that guidance should include.

Introduction

We note that the definition of a liability is currently used for two purposes:

(a) determining whether or not a present claim exists; and

(b) determining whether a present claim should be classified as a liability or equity. However, the IASB has decided to defer any discussion of the debt/equity issue.

Ideally, both matters should be considered at the same time, so that any revised definition of a liability continues to be suitable for both purposes. For example, in discussions about implications of applying the proposed description of a present obligation and its accompanying guidance, some of the specific situations under discussion relate to the distinction between liabilities and equity, rather than whether or not a present claim exists. One such situation being discussed in considering the proposals in the Exposure Draft is whether a blue chip company with a publicly announced dividend policy has a present obligation to pay dividends under the proposed guidance and, therefore, a liability for future dividends. This issue relates to the liability/equity distinction rather than whether a present claim exists, because many consider that shareholders have a present claim against the assets of the entity, irrespective of whether that claim is classified as a liability or equity.

Given the IASB's decision to defer the discussion of the distinction between liabilities and equity, our comments focus on whether or not a present claim exists. However, the IASB's future project on the distinction between debt and equity will need to consider the implications of any potential changes to the definition of a liability for both purposes, not merely for the purpose of distinguishing between liabilities and equity.

The remainder of our comments are divided into two categories:

(a) Section 1: General comments on the proposed description and guidance; and

(b) Section 2: Specific comments on the proposed description and guidance in the context of particular issues arising in practice.

Section 1: General Comments

Present claims

We consider that liabilities should represent present claims against the entity at the reporting date. The objective of financial reporting and the definitions of the elements, as set out in the *Conceptual Framework*, suggest a claims approach whereby:

(a) the statement of financial position provides information about the resources of the entity and claims against those resources; and

(b) the statement of comprehensive income provides information about changes in those resources and/or claims.

The focus, therefore, should be on whether there is a present claim against the entity's assets at a point in time.

The description of a present obligation and accompanying guidance proposed in the Exposure Draft appears to capture some situations in which present claims exist and we would agree that those claims should be recognised as liabilities. However, it appears that the proposed description and guidance introduces the notion of economic compulsion. Since there are many future transfers of economic resources that an entity has no practical ability to avoid in order to continue operating in the future, there is a risk that the proposals may capture too many items as a liability. For example, it may capture future asset maintenance costs, future salaries and wages and future operating losses of a start-up company. Although we understand that the IASB did not *intend* these types of future costs to be captured (as indicated in paragraph 4.39), our concern (which is also shared by our constituents and others) is that the description of a present obligation and the accompanying guidance has made such interpretations possible, thereby potentially extending the liability definition too far and making it more difficult (rather than less difficult) to distinguish between present and future claims against the entity's assets.

We understand that some of this additional guidance is intended to deal with the specific issue of levies. However, we are concerned that introducing guidance into the *Conceptual Framework* to deal with one particular issue will create more problems than it solves.

Despite attempts to limit the implications of introducing the notion of 'no practical ability to avoid' in paragraphs 4.36–4.39 of the Exposure Draft, we consider that the focus on that notion places too much emphasis on future outflows of economic resources and results in the definition being too broad. Our concerns relate to the fact that, as long as the entity continues to operate as a going concern, there are many expected future outflows that are linked to past events and transactions (hence can be linked to benefits previously received and/or past activities of the entity). Although the proposals attempt to place some limits on the expanded liability definition in the discussion about past events, we are concerned that it is inadequate to prevent a variety of future operating costs falling within the expanded liability definition.

We also consider that whether or not the entity has the practical ability to avoid future expenditure can be highly subjective. It also may not assist in addressing some common issues currently occurring in practice (for example, as discussed further below in our comments on contracts where the amount payable depends on the entity's future actions).

In our view, the liability definition needs to clearly distinguish between:

(a) present claims that result in future outflows of economic resources; and

(b) future outflows of economic resources that arise from future obligations that must be incurred to continue operating.

In our view, it is helpful to focus more on determining whether there is a present claim against the entity's assets, rather than whether a future transfer of economic resources can be avoided. The mere fact that an entity is economically compelled to make a future transfer of economic resources if it wishes to continue operating is not sufficient, in itself, to result in a present claim against the entity's assets.

Focusing on the existence of present claims would entail focusing on the existence of a claimant to the entity's assets, i.e. another party (or parties, which could be the public at large) that is entitled to receive (or benefit from) the future transfer of economic resources and who would therefore suffer harm if the entity failed to meet its responsibilities to transfer those resources.

