

IPSAS® ACCOUNTING STANDARD

IPSAS 43, *LEASES*

IPSAS®

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IPSAS 43, LEASES

History of IPSAS Accounting Standard

This version includes amendments resulting from IPSAS Accounting Standards issued up to January 31, 2026.

IPSAS 43, *Leases* was issued in January 2022.

Since then, IPSAS 43 has been amended by the following IPSAS Accounting Standards:

- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards* (issued November 2025)
- *Amendments to IPSAS Standards: Specific IFRIC Interpretations* (issued January 2025)
- *Concessionary Leases and Other Arrangements Conveying Rights over Assets* (issued October 2024)
- *Improvements to IPSAS, 2023* (issued April 2024)
- IPSAS 47, *Revenue* (issued May 2023)
- IPSAS 46, *Measurement* (issued May 2023)
- IPSAS 45, *Property, Plant, and Equipment* (issued May 2023)
- IPSAS 44, *Non-current Assets Held for Sale and Discontinued Operations* (issued May 2022)

Table of Amended Paragraphs in IPSAS 43

Paragraph Affected	How Affected	Affected By
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Paragraph Affected	How Affected	Affected By
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103A	New	IPSAS 44 May 2022
103B	New	IPSAS 45 May 2023
103C	New	IPSAS 46 May 2023
103D	New	IPSAS 47 May 2023
103E	New	<i>Improvements to IPSAS</i> , 2023 April 2024
103F	New	<i>Improvements to IPSAS</i> , 2023 April 2024
103G	New	<i>Concessionary Leases and Other Arrangements Conveying Rights over Assets</i> October 2024
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104	Amended	IPSAS 33 November 2025
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AG60	New	<i>Concessionary Leases and Other Arrangements Conveying Rights over Assets</i> October 2024
AG61	New	<i>Concessionary Leases and Other Arrangements Conveying Rights over Assets</i> October 2024
AG62	New	<i>Concessionary Leases and Other Arrangements Conveying Rights over Assets</i> October 2024
IE12	Amended	<i>Improvements to IPSAS, 2023</i> April 2024

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Comparison with IFRS 16

Comparison with GFS

International Public Sector Accounting Standard 43, *Leases*, is set out in paragraphs 1–127. All the paragraphs have equal authority. IPSAS 43 should be read in the context of its objective, the Basis for Conclusions, the *Preface to IPSAS Accounting Standards and IPSASB SRS Standards*, and *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

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

Scope

3. An entity shall apply this 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* held by a lessee;
 - (c) Service concession arrangements within the scope of IPSAS 32, *Service Concession Arrangements: Grantor*; and
 - (d) 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 Standard to leases of intangible assets other than those described in paragraph 3(d).

Definitions

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

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

A contract, for the purpose of this Standard, is an agreement between two or more parties that creates enforceable rights and obligations.

Economic life 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.

Fair value, for the purpose of applying the lessor accounting requirements in this Standard, is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an underlying asset.

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.

Gross investment in the lease is the sum of:

- (a) The lease payments receivable by a lessor under a finance lease; and
- (b) Any unguaranteed residual value accruing to the lessor.

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.

Net investment in the lease is the gross investment in the lease discounted at the interest rate implicit in the lease.

Operating lease is a lease that does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

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 fulfill 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.

Unearned finance revenue is the difference between:

- (a) The gross investment in the lease; and
- (b) The net investment in the lease.

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 IPSAS are used in this 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 Standard with the same meaning as in IPSAS 45, *Property, Plant, and Equipment*.

Recognition Exemptions (see paragraphs AG4–AG9)

6. A lessee may elect not to apply the requirements in paragraphs 18A–18D and 23–52 to:
 - (a) Short-term leases; and
 - (b) Leases for which the underlying asset is of low value (as described in paragraphs AG4–AG9).
7. If a lessee elects not to apply the requirements in paragraphs 23–52 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.
8. If a lessee accounts for short-term leases applying paragraph 7, the lessee shall consider the lease to be a new lease for the purposes of this 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).
9. 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.

Identifying a Lease (see paragraphs AG10–AG34, and AG60–AG62)

10. **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 AG10–AG32 set out guidance on the assessment of whether a contract is, or contains, a lease.**
11. 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).
12. 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

13. 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 16. Paragraphs AG33–AG34 set out guidance on separating components of a contract.

Lessee

14. 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.
15. 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.

16. 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 49 of IPSAS 41, *Financial Instruments*.
17. Unless the practical expedient in paragraph 16 is applied, a lessee shall account for non-lease components applying other applicable Standards.

Lessor

18. 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 47, *Revenue*.

Assessing Whether the Transaction is at Market Terms or at Below-Market Terms

- 18A. At inception, an entity will determine whether the transaction is at market terms or at below-market terms.
- 18B. In certain circumstances, such as when an entity enters into a lease at market terms, the lease is an exchange transaction. In other circumstances, such as when an entity enters into a lease at below-market terms, the lease is a concessionary lease. In this case, the lease has a concession component. In determining whether a lease has an identifiable concession component on initial recognition, professional judgment is exercised.
- 18C. As concessionary leases are granted or received at below-market terms, the present value of contractual payments (consideration) on initial recognition of the lease will be lower than the present value of payments for the lease at market rates based on the current use of the underlying asset.
- 18D. At inception, a:
 - (a) Lessee assesses the substance of the concessionary lease by applying the principles in this Standard and paragraphs AG153A–AG153B of IPSAS 47; and
 - (b) Lessor assesses the substance of the concessionary lease by applying the principles in this Standard.

Lease Term (see paragraphs AG35–AG42)

19. 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.
20. 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 AG38–AG41.
21. 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 AG42).

22. 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.

Lessee

Recognition

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

Measurement

Initial Measurement

Initial Measurement of the Right-of-Use Asset

24. **At the commencement date, a lessee shall measure the right-of-use asset at cost.**
25. 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 27;
 - (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.
26. A lessee shall recognize the costs described in paragraph 25(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 Standard or IPSAS 12 are recognized and measured applying IPSAS 19, *Provisions, Contingent Liabilities, and Contingent Assets*.
- 26A. **Where a right-of-use asset is acquired through a concessionary lease, its cost shall be measured at the present value of payments for the lease at market rates based on the current use of the underlying asset as at the commencement date.**
- 26B. The payments for the lease at market rates based on the current use of the underlying asset shall be discounted using the interest rates identified in paragraph 27. The cost of the right-of-use asset shall also include the items identified in paragraphs 25(c) and 25(d).
- 26C. A lessee shall make a reasonable level of effort in determining the present value of payments for the lease at market rates based on the current use of the underlying asset. If payments for the lease at market rates

based on the current use of the underlying asset are not readily available for the right-of-use asset, the lessee shall measure the right-of-use asset in a concessionary lease in accordance with paragraphs 24–26.

Initial Measurement of the Lease Liability

27. **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.**
28. 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 AG43), 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 29);
 - (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 AG38–AG41); and
 - (e) Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.
29. Variable lease payments that depend on an index or a rate described in paragraph 28(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.
- 29A. **Where a lease liability is recognized through a concessionary lease, its cost shall be measured in accordance with paragraphs 27–29.**

Subsequent Measurement

Subsequent Measurement of the Right-of-Use Asset

30. **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 35 and 36. If an entity's initial measurement of a right-of-use asset included an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, or restoring the site or underlying asset under paragraph 25(d), for which it recognized a corresponding liability in accordance with IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, the entity shall also apply Appendix B of IPSAS 19 in its subsequent measurement of the item.**

Historical Cost Model

31. To apply a historical 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 37(c).
32. A lessee shall apply the depreciation requirements in IPSAS 45 in depreciating the right-of-use asset, subject to the requirements in paragraph 33.

33. 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.
34. A lessee shall apply IPSAS 21, *Impairment of Non-Cash-Generating Assets* or IPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate, to determine whether the right-of-use asset is impaired and to account for any impairment loss identified.

Other Measurement Models

35. If a lessee applies the fair value measurement basis in the current value model in IPSAS 16, *Investment Property* to its investment property, the lessee shall also apply that fair value measurement basis to right-of-use assets that meet the definition of investment property in IPSAS 16.
36. If right-of-use assets relate to a class of property, plant, and equipment to which the lessee applies the current value model in IPSAS 45, a lessee may elect to apply that current value model to all of the right-of-use assets that relate to that class of property, plant, and equipment.

Subsequent Measurement of the Lease Liability

37. **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 40–47, or to reflect revised in-substance fixed lease payments (see paragraph AG43).**
38. 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 27, or if applicable the revised discount rate described in paragraph 42, paragraph 44 or paragraph 46(c).
39. 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.

Reassessment of the Lease Liability

40. After the commencement date, a lessee shall apply paragraphs 41–44 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.
41. 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 21–22. 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 21–22 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.
- 42. In applying paragraph 41, 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.
- 43. 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.
- 44. In applying paragraph 43, 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.

Lease Modifications

- 45. 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.
- 46. 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 14–17;
 - (b) Determine the lease term of the modified lease applying paragraphs 19–20; 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.
- 47. 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.

48. As a practical expedient, a lessee may elect not to assess whether a rent concession that meets the conditions in paragraph 49 is a lease modification. A lessee that makes this election shall account for any change in lease payments resulting from the rent concession the same way it would account for the change applying this Standard if the change were not a lease modification.
49. The practical expedient in paragraph 48 applies only to rent concessions occurring as a direct consequence of the COVID-19 pandemic and only if all of the following conditions are met:
- (a) The change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
 - (b) Any reduction in lease payments affects only payments originally due on or before June 30, 2022 (for example, a rent concession would meet this condition if it results in reduced lease payments on or before June 30, 2022 and increased lease payments that extend beyond June 30, 2022); and
 - (c) There is no substantive change to other terms and conditions of the lease.

Presentation

50. A lessee shall either present 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 present 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 present 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.
51. The requirement in paragraph 50(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.
52. 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, *Presentation of Financial Statements* requires to be presented separately in the statement of financial performance.
53. 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 Statement* 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.

Disclosure

54. **The objective of the 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 55–64A specify requirements on how to meet this objective.**

55. 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.
56. 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 7. 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 7. This expense shall not include the expense relating to short-term leases of low-value assets included in paragraph 56(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.
57. A lessee shall provide the disclosures specified in paragraph 56 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.
58. A lessee shall disclose the amount of its lease commitments for short-term leases accounted for applying paragraph 7 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 56(c) relates.
59. 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 56(a), 56(f), 56(h) or 56(j) for those right-of-use assets.
60. If a lessee measures right-of-use assets at revalued amounts applying IPSAS 45, the lessee shall disclose the information required by paragraph 74 of IPSAS 45 for those right-of-use assets.
61. A lessee shall disclose a maturity analysis of lease liabilities applying paragraphs 46 and AG12 of IPSAS 30, *Financial Instruments: Disclosures* separately from the maturity analyses of other financial liabilities.
62. In addition to the disclosures required in paragraphs 56–61, a lessee shall disclose additional qualitative and quantitative information about its leasing activities necessary to meet the disclosure objective in paragraph 54 (as described in paragraph AG49). 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 AG50);
 - (ii) Extension options and termination options (as described in paragraph AG51);
 - (iii) Residual value guarantees (as described in paragraph AG52); and
 - (iv) Leases not yet commenced to which the lessee is committed.
 - (c) Restrictions or covenants imposed by leases; and
 - (d) Sale and leaseback transactions (as described in paragraph AG53).
63. A lessee that accounts for short-term leases or leases of low-value assets applying paragraph 7 shall disclose that fact.
64. If a lessee applies the practical expedient in paragraph 48, the lessee shall disclose:
- (a) That it has applied the practical expedient to all rent concessions that meet the conditions in paragraph 49 or, if not applied to all such rent concessions, information about the nature of the contracts to which it has applied the practical expedient (see paragraph 2); and
 - (b) The amount recognized in surplus or deficit for the reporting period to reflect changes in lease payments that arise from rent concessions to which the lessee has applied the practical expedient in paragraph 48.

Concessionary Leases

- 64A. For concessionary leases received, a lessee shall disclose by class of underlying asset:
- (a) The amount of the concession on initial recognition;
 - (b) The amount of the contractual payments for the lease when the payments for the lease at market rates based on the current use of the underlying asset are not readily available;
 - (c) The purpose and terms of the various types of concessionary leases, including the nature of the concession; and
 - (d) Significant assumptions used in estimating the present value of the lease payments at market rates based on the current use of the underlying asset.

Lessor

Classification of Leases (see paragraphs AG54–AG60)

65. **A lessor shall classify each of its leases as either an operating lease or a finance lease.**
66. **A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.**
67. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:
- (a) The lease transfers ownership of the underlying asset to the lessee by the end of the lease term;
 - (b) The lessee has the option to purchase the underlying asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception date, that the option will be exercised;

- (c) The lease term is for the major part of the economic life of the underlying asset even if title is not transferred;
 - (d) At the inception date, the present value of the lease payments amounts to at least substantially all of the fair value of the underlying asset; and
 - (e) The underlying asset is of such a specialized nature that only the lessee can use it without major modifications.
68. Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:
- (a) If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
 - (b) Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equaling most of the sales proceeds at the end of the lease); and
 - (c) The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.
69. The examples and indicators in paragraphs 67–68 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset, the lease is classified as an operating lease. For example, this may be the case if ownership of the underlying asset transfers at the end of the lease for a variable payment equal to its then fair value, or if there are variable lease payments, as a result of which the lessor does not transfer substantially all such risks and rewards.
70. Lease classification is made at the inception date and is reassessed only if there is a lease modification. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the underlying asset), or changes in circumstances (for example, default by the lessee), do not give rise to a new classification of a lease for accounting purposes.