Legal and constructive obligations

Our comments above focus on the problems that can arise when the liability definition and guidance is too broad. We also understand that problems can arise if the liability definition and guidance is too narrow, particularly as some might regard a narrow definition as failing to reflect economic substance. In our view, some of these latter concerns can be addressed by giving greater attention to constructive obligations.

This would entail reframing the discussion in paragraph 4.34 so that it focuses on why a constructive obligation represents a present claim, rather than merely whether the entity has a practical ability to avoid a future action. In our view, there is a difference between: (a) a present constructive obligation arising from past events that requires a future transfer of economic resources, and (b) a future transfer of economic resources that the entity is economically compelled to make to continue operating.

In our view, the word ‘constructive’ should be used within the *Conceptual Framework* in the same way that it is used in law. That is, a constructive obligation would be an implicit, inferred or implied obligation that may not explicitly exist in a contract between the entity and the other parties concerned but which has been created by the entity’s actions in holding itself out as having accepted certain responsibilities and, as a result, the entity has created valid expectations in those other parties that it will discharge those responsibilities. Constructive obligations are, in substance, similar to contractual obligations, albeit that they are not actually documented in the form of a contract.

<u>Section 2: More specific comments</u>

We discuss below three issues that arise in practice when trying to determine whether or not a present obligation exists:

(a) contracts where the amount payable depends upon the entity’s future activities;

(b) executory contracts; and

(c) levies.

Contracts where the amount payable depends upon the entity’s future activities

In our view, the guidance in the *Conceptual Framework* on whether a present obligation exists should be able to be usefully applied to contracts where the amount payable depends on the entity’s future activities.

For example, consider contingent consideration in a business combination whereby the purchaser agrees to pay additional amounts to the vendor of the business, based upon the achievement of performance targets, with control of the business already transferred to the purchaser (so the vendor has performed its side of the contract). Ignoring the requirements of IFRS 3 *Business Combinations*, two views could be adopted:

View A: The contingent consideration does not represent a present claim, as the entity could avoid achieving the performance targets. In other words, if the future activities that determine the amount of the future payment are within the entity’s control, some argue that there is no present obligation for that future payment. Instead (to address concerns that the entity’s net financial position is overstated if the carrying amount of assets acquired assumes that the business will continue to operate and generate cash flows, but the portion of those cash flows payable to the vendor of the business is not recognised as a liability), it could be argued that the potential future payments for the contingent consideration should be considered when assessing the recoverability of the carrying amount of the assets (that is, the value-in-use of the assets acquired in the business combination might need to take into account the fact that some of the cash flows benefits generated from the use of those assets will be payable to another party. Therefore, it is a future cost that reduces the value in use of those assets).

View B: The contingent consideration represents a present claim against the entity's assets, as the vendor has performed its side of the contract (by transferring control of the business), which gives rise to a present obligation for the entity to perform its side of the contract, which includes settling the vendor's entitlement to a portion of the future returns generated by the business, in a similar way as other types of debt/equity instruments that entitle the holder to a portion of the entity's profits.

Based on paragraphs 4.31 and 4.32 of the Exposure Draft, either view A or view B is possible, depending on the wider economic implications of missing the target. Therefore, the guidance in the Exposure Draft does not assist in addressing this issue from a conceptual perspective.

In considering the two views above, although both views could be argued, the 'valuation' approach under View A is problematic as the business involves a collection of assets. It is unclear how contingent consideration would be dealt with when measuring the value in use or fair value of the assets if View A were adopted, given that often the contractual rights of the vendor result in a claim against the entity rather than claims against particular assets. This approach is particularly problematic for assets measured at fair value.

We consider that View B is appropriate and is consistent with a claims approach (and would help to clarify the conceptual basis for IFRS 3 as well as other similar issues).

The same issue, but involving a single asset with a future payment to the other party depending on the entity's future performance, would be something like a license royalty. If View B is adopted, as discussed above for a business acquisition, the same outcome would apply.

Executory contracts

In our view, the discussion of executory contracts is helpful but requires further elaboration in order to be clearer and more comprehensive.

When considering why executory contracts do not give rise to an obligation, the performance of the other party to the contract is a key factor, as that performance establishes the other party's claim. This should be clear from the discussion, and not only implied as in paragraph 4.39 of the Exposure Draft. For example, with executory contracts, such as employee contracts or contracts for asset maintenance, an entity might need to incur certain costs to continue operating but, as discussed earlier, that does not mean that a present claim exists. Rather, when the other party performs its side of the contract (by providing the specified goods or services), its performance creates a present claim against the assets of the entity. Hence, until it performs, the other party does not have a present claim against the entity's assets (unless the contract is onerous, in which case it is the contract itself that is the liability, not the payment required in exchange for the goods or services to be received).

The current discussion in the Exposure Draft focuses on equally unperformed contracts, not unequally performed contracts. We consider that the IASB should clarify the liability definition by providing a discussion of situations in which the contract is partially performed by one party but unperformed by the other party. For example, consider the common situation where one party has to perform over a period of time, with payment contingent on completing that performance (for example, long service leave or consulting/professional services where payment is contingent on delivering a report). Although the other party has not completed all of its performance, the part-performance is likely to create a liability for the entity to pay for the performance completed to date. This is because, although payment is deferred until the other party has completed its performance, and may not be required at all if the other party fails to complete all of the required performance, typically the entity cannot unilaterally cancel the partly performed contract without paying compensation for the partial performance to date by the other party. In other words, a legal or constructive obligation arises in respect of the other party's performance to date. In this case, the contract is executory in respect of both parties' future performance and non-executory to the extent of the other party's partial performance, thereby creating a present claim in respect of the non-executory element of the contract.

Levies

As noted earlier, some of the discussion in the guidance appears to be aimed at addressing the specific issue of levies.

In particular, the wording in paragraph 4.31(b) of the Exposure Draft about the entity having "…conducted the activities that establish the extent of its obligation" appears to be an attempt to deal with what some regard as the unsatisfactory outcomes in IFRIC 21 *Levies Charged by Public Authorities on Entities that Operate in a Specific Market*.

This wording appears intended to address concerns with levies that are charged based on past revenue. However, the use of past revenue as a base to determine levies could be merely a method used by regulators to calculate levies and allocate levies across market participants. It may be convenient to use past revenue, rather than estimated future revenue, to calculate levies. However, levies could also be calculated based on future revenue or average revenue for a certain period. Therefore, the mere fact that some levies are calculated based on past revenue should not influence the definition of a liability.

Also, the reference to 'extent' in paragraph 4.31(b) of the Exposure Draft can be read as mixing measurement of the liability with determining whether it exists at the reporting date.

As noted earlier, we consider it would be better to have a clear definition of a liability, with accompanying guidance that supports that definition, than to try to change the definition of a liability to solve a specific problem (but, in so doing, risk creating greater difficulties elsewhere).

We therefore consider that the levies problem should be addressed at the standards level.[1]

Summary

The table below summarises some situations which we consider result in present claims that should be captured within the definition of a present obligation and, therefore, recognised as a liability; and some situations that we consider will result in future claims that should not be captured and therefore not recognised.

It can be seen from the table that these future claims would not have been seen as liabilities in the past and we do not believe that the *Conceptual Framework* should envisage them as liabilities for the future.

Present claims (should be recognised as a liability)	**Future claims (should not be recognised as a liability)**
License royalties to the licensor	Costs of future asset maintenance
Long-service leave resulting from past performance (partly performed)	Costs of future employee services (i.e. services performed in the future)
Partly performed professional services	

Chapter 5—Recognition and derecognition

Question 6—Recognition criteria
Do you agree with the proposed approach to recognition? Why or why not? If you do not agree, what changes do you suggest and why?

We broadly agree with the proposed approach to recognition. In particular, we agree with the three criteria (relevance, faithful representation and cost benefit constraints) set out in paragraph 5.9 of the Exposure Draft. We also consider that it is helpful to discuss the circumstances in which recognition may not provide relevant information, may not result in faithful representation, or may not have benefits that exceed the cost of recognition (as set out in paragraphs 5.13 to 5.24).

However, we think that paragraph 5.14 of the Exposure Draft should explain more clearly that the factors in paragraph 5.13 and other relevant factors (such as the potential financial impact of the item concerned) cannot be considered in isolation of one another; they might be

1 For example, one possible idea to explore is whether the appropriate treatment depends on whether, in some situations, the objective of charging levies is to fund the activities of a regulator for a particular industry over a period, which provides economic benefits to the entity by enabling it to operate in that industry during that period. If this view is adopted, it is a matter of determining when the entity receives the economic benefits for which it is being levied, similar to executory contracts and partially performed contracts discussed above. However, this is something to consider at the standards level.

interrelated. For example, the fact that an inflow or outflow has a low probability of occurring (as discussed in paragraph 5.13(b) of the Exposure Draft) does not necessarily mean that it is less relevant, particularly when the possible inflow or outflow is a large amount.