Finance Leases (see paragraph AG62(a))

Recognition and Measurement

71. **At the commencement date, a lessor shall recognize assets held under a finance lease in its statement of financial position and present them as a receivable at an amount equal to the net investment in the lease.**
- 71A. At the commencement date, a lessor shall recognize assets under a concessionary finance lease applying the requirements in this Standard for finance leases.

Initial Measurement

72. The lessor shall use the interest rate implicit in the lease to measure the net investment 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 (adjusted for any initial direct costs associated with the sublease) to measure the net investment in the sublease.
73. Initial direct costs are included in the initial measurement of the net investment in the lease and reduce the amount of revenue recognized over the lease term. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the net investment in the lease; there is no need to add them separately.

Initial Measurement of the Lease Payments Included in the Net Investment in the Lease

74. At the commencement date, the lease payments included in the measurement of the net investment in the lease 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 AG43), less any lease incentives payable;
 - (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 paragraph AG38); and
 - (e) Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

Subsequent Measurement

75. **A lessor shall recognize finance revenue over the lease term, based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease.**
76. A lessor aims to allocate finance revenue over the lease term on a systematic and rational basis. A lessor shall apply the lease payments relating to the period against the gross investment in the lease to reduce both the principal and the unearned finance revenue.
77. A lessor shall apply the derecognition and impairment requirements in IPSAS 41 to the net investment in the lease. A lessor shall regularly review estimated unguaranteed residual values used in computing the gross investment in the lease. If there has been a reduction in the estimated unguaranteed residual value, the lessor shall revise the revenue allocation over the lease term and recognize immediately any reduction in respect of amounts accrued.
78. A lessor that classifies an asset under a finance lease as held for sale (or includes it in a disposal group that is classified as held for sale) applying IPSAS 44, *Non-current Assets Held for Sale and Discontinued Operations* shall account for the asset in accordance with that Standard.

Lease Modifications

79. A lessor shall account for a modification to a finance lease 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.
80. For a modification to a finance lease that is not accounted for as a separate lease, a lessor shall account for the modification as follows:
- (a) If the lease would have been classified as an operating lease had the modification been in effect at the inception date, the lessor shall:

- (i) Account for the lease modification as a new lease from the effective date of the modification; and
 - (ii) Measure the carrying amount of the underlying asset as the net investment in the lease immediately before the effective date of the lease modification.
- (b) Otherwise, the lessor shall apply the requirements of IPSAS 41.

Operating Leases (see paragraph AG62(b))

Recognition and Measurement

81. **A lessor shall recognize lease payments from operating leases as revenue on either a straight-line basis or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished.**
- 81A. A lessor shall recognize revenue under a concessionary operating lease applying the requirements in this Standard for operating leases.
82. A lessor shall recognize costs, including depreciation, incurred in earning the lease revenue as an expense.
83. A lessor shall add initial direct costs incurred in obtaining an operating lease to the carrying amount of the underlying asset and recognize those costs as an expense over the lease term on the same basis as the lease revenue.
84. The depreciation policy for depreciable underlying assets subject to operating leases shall be consistent with the lessor's normal depreciation policy for similar assets. A lessor shall calculate depreciation in accordance with IPSAS 31 and IPSAS 45.
85. A lessor shall apply IPSAS 21 or IPSAS 26, as appropriate, to determine whether an underlying asset subject to an operating lease is impaired and to account for any impairment loss identified.

Lease Modifications

86. A lessor shall account for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

Presentation

87. A lessor shall present underlying assets subject to operating leases in its statement of financial position according to the nature of the underlying asset.

Disclosure

88. **The objective of the disclosures 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 89–96 specify requirements on how to meet this objective.**
89. A lessor shall disclose the following amounts for the reporting period:
- (a) For finance leases:
 - (i) Selling surplus or deficit;
 - (ii) Finance revenue on the net investment in the lease; and

(iii) Revenue relating to variable lease payments not included in the measurement of the net investment in the lease.

(b) For operating leases, lease revenue, separately disclosing revenue relating to variable lease payments that do not depend on an index or a rate.

90. A lessor shall provide the disclosures specified in paragraph 89 in a tabular format, unless another format is more appropriate.

91. A lessor shall disclose additional qualitative and quantitative information about its leasing activities necessary to meet the disclosure objective in paragraph 88. 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; and

(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.

Finance Leases

92. A lessor shall provide a qualitative and quantitative explanation of the significant changes in the carrying amount of the net investment in finance leases.

93. 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. A lessor shall reconcile the undiscounted lease payments to the net investment in the lease. The reconciliation shall identify the unearned finance revenue relating to the lease payments receivable and any discounted unguaranteed residual value.

Operating Leases

94. For items of property, plant, and equipment subject to an operating lease, a lessor shall apply the disclosure requirements of IPSAS 45. In applying the disclosure requirements in IPSAS 45, a lessor shall disaggregate each class of property, plant, and equipment into assets subject to operating leases and assets not subject to operating leases. Accordingly, a lessor shall provide the disclosures required by IPSAS 45 for assets subject to an operating lease (by class of underlying asset) separately from owned assets held and used by the lessor.

95. A lessor shall apply the disclosure requirements in IPSAS 16, IPSAS 21 or IPSAS 26, as appropriate, IPSAS 27 and IPSAS 31 for assets subject to operating leases.

96. A lessor shall disclose a maturity analysis of lease payments, 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.

Concessionary Finance Leases

96A. For concessionary finance leases granted, a lessor shall disclose by class of underlying asset:

(a) The carrying amount of the underlying assets transferred during the period in accordance with the relevant IPSAS;

(b) The net investment in the lease at the commencement date in accordance with this Standard;

- (c) The difference between (a) and (b); and
- (d) The purpose and terms of the various types of concessionary finance leases, including the nature of the concession.

Concessionary Operating Leases

- 96B. For concessionary operating leases granted, a lessor shall disclose by class of underlying asset:
- (a) The amount of lease revenue accrued during the period;
 - (b) The costs associated with the underlying asset incurred on the accrual basis during the period;
 - (c) The difference between (a) and (b); and
 - (d) The purpose and terms of the various types of concessionary operating leases, including the nature of the concession.

Sale and Leaseback Transactions

97. If an entity (the seller-lessee) transfers an asset to another entity (the buyer-lessor) 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 98–102.
- 97A. An entity shall assess whether a sale and leaseback transaction contains an embedded concession at the inception of the lease.
- 97B. If an entity (the seller-lessee and the buyer-lessor) identifies below-market terms embedded in the leaseback transaction as a concession, the seller-lessee shall account for the concession in accordance with IPSAS 47, and the buyer-lessor shall account for the concession in accordance with this Standard. Otherwise, the entity shall account for the below-market terms as prepayments in accordance with paragraph 100(a).

Assessing Whether the Transfer of the Asset is a Sale

98. An entity shall apply the requirements for determining when a compliance obligation is satisfied in IPSAS 47 to determine whether the transfer of an asset is accounted for as a sale of that asset.

Transfer of the Asset is a Sale

99. If the transfer of an asset by the seller-lessee satisfies the requirements of IPSAS 47 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 Standards, and for the lease applying the lessor accounting requirements in this Standard.
100. 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 as a prepayment of lease payments; and
 - (b) Any above-market terms shall be accounted for as additional financing provided by the buyer-lessor to the seller-lessee.

101. The entity shall measure any potential adjustment required by paragraph 100 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.
- 101A. After the commencement date, the seller-lessee shall apply paragraphs 30–36 to the right-of-use asset arising from the leaseback and paragraphs 37–47 to the lease liability arising from the leaseback. In applying paragraphs 37–47, the seller-lessee shall determine 'lease payments' or 'revised lease payments' in a way that the seller-lessee would not recognize any amount of the gain or loss that relates to the right of use retained by the seller-lessee. Applying the requirements in this paragraph does not prevent the seller-lessee from recognizing in surplus or deficit any gain or loss relating to the partial or full termination of a lease as required by paragraph 47(a).

Transfer of the Asset is not a Sale

102. If the transfer of an asset by the seller-lessee does not satisfy the requirements of IPSAS 47 to be accounted for as a sale of the 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 41.
 - (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 41.

Temporary Exception Arising from Interest Rate Benchmark Reform

- 102A. A lessee shall apply paragraphs 102B–102C to all lease modifications that change the basis for determining future lease payments as a result of interest rate benchmark reform (see paragraphs 72B and 72D of IPSAS 41). These paragraphs apply only to such lease modifications. For this purpose, the term 'interest rate benchmark reform' refers to the market-wide reform of an interest rate benchmark as described in paragraph 155B of IPSAS 41.
- 102B. As a practical expedient, a lessee shall apply paragraph 43 to account for a lease modification required by interest rate benchmark reform. This practical expedient applies only to such modifications. For this purpose, a lease modification is required by interest rate benchmark reform if, and only if, both of these conditions are met:
- (a) The modification is necessary as a direct consequence of interest rate benchmark reform; and
 - (b) The new basis for determining the lease payments is economically equivalent to the previous basis (i.e., the basis immediately preceding the modification).
- 102C. However, if lease modifications are made in addition to those lease modifications required by interest rate benchmark reform, a lessee shall apply the applicable requirements in this Standard to account for all lease modifications made at the same time, including those required by interest rate benchmark reform.

Effective Date and Transition

Effective Date

103. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted for entities that apply IPSAS 41, at or before the**

date of initial application of this Standard. If an entity applies this Standard earlier, it shall disclose that fact.

- 103A. Paragraph 78 was amended by IPSAS 44 issued in May 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 44 at the same time.
- 103B. Paragraphs 5, 31, 32, 36, 60, 84, 94, and AG45 were amended by IPSAS 45 issued in May 2023. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is encouraged. If an entity applies these amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 45 at the same time.
- 103C. Paragraphs 35 and 113 were amended by IPSAS 46, *Measurement*, issued in May 2023. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 46 at the same time.
- 103D. Paragraphs 18, 98, 99, 102, and 120 were amended by IPSAS 47, issued in May 2023. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2026. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2026, it shall disclose that fact and apply IPSAS 47 at the same time.
- 103E. Paragraphs 102A–102C and 126A–126B were added by *Improvements to IPSAS, 2023*, issued in April 2024. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.
- 103F. Paragraphs 101A and 126C were added, and paragraph 106 was amended by *Improvements to IPSAS, 2023*, issued in April 2024. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2026. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.
- 103G. Paragraphs 18A–18D, 26A–26C, 29A, 64A, 71A, 81A, 96A, 96B, 97A, 97B, 117A–117F, AG32A, and AG60–AG62 were added and paragraphs 6, 54, 109, 118, and 120 were amended by *Concessionary Leases and Other Arrangements Conveying Rights over Assets* (Amendments to IPSAS 43, IPSAS 47, and IPSAS 48) issued in October 2024. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2027. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2027, it shall disclose that fact and apply IPSAS 43, IPSAS 45, IPSAS 46, *Measurement*, IPSAS 47, and IPSAS 48, *Transfer Expenses* at the same time.
- 103H. Paragraph 30 was amended by *Amendments to IPSAS Standards: Specific IFRIC Interpretations*, issued in January 2025. An entity shall apply these amendments for annual periods beginning on or after January 1, 2026. Earlier application is encouraged. If an entity applies these amendments to financial statements for a period beginning before January 1, 2026, it shall disclose that fact.
104. When an entity adopts accrual basis IPSAS Standards as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards* for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSAS Standards.

105. If a lessee elects to apply this Standard early, a lessee shall apply paragraphs 48, 49, 64, 124, 125 and 126 for annual financial statements covering periods beginning on or after February 1, 2022. Earlier application is permitted, including in financial statements not authorized for issue at January 31, 2022.

Transition

106. For the purposes of the requirements in paragraphs 103–126C, the date of initial application is the beginning of the annual reporting period in which an entity first applies this Standard.

Definition of a Lease

107. 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 Standard to contracts that were previously identified as leases applying IPSAS 13, *Leases*. The entity shall apply the transition requirements in paragraphs 109–122 to those leases.
 - (b) To not apply this Standard to contracts that were not previously identified as containing a lease applying IPSAS 13.
108. If an entity chooses the practical expedient in paragraph 107, it shall disclose that fact and apply the practical expedient to all of its contracts. As a result, the entity shall apply the requirements in paragraphs 10–12 only to contracts entered into (or changed) on or after the date of initial application.