Paragraph 5.9 of the Exposure Draft seems to imply that the recognition of an asset or liability is dependent on whether other related elements also meet the recognition criteria. We consider that the recognition of an asset or liability should be independent of whether other related elements also meet the recognition criteria (for example, the recognition of an asset should not occur only if the related income or change in equity provides relevant and faithfully representative information within cost-benefit constraints).

Question 7—Derecognition

Do you agree with the proposed discussion of derecognition? Why or why not? If you do not agree, what changes do you suggest and why?

We consider that derecognition mirrors (or should mirror) recognition. In this regard, we support the ‘control approach’ to derecognition discussed in the earlier Discussion Paper; that is, an item should be derecognised when the item no longer meets the recognition criteria.

In cases where an entity has disposed of only part of an asset or liability, we consider that circumstances would dictate whether full or partial derecognition is appropriate. However, this does not mean that the decision to use the full or partial derecognition approach is made at the standards level without guiding principles in the *Conceptual Framework.* The *Conceptual Framework* should still provide principles to distinguish circumstances in which full or partial derecognition might be appropriate.

Also refer to our earlier response to Question 4, which discusses the link between the asset definition, the unit of account and derecognition. For example, for the situation discussed in paragraph 5.30(a), it could be argued that the ‘retained component’ is actually a different set of rights or obligations compared with the rights previously held (the original asset), rather than being a component of that original asset, given the significantly different economic characteristics of the entity’s rights or obligations after the transaction. In the second situation discussed in paragraph 5.30(b), when all the related contracts are evaluated as a package, depending on the rights and obligations of the parties, in some situations the entity might have retained control, lost control or it might be similar to a lease arrangement, in which the entity has transferred control of one right in its original bundle of rights (such as the right to receive dividends or interest for a period of time) while retaining control of the remainder of the bundle of rights. Further consideration of the link between the asset definition, the unit of account and derecognition may assist in addressing such issues at the standards level, while maintaining a conceptually consistent approach in the *Conceptual Framework* by using control for both recognition and derecognition.

Chapter 6—Measurement

Question 8—Measurement bases

Has the IASB:

(a) correctly identified the measurement bases that should be described in the *Conceptual Framework*? If not, which measurement bases would you include and why?

(b) properly described the information provided by each of the measurement bases, and their advantages and disadvantages? If not, how would you describe the information provided by each measurement basis, and its advantages and disadvantages?

Question 9—Factors to consider when selecting a measurement basis

Has the IASB correctly identified the factors to consider when selecting a measurement basis? If not, what factors would you consider and why?

Question 10—More than one relevant measurement basis

Do you agree with the approach discussed in paragraphs 6.74–6.77 and BC6.68 of the Exposure Draft? Why or why not?

Overall comments

The measurement chapter is an improvement on the measurement chapter of the Discussion Paper. However, we consider that further development of this chapter is required.

Both the objective of this chapter and the intended users of this chapter remain unclear. It appears to be a description of current practice (or list of current measurement bases in use) rather than a set of objectives and principles to help clarify what the aims of measurement are and the extent to which various measurement bases might support those objectives. This is particularly so given that there is no overall measurement objective proposed and that some of the discussion of measurement bases focuses on describing accounting processes rather than what those measurement bases represent conceptually.

We consider that an overall measurement objective is necessary to provide a clear link between measurement bases and the objective and qualitative characteristics of financial reporting. This is particularly important as many doubt that there is a single measurement basis that is likely to ensure that reported information fulfils the objective and qualitative characteristics of financial reporting. Even if the measurement objective to some extent repeats the objective of financial reporting, it is helpful to be reminded of, and to remain focused on, the objective that is intended to be achieved in selecting a measurement basis.

Similarly, the discussion of available measurement bases should focus on a discussion of the conceptual basis for each measurement basis, including how each measurement basis could meet user information needs and contribute to achieving the qualitative characteristics of financial reporting.

Furthermore, in our view, a description of existing measurement bases in use and how they are determined is useful in filling the gap in the current *Conceptual Framework* only if all of those measurement bases have a sound conceptual basis. However, as is evidenced by some of the discussion in this chapter, existing accounting practice includes some measurement methods that do not have a clear conceptual rationale. For example, amortised cost, despite its name, is a mixed measurement method that combines what could be more accurately described as the historical *price* of finance charged to the borrower (rather than the historical *cost*) and current estimates of the amounts and timing of the future contractual cash inflows/outflows.[2]

We do not consider it helpful to catalogue existing measurement methods used in practice without a sound conceptual rationale. This not only results in portraying such methods in a misleading way, but also does not assist in standard-setting, because it encourages the perpetuation (or even the expansion) of such measurement methods, rather than providing concepts that enable financial reporting to be improved over time. The *Conceptual Framework* should be forward-looking, not simply a codification of current practice.

Measurement categories

We also have concerns about some of the measurement categories. In some cases, measurement bases have been included in one or other of the categories when they belong in a different category or in their own category. For example, the recoverable historical cost of the unconsumed part of a physical object is a mixed measurement in itself, it is not a pure historical cost measure. Also, as discussed above, the use of amortised cost in measuring fixed rate loans results in a mixture of historical and current measures. We note that paragraphs 6.7, 6.8, 6.9 and 6.11 of the Exposure Draft describe current practice rather than describing pure historical cost. Paragraph 6.18 discusses current cost, but has been treated as part of the discussion of measures based on historical cost/prices.

If the IASB proceeds with this chapter as proposed, the measurement categories need to be revised. There needs to be clear, conceptual descriptions of the categories including the objectives of the measurement bases. In particular, the section on historical cost needs revising, for the reasons explained above.

Also, in our view, the attempt to condense different measurement bases into two broad categories is not helpful. In our view, the measurement bases could be classified or categorised in a similar way as in the IPSASB conceptual framework. In particular, in our view, the following classifications would be helpful:

(a) Entry or exit measures – clarity of whether the measure is intended to represent an entry or exit measure can assist, for example, in determining the appropriate market price to select; for instance, fair value is an exit price (and therefore reflects the prices in the

[2] We acknowledge that amortised cost includes an element of historical cost, in that transaction costs are included in the carrying amount of the asset/liability concerned, but typically these costs are not a large portion of that carrying amount.

market in which the asset could be sold), whereas current cost is an entry price (and therefore reflects the prices in the market in which the asset could be purchased); and

(b) Entity-specific or non-entity-specific measures – clarity about whether the measure is intended to be an entity-specific or non-entity-specific measure can assist, for example, in determining the appropriate cash flows to include in the measurement of an asset without an observable market price, for which its value in use or fair value is estimated using discounted future cash flows.

Information value of different measurement bases

The information value of current measurements has not been adequately captured in the Exposure Draft. In saying this, we are not necessarily advocating for the use of fair value as a single measurement base. Some consider that using a single measurement base may be ideal, but this is unlikely to be achievable due to cost-benefit constraints and lack of agreement on the single, most appropriate, measurement base. In addition, we accept that the selection of the most relevant and representationally faithful measurement basis for particular items, including taking into account the entity's business model and other factors, inevitably results in the use of more than one measurement base. We also agree that historical cost often is practical to use and, in many cases, can provide relevant, decision-useful, information.

However, it is too simplistic to state that the appropriate measurement basis depends on how an entity uses an asset, particularly given the implication that a historical cost measure is preferable (as some argue and is implied in paragraph 6.30). Even if an entity's business model is to hold assets for use, such as property, plant and equipment, current measures often provide information that is more relevant for decision making and for assessing the stewardship of management. This is because current value provides users with information about the asset's current capacity to generate future cash flows, and depreciation based on the current measure provides a better indication of the real economic cost of consumption of the asset, as well as a better indication of return on investment and performance for a period. On the other hand, depreciation of historical cost could understate the cost or value consumed in using the asset, which may be misleading. For entities with assets that have long useful lives, this lack of transparency could create inequities between current and future shareholders.

We also note that historical cost measures are not necessarily subject to less measurement uncertainty than current value (as noted in paragraph 6.16). There can still be a significant amount of judgement involved in determining historical cost. As noted in a recent speech by Mr Hoogervorst:[3]

(a) despite its name, historical cost gets updated too, albeit less than fair value;

(b) subjectivity in historical cost accounting is even more pronounced when an asset is

[3] Mr Hans Hoogervorst, Chair, IASB, IFRS Conference, Paris, France, 29 June 2015: Historical cost versus fair value measurement

deemed to be impaired and an estimate of its value-in-use needs to be made; and

(c) the alleged stability resulting from historical cost accounting can be extremely misleading...

Factors to consider in selecting a measurement basis

We agree that the qualitative characteristics should be used to help determine a measurement basis.