Lessees

109. A lessee shall apply this Standard to its 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 Standard recognized at the date of initial application in accordance with paragraphs 111–117F.
110. A lessee shall apply the election described in paragraph 109 consistently to all of its leases in which it is a lessee.
111. If a lessee elects to apply this Standard in accordance with paragraph 109(b), the lessee shall not restate comparative information. Instead, the lessee shall recognize the cumulative effect of initially applying this Standard as an adjustment to the opening balance of accumulated surpluses/(deficits) (or other component of net assets/equity, as appropriate) at the date of initial application.

Leases Previously Classified as Operating Leases

112. If a lessee elects to apply this Standard in accordance with paragraph 109(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 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 114(b).
113. Notwithstanding the requirements in paragraph 112, 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 AG4–AG9) that will be accounted for applying paragraph 7. The lessee shall account for those leases applying this 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 measurement basis in the current 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 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 measurement basis in the current 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 Standard from the date of initial application.
114. A lessee may use one or more of the following practical expedients when applying this Standard retrospectively in accordance with paragraph 109(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 112 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 7; 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

115. If a lessee elects to apply this Standard in accordance with paragraph 109(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 Standard from the date of initial application.

Disclosure

116. If a lessee elects to apply this Standard in accordance with paragraph 109(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 112(a); and
 - (ii) Lease liabilities recognized in the statement of financial position at the date of initial application.
117. If a lessee uses one or more of the specified practical expedients in paragraph 114, it shall disclose that fact.

Concessionary Leases

Leases Previously Classified as Operating Leases

- 117A. If a lessee elects to apply this Standard in accordance with paragraph 109(b), the lessee shall:
- (a) Recognize a lease liability at the date of initial application for concessionary 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 concessionary leases previously classified as an operating lease applying IPSAS 13. The lessee shall measure that right-of-use asset at the present value of payments for the remaining lease term at market rates based on the current use of the underlying asset and discounted using the lessee's incremental borrowing rate at the date of initial application.
- 117B. Notwithstanding the requirements in paragraph 117A, for concessionary leases previously classified as operating leases applying IPSAS 13, a lessee is not required to make any adjustments on transition for concessionary leases previously accounted for as investment property using the fair value model in IPSAS 16, *Investment Property*. The lessee shall account for the right-of-use asset and the lease liability arising from those leases applying IPSAS 16 and this Standard from the date of initial application.
- 117C. A lessee may use one or more of the practical expedients in paragraphs 114(a), 114(b), 114(d), and 114(e) when applying this Standard retrospectively in accordance with paragraph 109(b) to concessionary leases previously classified as operating leases applying IPSAS 13.
- 117D. A lessee may elect not to apply the requirements in paragraph 117A to concessionary leases for which the lease term ends within 12 months of the date of initial application. In this case, the lessee shall:
- (a) Account for those leases in the same way as short-term leases as described in paragraph 7; and

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

Leases Previously Classified as Finance Leases

- 117E. If a lessee elects to apply this Standard in accordance with paragraph 109(b), for concessionary leases that were classified as finance leases applying IPSAS 13, at the date of initial application the lessee shall:
- (a) Measure the lease liability at the carrying amount of the lease liability immediately before that date measured applying IPSAS 13; and
 - (b) Recognize a right-of-use asset and measure in accordance with paragraph 117A(b).
 - (c) For those concessionary leases, a lessee shall account for the right-of-use asset and the lease liability applying this Standard from the date of initial application.

Disclosure

- 117F. If a lessee elects to apply this Standard in accordance with paragraph 109(b) for concessionary leases, the lessee shall disclose information according to paragraphs 116 and 117, as appropriate.

Lessors

118. Except as described in paragraph 119, a lessor is not required to make any adjustments on transition for leases, including concessionary leases, in which it is a lessor and shall account for those leases applying this Standard from the date of initial application.
119. An intermediate lessor shall:
- (a) Reassess subleases that were classified as operating leases applying IPSAS 13 and are ongoing at the date of initial application, to determine whether each sublease should be classified as an operating lease or a finance lease applying this Standard. The intermediate lessor shall perform this assessment at the date of initial application on the basis of the remaining contractual terms and conditions of the head lease and sublease at that date.
 - (b) For subleases that were classified as operating leases applying IPSAS 13 but finance leases applying this Standard, account for the sublease as a new finance lease entered into at the date of initial application.

Sale and Leaseback Transactions Before the Date of Initial Application

120. An entity shall not reassess sale and leaseback transactions entered into before the date of initial application to determine whether:
- (a) The transfer of the underlying asset satisfies the requirements in IPSAS 47 to be accounted for as a sale; and
 - (b) The leaseback satisfies the requirements in this Standard to be accounted for as a concessionary leaseback.
121. 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.

122. 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

123. If a lessee previously recognized an asset or a liability applying IPSAS 40, *Public Sector Combinations* relating to favorable or unfavorable terms of an operating lease acquired as part of a public sector 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.

COVID-19-Related Rent Concessions for Lessees

124. A lessee shall apply paragraphs 48, 49, and 64 retrospectively, recognizing the cumulative effect of initially applying that amendment as an adjustment to the opening balance of accumulated surpluses/(deficits) (or other component of net assets/equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies the amendment.
125. In the reporting period in which a lessee first applies paragraph 48, 49, and 64, a lessee is not required to disclose the information required by paragraph 33(f) of IPSAS 3.
126. Applying paragraph 2 of this Standard, a lessee shall apply the practical expedient in paragraph 48 consistently to eligible contracts with similar characteristics and in similar circumstances, irrespective of whether the contract became eligible for the practical expedient as a result of the lessee applying the COVID-19-Related Rent Concessions requirements.

Interest Rate Benchmark Reform—Phase 2

- 126A. An entity shall apply these amendments retrospectively in accordance with IPSAS 3, except as specified in paragraph 126B.
- 126B. An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognize any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application of these amendments in the opening net assets/equity (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.

Lease Liability in a Sale and Leaseback

- 126C. A seller-lessee shall apply paragraphs 101A and 106 (see paragraph 103F) retrospectively in accordance with IPSAS 3 to sale and leaseback transactions entered into after the date of initial application.

Withdrawal and Replacement of IPSAS 13 (December 2006)

127. This Standard supersedes IPSAS 13 issued in 2006. IPSAS 13 remains applicable until this Standard is applied or becomes effective, whichever is earlier.

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 43.

Portfolio Application

AG1. This Standard specifies the accounting for an individual lease. However, as a practical expedient, an entity may apply this Standard to a portfolio of leases with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this Standard to the portfolio would not differ materially from applying this 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 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 AG33.

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 Standard. Contracts, for the purposes of this Standard, are generally evidenced by the following (although this may differ from jurisdiction to jurisdiction):

- Contracts involve willing parties entering into an arrangement;
- 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; and
- The remedy for non-performance is enforceable by law.

Recognition Exemption: Leases for Which the Underlying Asset is of Low Value (paragraphs 6–9)

AG4. Except as specified in paragraph AG8, this Standard permits a lessee to apply paragraph 7 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.

AG5. The assessment of whether an underlying asset is of low value is performed on an absolute basis. Leases of low-value assets qualify for the accounting treatment in paragraph 7 regardless of whether those leases are material to the lessee. The assessment is not affected by the size, nature or circumstances of the lessee. Accordingly, different lessees are expected to reach similar conclusions about whether a particular underlying asset is of low value.

AG6. 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.

AG7. 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.

AG8. 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.

AG9. Examples of low-value underlying assets can include tablet and personal computers, small items of office furniture and telephones.

Identifying a Lease (paragraphs 10–12)

AG10. To assess whether a contract conveys the right to control the use of an identified asset (see paragraphs AG14–AG21) 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 or service potential from use of the identified asset (as described in paragraphs AG22–AG24); and

(b) The right to direct the use of the identified asset (as described in paragraphs AG25–AG31).

AG11. 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.

AG12. 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.

AG13. An entity shall assess whether a contract contains a lease for each potential separate lease component. Refer to paragraph AG33 for guidance on separate lease components.

Identified Asset

AG14. 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

AG15. 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).

- AG16. 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.
- AG17. 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.
- AG18. 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.
- AG19. 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.
- AG20. 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

- AG21. 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 fiber 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 or service potential from use of the asset.

Right to Obtain Economic Benefits or Service Potential from Use

- AG22. To control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits or service potential 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 or service potential from use of an asset directly or indirectly in many ways, such as by using, holding or sub-letting the asset. The economic benefits or service potential from use of an asset include its primary output and by-products (including potential cash flows derived from these items), and other economic benefits or service potential from using the asset that could be realized from a commercial transaction with a third party.
- AG23. When assessing the right to obtain substantially all of the economic benefits or service potential from use of an asset, an entity shall consider the economic benefits or service potential that result from use of the asset within the defined scope of a customer's right to use the asset (see paragraph AG31). 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 or service potential 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 or service potential from use of the motor vehicle for the permitted mileage, and not beyond.

AG24. 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 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 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 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

- AG25. 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 AG26–AG31); 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

- AG26. 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 or service potential 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.
- AG27. 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 a tourism outlet);
 - (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).

- AG28. 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 AG25(b)(i)).

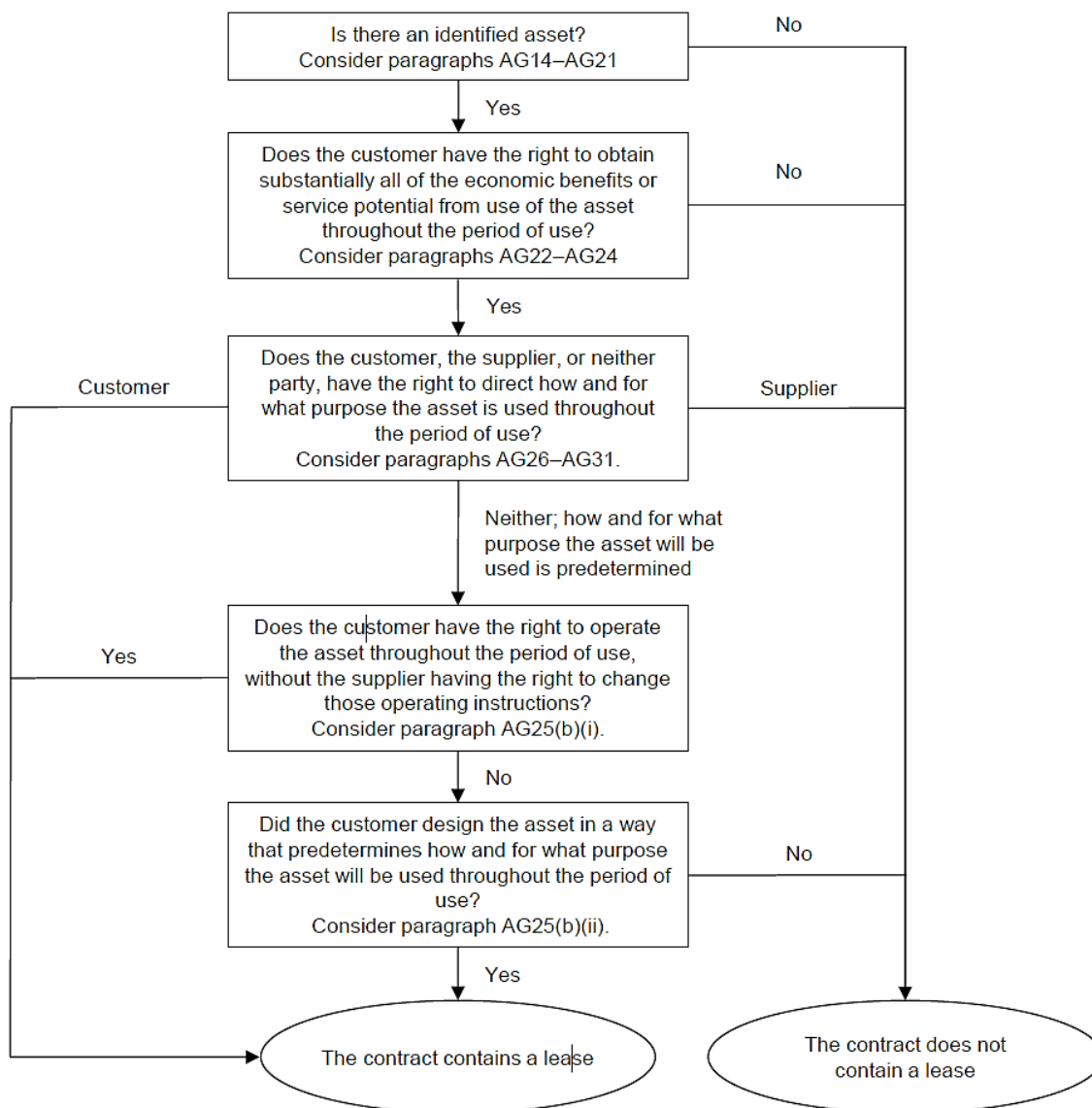
Decisions Determined During and Before the Period of Use

- AG29. 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.
- AG30. 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 AG25(b)(ii). Consequently, unless the conditions in paragraph AG25(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

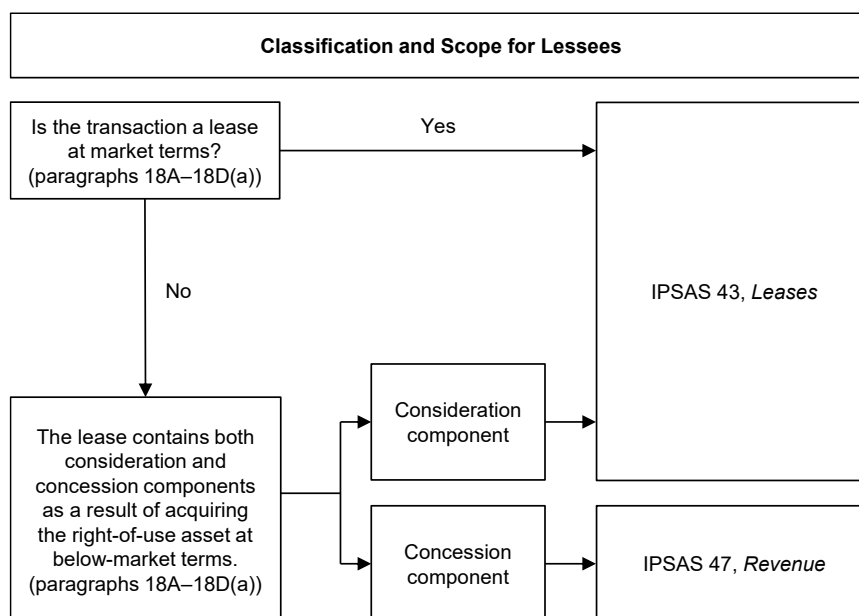
- AG31. A contract may include terms and conditions designed to protect the supplier's interest in the asset or other assets, to protect its personnel, or to ensure the supplier's compliance with laws or regulations. These are examples of protective rights. For example, a contract may (i) specify the 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.