However, we are concerned that the factors outlined in the Exposure Draft do not place enough emphasis on providing information to meet user needs. In our view, factors to consider in selecting an appropriate measurement basis should focus on the information value of a measurement basis for decision making and assessing the stewardship of management. However, the discussion in paragraph 6.54 of the Exposure Draft focuses on:

(a) how an asset is used by the entity to contribute to future cash flows; and

(b) the characteristics of the asset or liability, such as the nature or extent of the variability in cash flows or sensitivity to changes in market factors.

We agree that how an asset contributes to future cash flows, sometimes referred to as the entity's business model, is one factor that should be considered when selecting a measurement basis. However, an entity's business model is not the only, or the most significant, factor that should be considered when selecting a measurement basis. We consider that undue emphasis on the business model when selecting a measurement basis runs the risk of financial statements focusing too much on the intentions of the entity and management, rather than reporting information to meet user needs.

We also consider it important for the discussion in this chapter to be clear that consideration of an entity's business model does not necessarily lead to measurement based on historical cost for assets held for use (as discussed above). Ultimately, any measurement basis selected must provide information that meets user needs.

The second factor in paragraph 6.54 of the Exposure Draft could be read as implying that assets or liabilities with variable cash flows or which are subject to changes in market prices should be measured at historical cost (especially when read in conjunction with the second half of paragraph BC6.54 of the Exposure Draft). However, the opposite could also be argued, in that it could be argued that assets or liabilities with variable cash flows and/or which are sensitive to changes in market value should be measured at current values, so the economic effects of that variability/volatility are apparent. Ultimately, determining which measurement basis should be selected depends on which measure best serves user information needs, subject to the cost constraint; not the volatility in those measurements or their impact on defined totals and subtotals.

This chapter, taken together with the rest of the Exposure Draft, contains a significant amount of discussion about measurement uncertainty. We agree that measurement uncertainty is an important factor to consider in selecting a measurement basis and acknowledge that the IASB may have been trying to respond to comments that there was insufficient discussion on measurement uncertainty in the preceding Discussion Paper. However, we consider that there is a risk that too much emphasis on measurement uncertainty as a factor in determining a measurement basis could inadvertently prevent the evolution and development of accounting. For example, it could inadvertently prevent the future use of other, more appropriate measurement bases.

More than one relevant measurement basis

We support consideration of the financial statements as a whole in determining the appropriate measurement basis. In this regard, we support the interaction of the financial statements as illustrated in the diagram in paragraph 5.5 of the Exposure Draft. However, we are strongly opposed to split measurement, that is, the use of different measurement bases in different statements and the difference being recognised in OCI (as stated in paragraph 6.76 of the Exposure Draft). We consider that movements in elements should be measured on the same basis as those elements. Using different measurement bases in different statements results in bridging items (the balancing number in OCI) that reflect accounting responses rather than economic phenomena. As such, the balancing number does not appear to be consistent with the definitions of income and expenses.

Despite these comments, we do acknowledge that the measurement of a particular item can be affected by a number of factors. For example, a defined benefit obligation can be impacted by changes in discount rates, actuarial changes and other factors. However, rather than using two different measurement bases, an alternative approach would be to disaggregate the effect of each factor into separate income and expense items in profit or loss and OCI. We consider that exploring this approach is more likely to result in the amounts recognised in OCI reflecting economic phenomena. We comment further on this point below.

Chapter 7—Presentation and disclosure

Question 11—Objective and scope of financial statements and communication

Do you have any comments on the discussion of the objective and scope of financial statements, and on the use of presentation and disclosure as communication tools?

We agree with the discussion of the objective and scope of financial statements and the use of presentation and disclosure as communication tools. However, in our view, efficient and effective communication also includes the exercise of judgement in determining the appropriate extent and mix of qualitative and quantitative information that should be disclosed in order to achieve the objective of financial reporting and meet user needs.

Question 12—Description of the statement of profit or loss Do you support the proposed description of the statement of profit or loss? Why or why not? If you think that the *Conceptual Framework* should provide a definition of profit or loss, please explain why it is necessary and provide your suggestion for that definition. **Question 13—Reporting items of income or expenses in other comprehensive income** Do you agree with the proposals on the use of other comprehensive income? Do you think that they provide useful guidance to the IASB for future decisions about the use of other comprehensive income? Why or why not? If you disagree, what alternative do you suggest and why? **Question 14—Recycling** Do you agree that the *Conceptual Framework* should include the rebuttable presumption described above [that all items in OCI are recycled if doing so would enhance the relevance of profit or loss in that period]? Why or why not? If you disagree, what do you propose instead and why?