AG32. The following flowchart may assist entities in making the assessment of whether a contract is, or contains, a lease.



Classification of Leases at Market Terms and at Below-Market Terms and Scoping for Lessees (paragraphs 18A–18D)

AG32A. The diagram below establishes the classification and scope of leases for lessees.



Separating Components of a Contract (paragraphs 13–18)

AG33. 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.

AG34. 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 (paragraphs 19–22)

AG35. 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.

AG36. 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.

- AG37. The lease term begins at the commencement date and includes any rent-free periods provided to the lessee by the lessor.
- AG38. 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.
- AG39. 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 AG43, 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.
- AG40. 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.
- AG41. 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.

AG42. Paragraph 21 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 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).

In-Substance Fixed Lease Payments (paragraphs 28(a), 37(c) and 74(a))

AG43. 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.

Lessee Involvement with the Underlying Asset before the Commencement Date

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

AG44. 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.

- AG45. 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 45. 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

- AG46. 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.
- AG47. 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 97–102.
- AG48. 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. For example, this may be the case if a producer, a lessor and a lessee negotiate a transaction for the purchase of an asset from the producer by the lessor, which is in turn leased to the lessee. The lessee may obtain legal title to the underlying asset before legal title transfers to the lessor. In this case, if the lessee obtains legal title to the underlying asset but does not obtain control of the asset before it is transferred to the lessor, the transaction is not accounted for as a sale and leaseback transaction, but as a lease.

Lessee Disclosures (paragraph 62)

- AG49. In determining whether additional information about leasing activities is necessary to meet the disclosure objective in paragraph 54, a lessee shall consider:
- (a) Whether that information is relevant to users of financial statements. A lessee shall provide additional information specified in paragraph 62 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.
- AG50. Additional information relating to variable lease payments that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 54 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.

AG51. Additional information relating to extension options or termination options that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 54 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.

AG52. Additional information relating to residual value guarantees that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 54 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.

AG53. Additional information relating to sale and leaseback transactions that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 54 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.

Lessor Lease Classification (paragraphs 65–70)

AG54. The classification of leases for lessors in this Standard is based on the extent to which the lease transfers the risks and rewards incidental to ownership of an underlying asset. Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return because of changing economic conditions. Rewards may be represented by the expectation of service potential or profitable operation over the underlying asset's economic life and of gain from appreciation in value or realization of a residual value.

AG55. A lease contract may include terms and conditions to adjust the lease payments for particular changes that occur between the inception date and the commencement date (such as a change in the lessor's cost of the underlying asset or a change in the lessor's cost of financing the lease). In that case, for the purposes of classifying the lease, the effect of any such changes shall be deemed to have taken place at the inception date.

- AG56. When a lease includes both land and buildings elements, a lessor shall assess the classification of each element as a finance lease or an operating lease separately applying paragraphs 66–70 and AG54–AG55. In determining whether the land element is an operating lease or a finance lease, an important consideration is that land normally has an indefinite economic life.
- AG57. Whenever necessary in order to classify and account for a lease of land and buildings, a lessor shall allocate lease payments (including any lump-sum upfront payments) between the land and the buildings elements in proportion to the relative fair values of the leasehold interests in the land element and buildings element of the lease at the inception date. If the lease payments cannot be allocated reliably¹ between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case the entire lease is classified as an operating lease.
- AG58. For a lease of land and buildings in which the amount for the land element is immaterial to the lease, a lessor may treat the land and buildings as a single unit for the purpose of lease classification and classify it as a finance lease or an operating lease applying paragraphs 66–70 and AG54–AG55. In such a case, a lessor shall regard the economic life of the buildings as the economic life of the entire underlying asset.

Sublease Classification

- AG59. In classifying a sublease, an intermediate lessor shall classify the sublease as a finance lease or an operating lease as follows:
- (a) If the head lease is a short-term lease that the entity, as a lessee, has accounted for applying paragraph 6, the sublease shall be classified as an operating lease.
 - (b) Otherwise, the sublease shall be classified by reference to the right-of-use asset arising from the head lease, rather than by reference to the underlying asset (for example, the item of property, plant or equipment that is the subject of the lease).

Concessionary Leases (see paragraphs 18A–18D, 26A–26C, 29A, 64A, 71A, and 81A)

- AG60. Concessionary leases are granted to or received by a lessee at below-market terms. Examples of concessionary leases include leases granted to or received by international organizations or other public sector entities with public policy objectives at below-market terms at inception.
- AG61. If a lessee receiving the right-of-use asset has determined that the transaction has a concession component, the difference between the present value of payments for the lease at market rates based on the current use of the underlying asset and the present value of contractual payments is accounted for in accordance with paragraphs AG153A–AG153B of IPSAS 47 at the commencement date.
- AG62. If a lessor granting a concessionary lease has determined that the transaction has a concession component, at the commencement date:
- (a) In a concessionary finance lease, the lessor:
 - (i) Derecognizes the underlying asset in accordance with the applicable IPSAS;
 - (ii) Recognizes the net investment in the lease in accordance with this Standard; and
 - (iii) Does not recognize the foregone revenue obtained by the difference between the present value of payments for the lease at market rates based on the current use of the underlying asset and the newly recognized net investment in the lease.

¹ Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent. Paragraph BC16 of IPSAS 1 discusses the transitional approach to the explanation of reliability.

- (b) In a concessionary operating lease, the lessor:
 - (i) Recognizes lease revenue in accordance with this Standard;
 - (ii) Does not recognize the foregone revenue obtained by the difference between the contractual payments and the payments for the lease at market rates based on the current use of the underlying asset; and
 - (iii) Shall assess whether the underlying asset is impaired in accordance with the applicable IPSAS.

Illustrative Examples are provided in paragraph IE296A of the Illustrative Examples accompanying IPSAS 47 as well as in paragraphs IE5, IE10A, and IE11 of the Illustrative Examples accompanying this Standard.

Appendix B

Amendments to Other IPSAS

[deleted]

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 43.

Introduction

- BC1. IPSAS 13, *Leases*, was drawn primarily from International Accounting Standard (IAS) 17, *Leases*, (revised 2003) issued by the International Accounting Standards Board (IASB). In January 2016, the IASB issued International Financial Reporting Standard (IFRS) 16, *Leases*. IFRS 16 replaced IAS 17 and a number of related interpretations¹.
- BC2. In June 2016, the IPSASB approved a project brief to develop revised requirements for accounting for leases. This brief acknowledged, and reconfirmed, the IPSASB's conclusion in IPSAS 13 that the economics of a lease transaction are the same in both the public and private sectors, resulting in the decision that this should be an IFRS 16 alignment project.
- BC3. The IPSASB's policy document, *Process for Reviewing and Modifying IASB Documents*, sets out the process the IPSASB follows when developing an aligned Standard. The first step of the process is to consider whether there are any public sector issues that warrant a departure from an IASB document.
- 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 for Reviewing and Modifying IASB Documents* requires the IPSASB to make 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 IPSAS; and
 - (c) Consistency with the statistical bases.

Background

Development of ED 64, Leases

Lessee Accounting

- BC6. IFRS 16 introduced 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 lessee accounting as follows²:
- (a) Recognizes a 'right-of-use asset'; and

¹ 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*.

² Except for short-term leases and leases for which the underlying asset is of low value, as described in IFRS 16.5–8.

- (b) Recognizes a lease liability related to the future lease payments.

BC7. When developing ED 64, *Leases*, the IPSASB had 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 IPSASB's *Conceptual Framework*.
- (c) The information reported under the single right-of-use 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 accounting arbitrage and information asymmetry. It 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 for lessees associated with implementing the right-of-use model in the public sector. However, the IPSASB considered that the benefits outweigh the costs, particularly if the IPSASB also adopted the exemptions in IFRS 16.

BC8. Consequently, the IPSASB had 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 had decided to develop ED 64 with lessee accounting requirements that were aligned with the requirements in IFRS 16.

Lessor Accounting

BC9. IFRS 16 retained the 'risks and rewards incidental to ownership' model applied in IAS 17 (and IPSAS 13). The IPSASB had considered whether there were any public sector issues that warranted a departure from the lessor accounting requirements in IFRS 16. In developing ED 64, the IPSASB had come to the view that the 'risks and rewards incidental to ownership' model:

- (a) Is not based on control and would not be consistent with the IPSASB's *Conceptual Framework*.
- (b) Does not distinguish between the right-of-use asset and the underlying asset. The IPSASB considered these to be different economic phenomena which should both be accounted for.
- (c) If applied for lessor accounting, while a control-based model was applied for lessee accounting, would:
 - (i) Be inconsistent with IPSAS 17, *Property, Plant, and Equipment* and IPSAS 32, *Service Concession Arrangements: Grantor*, which are based on control; and
 - (ii) Raise consolidation issues and impair understandability and the decision usefulness of information where the lessor and the lessee are part of the same economic entity. For example, 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. In this context, the IPSASB had formed the view that a lessor would not be expected to derecognize a leased asset because the lessor has only transferred the right to use an underlying asset, not the underlying asset itself.

BC10. As a consequence, the IPSASB had decided to develop a right-of-use model for lessor accounting specifically designed for public sector financial reporting.

IPSASB Consultative Advisory Group

- BC11. The IPSASB Consultative Advisory Group (CAG) had been consulted during the development of ED 64, in particular on the IPSASB's decision to depart from IFRS 16 in lessor accounting.
- BC12. At its December 2016 meeting, the CAG advised the IPSASB of its views that:
- (a) Symmetry may not be needed in lease accounting;
 - (b) The treatment of the underlying asset is an important issue in the public sector, and it needs to be recognized in the financial statements; and
 - (c) An approach drawn from IFRS 16 would result in the underlying asset not appearing in the statement of financial position of either the lessor or lessee in some cases and expressed a view that this would give rise to a public interest concern.
- BC13. The CAG also advised the IPSASB that if it wants to pursue proposals other than IFRS 16 lessor accounting it may take a long time to develop an appropriate lessor accounting model given the experiences and challenges the IASB faced in attempting to do so.

ED 64, Leases

- BC14. In January 2018, the IPSASB published ED 64, *Leases* proposing a single right-of-use model for lease accounting for lessees and lessors under which:
- (a) The lessee would recognize a 'right-of-use asset' and a lease liability related to the future lease payments at the commencement of a lease; and
 - (b) The lessor would recognize a lease receivable and a lease liability (unearned revenue) at the commencement of a lease, while continuing to recognize and measure the underlying asset according to the applicable Standards.
- BC15. ED 64 also proposed specific public sector accounting requirements on leases at below-market terms, also known as concessionary leases. The proposal was that such leases be measured at fair value leading to recognition of the implicit subsidy (the difference between the market value and the lease contract value) in both lessees' and lessors' financial statements.