<u>*Summary*</u>

We consider that the *Conceptual Framework* should be clear about:

(a) what profit or loss is intended to represent and, therefore, clear about what revenue and expense items should be included in OCI to enhance the relevance of profit or loss; and

(b) when items in OCI would be recycled to profit or loss.

However, given the lack of an existing conceptual basis for OCI, the diversity of views on this matter, and the timeframe available, we consider that:

(a) it would be best to avoid setting requirements in the *Conceptual Framework* that inadvertently or unnecessarily prevent the future evolution of accounting;

(b) it would be premature to be more specific on this matter than is proposed in the Exposure Draft; and

(c) care must be taken not to prejudge the outcome of the IASB's performance reporting project.

Therefore, we strongly encourage the IASB to undertake further work on this matter and ensure that any discussion in the revised *Conceptual Framework* does not create a barrier to further progress.

Furthermore, we consider that:

(a) the argument that, if an entity intends to use an item, historical cost is the most appropriate measurement base for measuring items in profit or loss; and changes in current measurements should all be recognised in OCI (and subsequently recycled to profit or loss) oversimplifies the use of the business model;

(b) disaggregation of performance information is necessary to fully explain all aspects of an entity's performance. However, we question the presumption that users of financial statements would prefer to have all volatility arising from the use of current measurements removed from profit or loss; and

(c) if OCI is retained, then all items reported in OCI should be recycled as this is most consistent with the IASB's rationale for reporting items in OCI and the proposals in the Exposure Draft could also be read as implying a form of realisation concept.

The above points are discussed in more detail below.

Description of the statement of profit or loss and reporting of items in OCI

We appreciate the problem that the IASB is trying to address, in that there appears to be widespread support for continuing to report some items of income and expense in profit or loss and some in OCI. However, current practice is not supported by any clear conceptual rationale for why items are presented in OCI or when, or if, they should be recycled.

We find the proposals in the Exposure Draft unclear about what profit or loss is intended to represent. We consider that, in principle, the *Conceptual Framework* should be clear about what profit or loss is intended to represent and, therefore, clear about what revenue and expense items should be included in OCI to enhance the relevance of profit or loss. Further, in principle, the *Conceptual Framework* should be clear about when items in OCI would be recycled to profit or loss. Given the lack of an existing conceptual basis for OCI and the diversity of views on this matter, we consider that, at this stage, it would be best to avoid setting requirements in the *Conceptual Framework* that inadvertently or unnecessarily prevent the future evolution of accounting. This suggests that the *Conceptual Framework* should either:

(a) not contain a discussion on this issue until a more robust conceptual basis is developed. For example, future work on the research project on reporting financial performance may assist in developing concepts that could be included in the *Conceptual Framework*; or

(b) restrict the discussion to providing some brief high-level guidance while retaining flexibility to consider what approach best meets the information needs of users of financial statements, taking into account cost/benefit considerations, in particular standard-setting projects.

Although neither of the above approaches is ideal, we consider that, given the timeframe available, it would be premature to be more specific on this matter than is proposed in the Exposure Draft. Care must be taken not to prejudge the outcome of the IASB's performance reporting project. For example, as accounting evolves, it may transpire that focusing on a single measure of performance (either profit or loss or total comprehensive income) is not the best way to provide users with a sufficient understanding of an entity's performance, and that there is a role for disaggregated performance information.

Therefore, we strongly encourage the IASB to undertake further work on this matter and ensure that any discussion in the revised *Conceptual Framework* does not create a barrier to further progress.

We have some additional comments about possible links between an entity's business model and the use of OCI. We note that some of the IASB's constituents propose that an entity's business model should be a key factor in distinguishing between profit or loss and OCI. Some would argue that, if an entity intends to use an item, historical cost is the most appropriate measurement base for measuring items in profit or loss; and changes in current measurements (if recognised in the statement of financial position) should all be recognised in OCI and subsequently recycled to profit or loss. We consider that this argument oversimplifies the use of the business model since, in reality, there are a wide variety of potential business models and a single entity could operate a number of business models. We also have other concerns about the assumption that historical cost provides the most relevant information if assets are held for use (as discussed in our response to Qs 8-10). We therefore do not support giving greater emphasis to the business model, either in this chapter or the chapter on measurement.