Feedback from Constituents on ED 64, Leases

- BC16. The IPSASB received 39 comment letters in response to ED 64. This feedback indicated that:
- (a) The vast majority of respondents agreed with the right-of-use model for lessee accounting. Many respondents who agreed with the proposals noted that their thinking was generally consistent with IPSASB's reasoning set out in the Basis for Conclusions to ED 64.
 - (b) Respondents that disagreed or partially agreed with the right-of-use model for lessees were of the view that:
 - (i) The proposed model was too complicated, costly and focused on the statement of financial position;
 - (ii) The right-of-use model for lessee accounting by itself was inadequate for public sector reporting because the IPSASB did not consider sufficiently the allocations of rights, which pertain to physical and intangible assets, which are prevalent in the public sector;
 - (iii) An exemption should be provided for leases between public sector entities; and

- (iv) Guidance should be provided on the recognition and measurement of the transferred asset at the end of the lease term.³
- (c) Respondents were almost equally divided over whether a departure from IFRS 16 lessor accounting was justified, with a small majority supporting departure. Generally, those in support of IFRS 16 lessor accounting, were of the view that the IPSASB had not made a strong enough case to depart from IFRS 16. On the other hand, those supporting departure from IFRS 16 lessor accounting on conceptual grounds agreed with the IPSASB's reasoning set out in the Basis for Conclusions, but did not agree consistently with the proposals for lessor accounting set out in ED 64.
- (d) Respondents that did not agree with ED 64 proposals for lessor accounting did not have a unified view on the approach that should be adopted for lessor accounting and proposed a number of alternatives. The lack of consensus among respondents on the economics of, and accounting for, leases by lessors highlighted significant differences across jurisdictions.
- (e) Respondents were of the view that the IPSASB needed to address public sector specific issues related to leases (for example, concessionary leases, access rights, and other types of arrangements in the public sector, etc.). However, respondents provided diverse views on how to address these public sector specific issues.

IPSASB's Response to Constituents' Feedback on ED 64, Leases

IPSASB Consultative Advisory Group

- BC17. After considering constituents' feedback on ED 64, at the December 2018 CAG meeting the IPSASB sought CAG's views on actions to move the Leases project forward in light of the responses to ED 64.
- BC18. The CAG advised the IPSASB that at this stage of the Leases project it would be in the public interest to:
 - (a) Slow down the Leases project by extending its timeline to better understand the issues raised by respondents to ED 64;
 - (b) Further consider alignment with IFRS 16 regarding lessor accounting; and
 - (c) Focus on public sector differences related to lease transactions.

Other IPSASB initiatives

- BC19. The IPSASB decided to:
 - (a) Create a Task Force in December 2018, with members from several jurisdictions, including preparers, users, auditors and standard-setters, to undertake an in-depth review of all constituent comments; and
 - (b) Invite guest speakers to the June and September 2019 IPSASB meetings to provide their views on lease accounting and the implementation challenges of applying IFRS 16 in both the private and public sectors. Speakers included national standard-setters, auditors, preparers and the statistical accounting community.
- BC20. The guest speakers highlighted that the new lessee accounting model in IFRS 16 was raising significant implementation issues in both the private and public sectors. The IPSASB considered that leases are a very common transaction in the public sector, and that any changes on how to account for leases would have similar or greater implementation cost and challenges for the public sector. IFRS 16 also presents significant conceptual and practical challenges for the statistical community.

³ See paragraph BC27.

New Approach to the Leases Project

- BC21. In the light of these presentations and the responses to ED 64, in March 2020 the IPSASB decided to revisit its overall approach to the Leases project, and to adopt a phased approach as follows:
- (a) Phase One, dealing with lease accounting model(s) for both lessees and lessors based on the same definition of a lease as in IFRS 16; and
 - (b) Phase Two, dealing with public sector specific issues, such as concessionary leases, access rights, and other types of arrangements in the public sector. The IPSASB also decided to issue a 'Request for Information' to better inform this Phase Two work.
- BC22. In determining how to approach the first phase of the project, the IPSASB discussed whether it should consider a variant to IFRS 16 lessor accounting that would require all lessors to account for leases as operating leases only. The aim of this variant would be to deal with the concern raised by respondents regarding the non-recognition of the underlying asset by both the lessor and the lessee if the lessor classifies the lease as a finance lease.
- BC23. The IPSASB decided not to proceed with this IFRS 16 variant for lessors because:
- (a) Requiring operating lease accounting for all lessor transactions would remove the judgement by preparers that is inherent to the risks and rewards model and would transform it into a rules-based model without sufficient economic rationale;
 - (b) It would create consolidation issues where both lessor and lessee are part of the same economic entity applying IPSAS; and
 - (c) It would create mixed group⁴ issues where some commercial public sector entities apply IFRS Standards but are controlled by public sector entities that apply IPSAS. Different requirements are costly to those applying IPSAS when there is no public sector specific reason to develop different accounting treatments.

Three Strategic Options for the Leases Project

- BC24. After making this decision, the IPSASB discussed three strategic options:
- (a) Option 1 – Retain IPSAS 13, which would pause the project;
 - (b) Option 2 – Proceed with the right-of-use model for lessees and risks and rewards model for lessors in developing a Standard aligned with IFRS 16; or
 - (c) Option 3 – Proceed with the right-of-use model for both lessees and lessors and develop a Standard based on ED 64.
- BC25. In order to make this strategic decision on the overall future direction of the project, the IPSASB considered the following six factors alongside the public interest:
- (a) Public Financial Management (PFM)⁵ benefits;

⁴ Mixed groups are groups that encompass public sector entities that apply IPSAS and commercial public sector entities that apply IFRS Standards.

⁵ Defined in *The CIPFA FM Model, Statements of Good Practice* as "Public Financial Management is the system by which financial resources are planned, directed and controlled to enable and influence the efficient and effective achievement of public service outcomes." This definition is aligned with the principles in the *IFAC/CIPFA International Framework: Good Governance in the Public Sector* (see <https://www.ifac.org/knowledge-gateway/contributing-global-economy/publications/international-framework-good-governance-public-sector>)

- (b) Implementation costs and challenges—training, information technology changes, change of processes, accounting changes (first-time implementation of new Standard), and on-going accounting (maintenance);
- (c) Government Finance Statistics (GFS) alignment—at the conceptual level, when comparing IPSAS and GFS accounting frameworks, and at the practical level, when compiling GFS accounts using information from accrual-based IPSAS accounts;
- (d) IPSASB's *Conceptual Framework*—public sector financial reporting objectives of accountability and decision-making, and whether transactions and events meet the definition of elements⁶;
- (e) IFRS Alignment—alignment with IFRS 16; and
- (f) Feasibility of the Leases project—timeliness, and impact on project management, IPSASB's resource allocation, and IPSASB's Work Program.

BC26. The IPSASB first considered whether to pause with the leases project by retaining IPSAS 13 (Option 1). The IPSASB was of the view that retaining IPSAS 13 would be the least favorable option in terms of PFM benefits, consistency with the IPSASB's *Conceptual Framework* and IFRS Alignment because it would:

- (a) Continue to allow off-balance sheet financing of operating leases for lessees;
- (b) Create mixed group issues where some controlled entities are required to apply IFRS Standards;
- (c) Result in some cases the underlying asset not being recognized by either the lessee or the lessor, or being recognized by both;
- (d) Be inconsistent with the control-based approach to asset recognition and derecognition in the IPSASB's *Conceptual Framework*; and
- (e) Retain an accounting model that differs from that in IFRS 16 for both lessees and, to a lesser extent, lessors⁷.

BC27. During its discussion of Option 1, the IPSASB also considered the comments made by respondents that disagreed or partially agreed with the right-of-use model for lessees (see paragraphs BC16(b)(i)–BC16(b)(ii)). The IPSASB concluded that the respondents' concerns were not public sector specific and, therefore, did not warrant a departure from IFRS 16. The IPSASB also concluded that the benefits of the right-of-use model for lessees would outweigh the costs of the accounting changes as there would be a number of simplifications, such as:

- (a) Providing a single accounting model for lessees which would remove the different lease classifications in IPSAS 13;
- (b) Permitting a lessee not to recognize assets and liabilities, for short-term leases and leases of low-value assets;
- (c) Permitting application of the Standard by entities on a portfolio basis for leases with similar characteristics;
- (d) Simplifying the measurement requirements for lease liabilities, in particular the requirements for variable lease payments, payments during optional periods and the reassessment of lease liabilities;

⁶ The main difference between the three options is related to recognition of elements and how this impacts accountability and decision-making.

⁷ For lessees, IPSAS 13 includes the risks and rewards incidental to ownership model and IFRS 16 includes the right-of-use model. For lessors, IFRS 16 changed the risks and rewards incidental to ownership model compared to IAS 17 (the Standard from which IPSAS 13 was drawn primarily) because it made changes to the requirements for subleases, lease modifications, initial direct costs, variable lease payments, and disclosures.

- (e) Establishing requirements for separating lease and non-lease components included in the same contract;
- (f) Establishing lessee disclosure requirements focused on the most significant features of their lease portfolios; and
- (g) Simplifying lessee transition requirements.

- BC28. Consequently, the IPSASB decided that it would be in the public interest not to proceed with Option 1, and so to replace IPSAS 13 with a new Standard.
- BC29. The IPSASB then considered whether to proceed with Option 2 (an IFRS 16-aligned Standard) or to proceed with Option 3 (ED 64) by applying the six factors outlined in paragraph BC25. Since the main difference between these two options was the lessor accounting model, this was the focus for the Board's discussions, and therefore the paragraphs below focus on lessor accounting, except where otherwise stated.
- BC30. Regarding PFM benefits, it was not clear from the responses to ED 64 which option provides the greater overall benefits. For example, some respondents argued that the recognition of a liability would lead to increased financial leverage reflected in the lessor's statement of financial position. Therefore, this factor did not provide a clear indication of which option was preferable.
- BC31. Option 3 would entail greater implementation costs and challenges than Option 2 because IFRS 16 substantially carried forward the lessor accounting model in IAS 17 (with which IPSAS 13 is aligned), making only relatively minor changes.
- BC32. With respect to alignment with GFS, wherein the lessees and lessors both follow the concept of risks and rewards, the Option 2 accounting model would be aligned for lessors, but not for lessees. From a GFS perspective Option 2 would still require the use of surveys to obtain data on the underlying asset in a lease (when the lessor has a finance lease). However, Option 2 is currently being applied in the private sector and any additional statistical information or data processes required by GFS can be replicated in the public sector if the IPSASB chose this option. Under Option 3, the accounting model would not be aligned with GFS for both lessees and lessors.
- BC33. Option 3, under which both the lessees and lessors would follow the concept of control, would be more consistent with the IPSASB's *Conceptual Framework*, while Option 2 would be less consistent with the IPSASB's *Conceptual Framework*⁸.
- BC34. On the other hand, Option 2 would be aligned with IFRS Standards, while Option 3 would not be so aligned.
- BC35. From a project management perspective, Option 2 would have the advantage of being more straightforward and therefore more feasible than Option 3. Additionally, Option 3 would be more challenging from a project delivery perspective because of the probable continued variations in views in further developing the ED 64 lessor accounting proposals, which could therefore extend the project timeline.
- BC36. After careful consideration of the respective arguments for and against the Options for each of the six factors, the IPSASB decided that, on balance, the public interest would be better served by proceeding with Option 2 (an IFRS 16-aligned Standard) because it would:
- (a) Be less costly and challenging to implement by changing only lessee accounting, and the public sector could benefit from the private sector experience in implementing IFRS 16;
 - (b) Align with the IPSASB's Strategy & Work Plan strategic theme of Maintaining IFRS Alignment, which was an original objective of the Leases project;

⁸ Where a Standard is developed that departs from the *Conceptual Framework*, the IPSASB explains the reasons.

- (c) Address more quickly the important off-balance sheet financing of operating leases by lessees that IPSAS 13 permits, without waiting for a new accounting model for lessors; and
- (d) Facilitate Phase One delivery, thus permitting the IPSASB to focus on Phase Two of the project, and so to address the important public sector specific issues described in paragraph BC21(b) in a more timely manner.

Exposure Draft (ED) 75, *Leases* and Request for Information

BC37. In January 2020, the IPSASB published:

- (a) ED 75, *Leases* as part of Phase One of the Leases project; and
- (b) Request for Information, *Concessionary Leases and Other Arrangements Similar to Leases* as part of the Phase Two of the Leases project.

BC38. The IPSASB received 48 and 37 comment letters in response to ED 75 and Request for Information, respectively.

BC39. The feedback received on the proposals in ED 75⁹ indicated that:

- (a) The majority of respondents agree or partially agreed with the ED 75 proposals for alignment with IFRS 16 and consequently with the right-of-use model for lessees¹⁰ and risks and rewards model for lessors; and
- (b) Some respondents who agreed with ED 75 noted that their thinking was generally consistent with IPSASB's reasoning set out in the Basis for Conclusions (BC) to ED 75. Other respondents agreed with ED 75 without providing additional reasons.

BC40. The IPSASB noted that the ED 75 proposals for lessor accounting have much stronger support from respondents when comparing with the ED 64 proposals, which received mixed support.

BC41. Some respondents, while agreeing with the ED 75 proposals for lessee and lessor accounting, provided minor points for further consideration by the IPSASB.

BC42. The few respondents that partially agreed or disagreed with ED 75 provided the following reasons:

- (a) Exemption should be added for public sector entities to provide relief from applying the proposed accounting requirements for leases between entities of the public sector because of cost-benefit reasons;
- (b) Accounting asymmetry between lessee and lessor;
- (c) The underlying asset is recognized neither in the lessor's nor in the lessee's financial statements in the case of a finance lease from the lessor's perspective;
- (d) Divergence with Government Finance Statistics (GFS) in lessee accounting;
- (e) Scope of public debt for lessees;
- (f) The Leases project should have a single phase;
- (g) Continue adopting IPSAS 13; and
- (h) Proposed model for lessees is too complicated, costly and concentrated on the statement of financial position

⁹ The analysis of the responses to the Request for Information will be made in Phase Two of the Leases project.