In our view, disaggregation of performance information is necessary to fully explain all aspects of an entity's performance. In this regard, we support the alternative views of Stephen Cooper and Patrick Finnegan expressed in the first part of paragraph AV4 of the Exposure Draft. By disaggregation we mean analysis of changes in assets and liabilities into different aspects of the transaction or event that caused the change in the assets or liabilities. There are a number of ways in which disaggregated information can be presented and we are not necessarily saying that the distinction between profit or loss and OCI should be removed. However, we question the presumption that users of financial statements would prefer to have all volatility arising from the use of current measurements removed from profit or loss. Whilst this might be helpful in some cases, in other cases it might be more appropriate to report changes in current value in profit or loss, together with an explanation of the effect of this in the financial statements. Therefore, care should be taken that any discussion in the *Conceptual Framework* does not imply that all or most changes in current values should be reported in OCI.

Recycling

In our view, if OCI is retained, then all items reported in OCI should be recycled. Firstly, we consider recycling all items to be consistent with the IASB's rationale for reporting items in OCI. We also note that, at present, most items recognised in OCI appear to be 'unrealised'. The proposals in the Exposure Draft could also be read as implying a form of realisation concept. Therefore, it seems appropriate to recycle all of these items to profit or loss once they are realised.

We note that some disagree with recycling on the grounds that it results in the reporting of income and expense items twice – once in OCI and again in profit or loss. However, in addition to our comments above that support recycling, in some cases it also could be argued that amounts recognised in OCI are parts of a larger transaction/event that has been disaggregated (similar to the profit on the sale of inventory being disaggregated into revenue and expense). Therefore, recycling does not result in the same item being recognised in profit or loss more than once, it could be viewed as a disaggregation of the transaction resulting in settlement/realisation of an asset/liability.

We also note that the discussion in paragraph 7.27 of the Exposure Draft seems to result in a null set. It gives an example of when the presumption that all amounts in OCI would be recycled to profit or loss might be rebutted, but then states that this situation might indicate that the amount should not have been recognised in OCI in the first place.

Other questions for respondents

Question 15—Effects of the proposed changes to the *Conceptual Framework*

Do you agree with the analysis in paragraphs BCE.1–BCE.31? Should the IASB consider any other effects of the proposals in the Exposure Draft?

We agree with the analysis of the effects of the proposed changes to the *Conceptual Framework.*

Question 16—Business activities

Do you agree with the proposed approach to business activities? Why or why not?

We broadly agree with the proposals. We consider that the *Conceptual Framework* should include a discussion of the way in which the entity conducts its activities as a factor to consider in developing standards, but should not mandate that business activities be considered in every instance. As noted in our responses to other questions, we caution against placing too much emphasis on an entity's business activities. See our responses to questions 8–10, 12–14 and 17.

Question 17—Long-term investment

Do you agree with the IASB's conclusions on long-term investment? Why or why not?

We agree that the *Conceptual Framework* does not need to specifically refer to the business activity of long-term investment.

As discussed in our responses to previous questions, although we agree that the business model should play a part in the selection of a measurement basis, it is not the only factor to consider; other factors are also important.

We do not agree with the views expressed in BCIN.36 that entities should not use current value measurement for their long-term investments. On the contrary, as explained in response to questions 8–10, we consider that it is too simplistic to view historical cost as being more relevant if the entity intends to hold the asset for use. Even if an entity does not intend to sell an asset, current value provides users with information about the asset's capacity to generate future cash flows and depreciation of the current value provides a better indication of the consumption of the asset as well as a better indication of return on investment.

Question 18—Other comments

Do you have comments on any other aspect of the Exposure Draft? Please indicate the specific paragraphs or group of paragraphs to which your comments relate (if applicable).

As previously noted, the IASB is not requesting comments on all parts of Chapters 1 and 2, on how to distinguish liabilities from equity claims (see Chapter 4) or on Chapter 8.

We consider the discussion of concepts of capital maintenance to be too brief to adequately address the pros and cons of various concepts of capital maintenance, including the implications for various parts of the *Conceptual Framework*, such as elements, measurement and the objective of various financial statements. We understand why the IASB has decided not to make any change to the existing *Conceptual Framework*. However, having decided not to change the current approach to capital maintenance, the Basis for Conclusions to the *Conceptual Framework* should explain why alternative approaches were rejected. The explanation in paragraph BCIN.24 is inadequate and indicates a lack of understanding of the objective of capital maintenance concepts.