¹⁰ This feedback was consistent with ED 64 lessee accounting model aligned with IFRS 16, which was also supported.

- BC43. The IPSASB considered the overall feedback received and concluded that the issues raised by respondents that partially agreed or disagreed with ED 75 were:
- (a) Not public sector specific that warrant departure from IFRS 16; or
 - (b) Considered by the IPSASB during the development of ED 75 as set out in its Basis for Conclusions (see BC21–BC36).
- BC44. Therefore, the IPSASB decided to proceed with the ED 75 proposals for lessee and lessor accounting, subject to addressing the minor points raised by respondents that in the view of the IPSASB would enhance ED 75.

IPSAS 43, Leases

- BC45. This Standard is based on IFRS 16, *Leases* issued by the IASB. In accordance with existing practice, this Basis for Conclusions outlines only those areas where IPSAS 43 departs from the main requirements of IFRS 16, or where the IPSASB considered such departures taking into consideration the feedback received to ED 75.

Scope (see paragraph 3)

- BC46. In developing ED 75, the IPSASB had considered whether to provide an explicit scope exclusion for concessionary leases. The IPSASB had decided not to provide that explicit scope exclusion because:
- (a) IPSAS 13 does not have a scope exclusion for concessionary leases;
 - (b) ED 75 is an IFRS aligned Standard, and IFRS 16 does not exclude concessionary leases from its scope; and
 - (c) Any issues in applying ED 75 to concessionary leases, including the concession component, will be considered further in Phase Two of the Leases project (see paragraph BC21(b)).
- BC47. In reaching this decision, the IPSASB had noted that ED 75 already addressed lease incentives paid by the lessor to the lessee to entice the lessee to enter into the lease. However, in this situation the lease incentives do not modify the nature of the lease as being a lease at market terms. The leases to be considered in Phase Two of the Leases project are concessionary leases where the lessor has the intention of providing a concession that modifies the nature of the lease into a lease at below-market terms.

Responses to ED 75, Leases

- BC48. The majority of respondents to ED 75 supported the proposed scope based on the same reasons as set out in paragraph BC39.
- BC49. The minority respondents who did not support the proposed scope in ED 75 commented that they would prefer to explicitly scope out concessionary lease because:
- (a) The separation of the lease component requirement cannot be applied to leases with no consideration or the exchange is insignificant;
 - (b) It would help clarify whether ED 75 (measured at cost) or IPSAS 23 (measured at fair value) applies to concessionary leases;
 - (c) It would help clarify whether ED 75 or the future pronouncement based on the RFI apply to concessionary leases;
 - (d) Preparers may have to change their accounting treatment of concessionary leases in order to comply with ED 75 following Phase One, and later on have to again change their accounting treatment of

concessionary leases in order to comply with the pronouncement issued following Phase Two of IPSASB's Leases project.

BC50. The IPSASB considered the issues raised by the respondents and decided to proceed with the ED 75 proposals as the basis for IPSAS 43 due to:

- (a) The reasons identified in paragraph BC46; and
- (b) The issues raised by respondents to ED 75 were not persuasive enough to justify a different approach.

Definitions

Definition of a Lease

BC51. In developing ED 75, the IPSASB decided to adopt the IFRS 16 definition of a lease because it had not identified a public sector specific reason that warranted departure from IFRS 16.

Responses to ED 75, Leases

BC52. While the majority of respondents agreed with the ED 75 proposal, a few respondents suggested that the IPSASB should:

- (a) Clarify the term consideration to refer to financial or nonfinancial consideration as public sector entities may also enter into lease contracts in exchange for consideration that is nonfinancial;
- (b) Clarify the difference between concessionary leases and nominal leases and quantifying the value and the basis of a nominal lease from the definition of a lease perspective; and
- (c) Amend the definition of a lease by adding the term "control the" before "use of an identified asset" to be consistent with the application guidance of ED 75.AG10 because inconsistent references to the right to use make it difficult to decide whether the analysis should focus on the right to use, the right to control the use or the right to direct the use."

BC53. The IPSASB noted that ED 75 deals with consideration in the form of cash flows because:

- (a) The definition of a lease is linked to the definition of lease payments, and
- (b) This approach is consistent with both IPSAS 13, *Leases* and IFRS 16, *Leases*.

BC54. The IPSASB also noted that Phase Two of the Leases project will address concessionary leases, which the Request for Information, *Concessionary Leases and Other Arrangements Similar to Leases* is part of.

BC55. The IPSASB considered the consistency between the definition of a lease and its application guidance. The IPSASB concluded that the application guidance in ED 75 clarifies the principle set out in the definition of a lease about conveying the right to use an identified asset by explicitly referring to the right to control the use of an identified asset, without the need to include it in the definition of a lease. The IPSASB noted that this approach is consistent with the approach in IFRS 16.

BC56. In conclusion, the IPSASB decided to retain the ED 75 proposals in IPSAS 43, *Leases* because it did not identify a public sector specific reason that would warrant a departure from IFRS 16.

Contractual Arrangements

BC57. In developing ED 75, the IPSASB had 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 had 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.

- BC58. Consideration was given to whether the term “binding arrangement” should be used to describe the arrangements highlighted in paragraph AG3. The term “binding arrangement” is defined in IPSAS 32, *Service Concession Arrangements: Grantor* 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 had concluded that the term “binding arrangements,” as used in IPSAS, embraces a wider set of arrangements than those identified in paragraph AG3 and therefore concluded that it should not be used in this Standard. Entities in a binding arrangement would enforce their rights and obligations through legal (enforceable through judicial system) or equivalent means (enforceable through cabinet and ministerial directives, executive authority, or other means that are similar). However, entities in a contract would enforce their rights and obligations only through legal means (i.e., by law, through judicial system).

Responses to ED 75, Leases

- BC59. ED 75 specifically referred to contracts in the definition of a lease. Although the majority of respondents agreed with the ED 75 proposals, some respondents disagreed with limiting the definition of a lease to contracts because it would scope out from the final IPSAS on Leases types of arrangements that are not contracts, but are prevalent in the public sector because:
- (a) There might not be willing parties to the arrangement; or
 - (b) Many public sector entities do not have the power to enter into contracts but enter into binding arrangements that confer similar rights and obligations on the parties as if they were a form of contract.
- BC60. As a result of these concerns, the IPSASB decided to clarify that IPSAS 43 is designed only for transactions that have the three elements identified in paragraph AG3.
- BC61. As noted in BC58, the IPSASB differentiated contracts as enforced by legal means whereas binding arrangements are enforced by legal or equivalent means. A transaction that does not have willing parties is neither a contract nor a binding arrangement.
- BC62. As a result, the IPSASB decided to retain the term “contract” in the definition of a lease in IPSAS 43.

Initial Direct Costs

- BC63. The IPSASB decided not to include the IFRS 16 requirements for a manufacturer or dealer lessor (see paragraph BC93) in IPSAS 43. Therefore, the IFRS 16 definition of ‘initial direct costs’ has also been amended to remove the reference to a manufacturer or dealer lessor.

Fair Value

- BC64. In developing ED 75, the IPSASB had considered whether to retain the fair value definition consistent with IFRS 16 and IPSAS 13 or to include the fair value definition consistent with ED 77.
- BC65. The IPSASB had noted that including the fair value definition consistent with ED 77 might significantly change the lease classification and the timing of recognizing gains or losses for sale and leaseback transactions.
- BC66. Therefore, the IPSASB had decided to retain the fair value definition consistent with IFRS 16 because:
- (a) It is consistent with the IPSASB’s March 2020 decision to retain the IPSAS 13 lessor requirements and align with IFRS 16 for cost-benefit reasons (see paragraph BC36); and

- (b) It is consistent with the IASB's decision to retain in IFRS 16 the fair value definition that existed in IAS 17, as the previous lessor accounting model in IAS 17 was not fundamentally flawed and should not be changed.

Responses to ED 75, *Leases*

- BC67. While the majority of respondents agreed with the ED 75 proposals, some respondents disagreed with the retention of the fair value definition from IFRS 16, *Leases* and IPSAS 13, *Leases* in ED 75 because:
- (a) Of the possible confusion for users and preparers of having two different fair value definitions in IPSASB's literature;
 - (b) Sale and leaseback transactions (where the definition of fair value is used) occur infrequently in the public sector;
 - (c) Of the benefits of the consistent use of terminology in IPSASB literature; and
 - (d) Most countries are still in the process of implementing IPSAS and, therefore, the change to the ED 77 fair value definition would not cause significant change for their accounting system.
- BC68. The IPSASB decided to retain the ED 75 fair value definition in IPSAS 43 because there was no compelling public sector reason to depart from IFRS 16.

Identifying a Lease

- BC69. In developing ED 75, the IPSASB had considered whether to refer to both "economic benefits" and "service potential" in the application guidance section in ED 75 on identifying a lease, rather than "economic benefits" alone.
- BC70. If the guidance referred only to "economic benefits", the IPSASB had noted that an entity that intends to use the identified asset to provide services to the community might reach the conclusion that the transaction is not a lease because it does not derive economic benefits from the use of that asset, despite the fact that the transaction meets the definition of a lease in ED 75.5. Therefore, the IPSASB had decided to add the term "service potential" in the application guidance section on identifying a lease, where appropriate.
- BC71. In reaching this conclusion, the IPSASB had also noted that this approach is consistent with *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (2014) in referring to assets in terms of both economic benefits and service potential.

Responses to ED 75, *Leases*

- BC72. All respondents to ED 75 supported referring to both "economic benefits" and "service potential" in the application guidance section on identifying a lease, rather than "economic benefits" alone.
- BC73. Based on a respondent's suggestion, the IPSASB decided to extend this approach, where appropriate, to the Illustrative Examples. In doing so, the IPSASB's rationale was to refer to "service potential" in all illustrative examples that have generic references to the benefits of the lease.

Lessee Accounting

Recognition Exemptions

- BC74. 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 Standard.
- BC75. The IPSASB also considered whether the permissible recognition exemptions in IFRS 16 should be a requirement or an option in this 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.

- BC76. 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 appropriately provides a faithful representation of leasing transactions in terms of their own statements of financial position.
- BC77. 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 the 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 Standard.
- BC78. 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 individual 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. The IPSASB concluded that it would not provide guidance on a specific monetary amount. In assessing materiality, preparers consider whether the omission of information could influence financial statement users’ assessments of accountability or their decision-making.

Responses to ED 75, *Leases*

- BC79. In determining a dollar amount for leases of low-value assets, the IPSASB considered the following feedback received on ED 75:
- (a) There is an apparent inconsistency between the application guidance on leases of low value assets that refers to an assessment on an absolute basis and the Basis for Conclusions where it refers to an assessment in terms of materiality; and
 - (b) There is no public sector specific reason for public sector entities not to benefit from the same monetary amount to guide entities in applying the exemption.
- BC80. Based on the feedback received, 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 guidance in IPSAS 43.AG4–AG9. The IPSASB noted that the exemption is to apply to leases for which the underlying asset, when new, is of low value. A lease will not qualify for the exemption if the nature of the underlying asset is such that, when new, its value is typically not low.
- BC81. The IPSASB concluded that it would not provide a specific monetary amount in the Basis for Conclusions because the application guidance already provides guidance for applying the requirements consistent with IFRS 16. The IPSASB decided that the outcome of the assessment of whether an underlying asset is of low value should not be affected by the size, nature, or circumstances of the lessee—i.e., the exemption is based on the value, when new, of the asset being leased; it is not based on the size or nature of the entity that leases the asset.

Discount Rate

- BC82. In developing ED 75, the IPSASB had considered whether to provide additional guidance where:
- (a) The lessee’s incremental borrowing rate is different from the likely interest rate implicit in the lease; or

- (b) The lessee is unable to determine the interest rate implicit in the lease or has difficulties in determining the incremental borrowing rate.

BC83. The IPSASB had decided that this issue is not public sector specific because private sector entities encounter similar difficulties in determining the implicit rate in the lease and the incremental borrowing rate.

BC84. The IPSASB had noted that the incremental borrowing rate can be determined by:

- (a) Taking into account the terms and conditions of the lease;
- (b) Referring to a rate that is readily observable as a starting point (for example, the rate that a lessee has paid, or would pay, to borrow money to purchase the type of asset being leased, or the property yield when determining the discount rate to apply to property leases); and
- (c) Adjusting such observable rates as is needed to determine the lessee's incremental borrowing rate as defined in ED 75.

Responses to ED 75, *Leases*

BC85. While the majority of respondents agreed with the ED 75 proposals, a few respondents suggested including some guidance on determining the discount rate because of:

- (a) Difficulties in determining the implicit rate in the lease, where public sector entities have challenges in accessing borrowings to determine the incremental borrowing rate;
- (b) Differences between real and nominal interest rates in non-developed countries with high inflation; and
- (c) The lack of guidance on the meaning of "similar value" in the definition of lessee's incremental borrowing rate.

BC86. The IPSASB decided to proceed with the proposals in ED 75 and not provide additional guidance on the discount rate because:

- (a) Lack of incremental borrowing rate is also prevalent in the private sector;
- (b) The IPSASB has already clarified in BC84 how to identify an appropriate incremental borrowing rate based on similar transactions; and
- (c) Differences between real and nominal interest rates are not a public sector specific issue.

COVID-19 Requirements

BC87. In developing ED 75, the IPSASB had included the 2020 amendments to IFRS 16 for COVID-19-related rent concessions. The IPSASB was of the view that the inclusion of these requirements might be useful to preparers and users of general purpose financial reports (GPFRs) because of the uncertain duration and future impacts of the pandemic.

Responses to ED 75, *Leases*

BC88. While the majority of respondents agreed with the ED 75 proposals, a few respondents suggested that these requirements should be applicable to pandemics in general due to the:

- (a) Applicability of these requirements may be overtaken by events and therefore will be of no value to the preparers and users of GPFRs; and
- (b) Delayed effective dates of other IPSAS.

BC89. The IPSASB noted that the IASB also considered the risk of the practical expedient being applied too broadly, which could result in unintended consequences. Therefore, the IASB decided to limit the scope of the

practical expedient so that it applies only to rent concessions that occur as a direct consequence of the COVID-19 pandemic if other conditions are met.

- BC90. Additionally, some respondents suggested changing the date until which the practical expedient can be applied because it will date the Standard and will limit the duration affected by COVID-19. In the end, having the same affected period for all might not work because it might not be the case for everyone.
- BC91. The IPSASB noted that, in March 2021, the IASB published Covid-19-Related Rent Concessions beyond 30 June 2021 (Amendments to IFRS 16). In this publication, the IASB only extended the date of the practical expedient to end on June 30, 2022—it did not introduce either a new practical expedient or a new option to apply (or not apply) the practical expedient. The IASB only wanted these requirements to be applicable to the COVID-19 pandemic by providing a single criterion to be applicable in all jurisdictions.
- BC92. The IPSASB decided to retain the ED 75 proposals in IPSAS 43 because it did not identify a public sector specific reason that would warrant a departure from IFRS 16.

Lessor Accounting

Manufacturer or Dealer Lessors

- BC93. The IPSASB decided not to include in this Standard the manufacturer or dealer lessor requirements included in IFRS 16 because:
- (a) They are not expected to be applied to public sector entities for which IPSAS are designed; and
 - (b) The IPSASB's constituents did not request its inclusion during consultation on ED 64, which also excluded those requirements.

Responses to ED 75, *Leases*

- BC94. While respondents strongly agreed with the ED 75 proposal, one respondent was of the view that the rationale for excluding manufacturer or dealer lessor requirements was not persuasive because although it might not be expected, the public sector is not prohibited from manufacturing or dealing activities.
- BC95. The IPSASB recognizes that the relative importance of manufacturer or dealer lessors requirements might vary across jurisdictions. However, the IPSASB decided to proceed with the ED 75 proposal to exclude the manufacturer or dealer lessors requirements in IPSAS 43 because of the:
- (a) Reasons identified in paragraph BC93;
 - (b) Overwhelming support for the ED 75 proposal.
- BC96. In reaching this conclusion, the IPSASB noted that if a public sector entity does have manufacturer or dealer lessor arrangements, they could follow IFRS 16 under the hierarchy in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Intermediate Lessors

Responses to ED 75, *Leases*

- BC97. While respondents strongly agreed with the ED 75 proposal, one respondent suggested that the IPSASB consider adding guidance related to the scenario where there is a head lease with fixed payments and a sublease with variable lease payments linked to sales, when both have the same lease period. This respondent was of the view that judgements may differ on whether the lease should be classified as an operating lease or a finance lease by the intermediate lessor. A further consideration was related to the recognition of profit and loss related to the right-of-use asset at the commencement date of the sublease.

- BC98. The IPSASB decided to proceed with the ED 75 proposals in IPSAS 43 because the IPSASB did not identify a public sector specific reason to depart from the IFRS 16 requirements for intermediate lessors.

Cross-Reference to IFRS 15 Revenue from Contracts with Customers

- BC99. When developing this Standard, the IPSASB decided to refer to IFRS 15 instead of the relevant national or international accounting standard dealing with revenue from contracts with customers, where appropriate, because it is consistent with the:
- (a) Control-based approach to lessee accounting in IPSAS 43; and
 - (b) IFRS 16 reference to IFRS 15 in the corresponding requirements.
- BC100. In reaching this decision, the IPSASB noted that these references will be updated when the new IPSAS 47, *Revenue* is issued.

Effective Date

- BC101. The IPSASB decided that IPSAS 43 should have an effective date of annual financial statements covering periods beginning on or after January 1, 2025, with earlier application permitted.
- BC102. In deciding the effective date, the IPSASB considered that:
- (a) IFRS 16 also had a three-year period for its application;
 - (b) IPSAS 41, *Financial Instruments* will be effective in January 1, 2023, which will add to the workload for preparers before having to apply IPSAS 43;
 - (c) It provides sufficient time for the IPSASB to finalize the new IPSAS 47 and other IPSAS under development in the IPSASB's Work Program, which may have consequential amendments to IPSAS 43;
 - (d) It allows the IPSASB time to finish Phase Two of the Leases project; and
 - (e) It allows public sector entities time to identify the impacts of and to prepare for the implementation of the new Leases Standard.
- BC103. The IPSASB decided to permit the earlier application of IPSAS 43, instead of encouraging it, because, ideally, the Standard should be applied together with the new IPSAS 47 aligned with IFRS 15.
- BC104. The IPSASB noted during the development of this Standard that, for those public sector entities that elect to apply IPSAS 43 early, there might be greater complexity in analyzing revenue transactions under different principles: some lease transactions would be accounted for according to the principles in IFRS 15, while the revenue from other non-lease transactions will still be accounted for according to the principles in IPSAS 9, *Revenue from Exchange Transactions*, until the IPSASB publishes a new IPSAS on Revenue. However, cross-referencing to IFRS 15, where appropriate for revenue recognition, provides a temporary solution that allows public sector entities to prepare for the future changes that might be required when the IPSASB completes its Revenue project and issues the new IPSAS 47.

Revision of IPSAS 43 as a result of *Improvements to IPSAS, 2023*

- BC105. The IPSASB reviewed the revisions to IFRS 16, *Leases*, included in *Interest Rate Benchmark Reform—Phase 2* (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16) issued by the IASB in August 2020, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions, and generally concurred that there was no public sector specific reason for not adopting these amendments, henceforth labeled as *Interest Rate Benchmark Reform—Phase 2* amendments.

- BC106. The IPSASB reviewed the revisions to IPSAS 43, Leases, included in *Lease Liability in a Sale and Leaseback* (Amendments to IFRS 16) issued by the IASB in September 2022, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions, and generally concurred that there was no public sector specific reason for not adopting these amendments, henceforth labeled as *Lease Liability in a Sale and Leaseback* amendments.

Revision of IPSAS 43 as a result of *Concessionary Leases and Other Arrangements Conveying Rights over Assets* (Amendments to IPSAS 43, IPSAS 47, and IPSAS 48) issued in October 2024

Introduction

- BC107. In January 2021, the IPSASB issued the Request for Information (RFI), *Concessionary Leases and Other Arrangements Similar to Leases*. The RFI included a set of arrangements similar to leases that are common in the public sector¹¹.
- BC108. Based on the information received from respondents to the RFI, in January 2023, the IPSASB issued Exposure Draft (ED) 84, *Concessionary Leases and Right-of-Use Assets In-kind* (Amendments to IPSAS 43 and IPSAS 23). ED 84 proposed new public sector specific accounting requirements for two of the six types of arrangements identified in the RFI. Regarding the RFI remaining arrangements, the IPSASB had taken the view that the applicable IPSAS at the time of publication of ED 84 already provided the principles on how to account for those arrangements.
- BC109. During the review of responses to ED 84, the IPSASB noted that some respondents raised some issues that were related to arrangements that do not meet the definition of a lease or a right-of-use asset in-kind. The IPSASB also noted that this may be related to the fact that ED 84 did not propose accounting for the remaining types of arrangements included in the RFI that do not meet the definition of a lease or right-of-use asset in-kind. Therefore, respondents did not have a comprehensive view on the accounting for these types of arrangements that convey rights over assets.
- BC110. In May 2023, the IPSASB published IPSAS 45, *Property, Plant, and Equipment*¹², IPSAS 46, *Measurement*, IPSAS 47, *Revenue*¹³, and IPSAS 48, *Transfer Expenses*. As IPSAS 47 supersedes IPSAS 23, the ED 84 proposals of amendments to IPSAS 23 will no longer be applicable from 2026 onwards.
- BC111. In March 2024, the IPSASB published ED 88, *Arrangements Conveying Rights over Assets* (Amendments to IPSAS 47 and IPSAS 48) with proposed authoritative and non-authoritative guidance for lessees in IPSAS 47 for the concession in concessionary leases update the proposals in ED 84 related to IPSAS 23, as well as non-authoritative proposals to update IPSAS 48 with guidance on other arrangements conveying rights over assets.
- BC112. This Basis for Conclusions present the IPSASB's main considerations and decisions when developing *Concessionary Leases and Other Arrangements Conveying Rights over Assets* (Amendments to IPSAS 43, IPSAS 47, and IPSAS 48), regarding the amendments to IPSAS 43 including respondents' feedback to ED 84.

¹¹ The Request for Information included six types of arrangements, as follows: (i) Concessionary Leases, (ii) Leases for Zero or Nominal Consideration, (iii) Access Rights (or Rights of Access to Property and/or Land), (iv) Arrangements Allowing Right-of-Use, (v) Social Housing Rental Arrangements, and (vi) Shared Properties with or without a Lease-Arrangement in Place.

¹² IPSAS 45 will be effective on January 1, 2025, and supersedes IPSAS 17, *Property, Plant, and Equipment*.

¹³ IPSAS 47 will be effective on January 1, 2026, and supersedes IPSAS 9, *Revenue from Exchange Transactions*, IPSAS 11, *Construction Contracts*, and IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

Definitions

- BC113. The IPSASB reconsidered whether to modify the definition of a lease to include other types of arrangements that are not contracts.
- BC114. The IPSASB decided not to extend the definition of a lease to non-binding arrangements because a lease includes enforceable rights and enforceable obligations for the lessor and lessee; a non-binding arrangement does not.
- BC115. Regarding binding arrangements that are not contracts, the IPSASB, when developing IPSAS 43, decided to expand the types of arrangements within the scope of the definition of a contract by adding paragraph AG3 and clarifying that IPSAS 43 is designed only for arrangements that:
- (a) Are in substance a contract rather than having the legal form of a contract; and
 - (b) Have the following three elements:
 - (i) Willing parties;
 - (ii) Rights and obligations for the parties to the contract; and
 - (iii) The remedy for non-performance is enforceable by law.
- BC116. The fundamental difference between the definition of a contract in IPSAS 43 and the definition of a binding arrangement is that in the latter the enforceability is broader and includes "equivalent means". In other words, binding arrangements are enforceable both within and outside the legal system, whereas contracts are enforceable only within the legal system. Enforceability through equivalent means is the presence of enforcement mechanisms outside of the legal system, that is similar to the force of law without being legal in nature, such as statutory mechanisms, legislative or executive authority, and cabinet or ministerial directives.
- BC117. The IPSASB's Conceptual Framework acknowledges that there are jurisdictions where government and public sector entities cannot enter into legal obligations, because, for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect to enforce the rights and obligations in those arrangements.
- BC118. Sometimes in the public sector, there are binding arrangements that, although conveying the right to use an underlying asset, are not, in substance, contracts. For example:
- (a) One or both parties to the arrangement are not a willing party (for example: a government conveys to another party the right to use an underlying asset on a unilateral basis);
 - (b) The enforceable rights and obligations did not arise from a contract (for example: the rights and obligations are stipulated by a government unilaterally); and
 - (c) Binding arrangements with enforceability mechanisms outside of the legal system (for example, enforcement achieved through executive authority, either cabinet or ministerial directives).
- BC119. By extension, when entities have arrangements as described in paragraph BC116, the IPSASB noted that they should not apply IPSAS 43 because:
- (a) Those arrangements are not, in substance, contracts, as leases are contractual arrangements by nature; and
 - (b) IPSAS 43 was designed for arrangements that are in substance lease contracts, provided that the arrangement conveys the right to obtain substantially all of the economic benefits or service potential from the use of the identified asset and the right to direct the use of the identified asset¹⁴.

¹⁴ IPSAS 43 introduced extensive application guidance on the assessment of both rights.

- BC120. Therefore, the IPSASB decided to retain the definition of a lease as contractual arrangements in IPSAS 43 because:
- (a) IPSAS 43 is designed to be applicable only to leases that are, in substance, contracts; and
 - (b) It is consistent with IPSAS 41, *Financial Instruments*, which is also only applicable to contracts.
- BC121. The IPSASB also considered whether to provide a definition or a description of a concessionary lease. The IPSASB noted that concessionary leases may vary depending on the level of consideration being exchanged, which may make them at below-market terms. In these cases, professional judgment may be required to assess whether, in substance, the transaction meets the definition of a lease or whether it is, in substance, a revenue transaction as a whole.
- BC122. The IPSASB decided to provide a description rather than a definition of a concessionary lease because:
- (a) It prevents an apparent contradiction of labelling as a lease an arrangement that conveys the right to use an underlying asset without the exchange of consideration; and
 - (b) It is consistent with the approach in IPSAS 41, *Financial Instruments*, where concessionary loans are not defined, but only described.
- BC123. The IPSASB noted that there are transactions that convey the right to use an underlying asset without consideration (right-of-use asset in-kind). The IPSASB is of the view that transactions that convey the right to use an underlying asset without consideration do not meet the definition of a lease as defined in IPSAS 43.
- BC124. The IPSASB concluded that a transaction that conveys a right-of-use asset in-kind is in substance a revenue transaction and, therefore, the principles in IPSAS 23, *Revenue from Non-Exchange Transactions* (Taxes and Transfers) and IPSAS 47, *Revenue* are applicable to this type of transaction.

Responses to ED 84, Concessionary Leases and Right-of-Use Assets In-kind

- BC125. While respondents strongly agreed with ED 84 proposals, a few respondents suggested:
- (a) Expanding the definition of a lease to include binding arrangements that are not contracts for consistency with IPSAS 47 and IPSAS 48, *Transfer Expenses*; and
 - (b) Introducing new definitions on varied topics or adding more guidance related to the proposed definitions.
- BC126. The IPSASB considered the reasons raised by the respondents and decided to proceed with the ED 84 proposals on keeping the definition of a lease limited to contracts and not adding new definitions for consistency with current IPSAS.

Identification, Classification, and Scope of Concessionary Leases

- BC127. IPSAS 43 introduced new guidance on identifying a lease as a result of an exchange transaction. Building on this guidance, the IPSASB proposed additional guidance to identify, classify, and scope concessionary leases.
- BC128. The IPSASB proposed this new guidance because it would help preparers:
- (a) Distinguish leases at market terms from leases that have embedded concessions;
 - (b) Understand the relationship between IPSAS 43 and other IPSAS; and
 - (c) Apply the IPSAS 43 principles to leases at market terms and apply the principles in other IPSAS to the concessions, as appropriate.

- BC129. The IPSASB considered whether to include additional specific guidance on variable lease payments other than those referred in IPSAS 43 when identifying and classifying leases at market or at below-market terms. Lease payments that are dependent on a lessee's sales might influence the identification of a concessionary lease.
- BC130. The IPSASB decided not to include this additional guidance in IPSAS 43 because it is not prevalent in the public sector.
- BC131. The IPSASB also considered the role of lease modifications when identifying and classifying leases at market or at below-market terms.
- BC132. The IPSASB decided not to include additional guidance on lease modifications because an entity needs to apply professional judgment when assessing the conditions in IPSAS 43.

Responses to ED 84, *Concessionary Leases and Right-of-Use Assets In-kind*

- BC133. The majority of respondents to ED 84 supported the proposed guidance on identification, classification, and scope.
- BC134. Some respondents who did not support ED 84 proposals suggested providing additional guidance on:
- (a) Other types of arrangements that convey the right to use an underlying asset in order to have a holistic approach;
 - (b) Arrangements that convey the right to use that (i) are binding arrangements, but are not in-substance contracts, or (ii) are not binding arrangements;
 - (c) What constitutes a condition or compliance obligation in the context of a concessionary lease in IPSAS 23; and
 - (d) Arrangements involving unwilling parties.
- BC135. The IPSASB considered the issues raised by respondents and decided to proceed with ED 84 proposals because the respondents' suggestions are outside of the scope of IPSASB's project that led to the development of ED 84.
- BC136. A respondent suggested providing a scope exclusion:
- (a) Based on significance to public sector accountability (such as those where one party to the lease is a commercial entity); and
 - (b) Between entities within the same public sector group.
- BC137. The IPSASB considered the above suggestions and decided not to provide scope exclusions based on specific characteristics of the entities because it impairs accountability and decision-making: the impact of receiving resources at below-market terms would no longer be visible in the financial statements and the accountability mechanisms may also be applied at entity level, not only at group level on consolidation.
- BC138. A respondent suggested providing guidance on right-of-use assets in kind in a single Standard.
- BC139. The IPSASB considered the above suggestion and decided to proceed with ED 84 proposals in two Standards because the scope of IPSAS 43 and IPSAS 23¹⁵ was not meant to be changed, and ED 84 proposals need to be consistent with the current scoping of IPSAS. The IPSASB notes that some of the guidance provided to concessionary leases can also be applicable to right-of-use assets in-kind.

¹⁵ The IPSASB carried over this decision to ED 88 with separate proposals for IPSAS 47, which was then carried over to *Concessionary Leases and Other Arrangements Conveying Rights over Assets*.

- BC140. Several respondents made suggestions about the proposed application guidance sections on classification of concessionary leases, including the diagrams and the role of consideration in the arrangements. These respondents were of the view that the diagram for lessors was confusing as the lessor did not recognize the non-exchange component and made several drafting suggestions.
- BC141. The IPSASB considered these views and decided to enhance the application guidance section on identifying concessionary leases and the terminology in the diagram for lessees. The IPSASB also decided to remove the diagram for lessors because there is no:
- (a) Change in the accounting for concessionary leases for lessors compared to leases at market terms; and
 - (b) Accounting for the foregone revenue in a concessionary lease for lessors.
- BC142. Some respondents suggested more guidance on:
- (a) Whether the goals/intent of the parties in entering into a lease contract has weight in the determination of concessionary leases; and
 - (b) Whether the use of the underlying asset for either its financial or its operational capacity influences the determination of whether the market rates based on the current use or the highest-and-best use is appropriate.
- BC143. The IPSASB considered these suggestions and decided not to provide more guidance on the above topics because:
- (a) The current guidance in IPSAS 43 and in *Concessionary Leases and Other Arrangements Conveying Rights over Assets* is sufficient to help preparers identify a concessionary lease based on the definition of a lease and its market terms; and
 - (b) The requirements in *Concessionary Leases and Other Arrangements Conveying Rights over Assets* apply a measurement technique specifically developed for concessionary leases, where the requirement of “based on the current use” is provided as a cost-relief to preparers.
- BC144. However, the IPSASB decided to add illustrative examples on other lease-type arrangements that are common in the public sector to help preparers identifying a lease.

Lessee

Recognition and Measurement

- BC145. IPSAS 43 initially measures the right-of-use assets at cost. This is consistent with the measurement of many other non-financial assets, such as assets within the scope of IPSAS 12, *Inventories*, IPSAS 16, IPSAS 31, *Intangible Assets*, and IPSAS 45 that are a result of exchange transactions. However, for non-exchange transactions a cost measurement basis does not reflect the economics of the transaction because it does not capture the embedded concession.
- BC146. To address this issue, when developing the guidance to account for the right-of-use asset and the concession component in concessionary leases in ED 84 and ED 88, the IPSASB considered the principles in the IPSAS mentioned in paragraph BC143, as well as in IPSAS 23, IPSAS 41, *Financial Instruments*, and IPSAS 47.
- BC147. The IPSASB noted that the above IPSAS require that assets acquired through non-exchange transactions be measured at their fair value as at the date of acquisition. The IPSASB considered also requiring measuring the right-of-use asset at fair value in a concessionary lease because:
- (a) It is consistent with IPSASB’s literature on the accounting for non-exchange transactions, including concessionary loans;

- (b) It provides information on operating and financial capacity as referred in the Conceptual Framework for accountability and decision-making purposes; and
- (c) Recognizing the implicit concession in a lease at below-market terms would enhance Public Financial Management (PFM) to the extent that the improvements would outweigh the costs associated with such a change for accountability and decision-making purposes.

BC148. However, the IPSASB noted that when an entity values the right-of-use asset at fair value it should measure the right to use the underlying asset, not the underlying asset itself, which is reflected in the payments for the lease at market rates. Therefore, the IPSASB decided to propose measuring the right-of-use asset in a concessionary lease at the present value of payments for the lease at market rates based on the current use of the underlying asset because:

- (a) It is a measurement technique consistent with the fair value measurement basis;
- (b) It helps preparers in measuring the right-of-use asset using a measurement technique that already exists in IPSAS 43 when dealing with leases that are not at market rates; and
- (c) When comparing them with the present value of the contractual payments, preparers can measure the embedded concession.

BC149. The IPSASB also noted that IPSAS 46, *Measurement* introduced a new fair value definition drawn from IFRS 13 *Fair Value Measurement*. The IPSASB also noted that the new fair value definition is associated with the definition of highest and best use.

BC150. The IPSASB decided to refer to the present value of payments for the lease at market rates based on the current use, instead of the highest and best use as implied in the new fair value definition. The IPSASB considered the new fair value definition would not be appropriate because:

- (a) The measurement of the right-of-use asset would no longer be based on the current use of the underlying asset, once the current fair value definition is replaced;
- (b) There would be increased difficulty in measuring the right-of-use asset as it would be based on other possible uses of the asset to achieve the highest and best use; and
- (c) Quite often there is not an active market for right-of-use assets to obtain the highest and best use.

BC151. In reaching this decision, the IPSASB noted that measuring a right-of-use asset at the present value of the lease payments at market rates based on the current use of the underlying asset is determined by considering right-of-use assets that have similar economic benefits or service potential.

BC152. As an exception to the above principle, the IPSASB decided to require measuring the right-of-use asset under a concessionary lease using the contractual payments if the payments for the lease at market rates based on the current use of the underlying asset are not readily available, in order to address the increased difficulty in measuring right-of-use assets in the public sector because of its nature and/or current use (for example, specialized assets). The IPSASB noted that the lease liability would still be reliably measured using the contractual payments for the lease.

BC153. When initially measuring the right-of-use asset in a concessionary lease, the IPSASB expects preparers to apply a reasonable level of effort in determining the present value of lease payments at market rates based on the current use of the underlying asset.

BC154. The IPSASB also decided to account for the concession component in a concessionary lease following the principles applicable to concessionary loans in IPSAS 23¹⁶ because:

¹⁶ The IPSASB carried over this decision to ED 88 with proposals for IPSAS 47, which are broadly consistent with the principles in IPSAS 23.

- (a) Both transactions:
 - (i) Are at below-market terms at inception;
 - (ii) Have a concession to the price of the resource being transferred; and
 - (iii) Have the objective to provide/receive resources with a price at below-market terms;
- (b) Transferring a resource in cash or in-kind should not modify the accounting for the concession component as revenue in both transactions, as concessionary leases are in substance financing transactions; and
- (c) It prevents preparers choosing between concessionary leases and concessionary loans to achieve desired accounting outcomes.

Responses to ED 84, Concessionary Leases and Right-of-Use Assets In-kind

Overview

- BC155. The majority of respondents to ED 84 supported the proposed guidance on recognition and measurement for concessionary leases for lessees.
- BC156. Some respondents disagreed with ED 84 proposals because:
- (a) There is a lack of consistency between lessee and lessor accounting;
 - (b) They are of the view that concessionary leases are:
 - (i) Not viewed as financing transactions, rather a means to achieve particular objectives or providing social services; and
 - (ii) Analogous to services in-kind and service concession arrangements.
- BC157. The IPSASB considered these views and decided to proceed with ED 84 proposals because:
- (a) The lack of consistency between lessee and lessor accounting impacts all leases, and not only concessionary leases. The IPSASB reaffirmed that it is not within the scope of *Concessionary Leases and Other Arrangements Conveying Rights over Assets* to change the accounting models in IPSAS 43.
 - (b) Both concessionary leases and concessionary loans can be a way to achieve particular objectives, and therefore it is not a specific feature of concessionary leases. The objectives under which concessionary leases are received or granted have no impact on the classification of the transaction as a lease. This means that, provided that the transaction meets the definition of a lease, the principles proposed in ED 84 are appropriate. Concessionary leases are still financing transactions where there is a significant obligation to pay for the acquisition of the right-of-use asset albeit at below-market terms.
 - (c) Leases from the lessee perspective under the right-of-use model are not analogous to:
 - (i) Services because in a lease the resource-recipient (lessee) controls the use of the identified asset, while in a service the resource-provider (supplier) controls the use of the asset. Right-of-use assets are analogous to owned assets by owners where the resource-recipient (lessee) controls the use of the asset (the right-of-use asset in a lease).
 - (ii) Service concession arrangements because in a lease the resource-recipient (lessee) controls the use of the identified asset:
 - 1. While in a service concession arrangement the resource-provider (grantor) controls the use of the identified asset; and

2. To provide services not on behalf of the resource-provider (lessor), whereas in a service concession arrangement the resource-recipient (operator) has a right to access to operate the underlying asset to provide public service on behalf of the resource-provider (grantor).

Option Between Cost and Fair Value

- BC158. Some respondents suggested providing an option between cost and fair value to avoid undue cost or effort and others suggested no recognition and measurement of concessionary leases at market rates for cost-benefit reasons.
- BC159. The IPSASB considered these suggestions and decided to proceed with ED 84 proposal because:
- (a) It is consistent with *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*, which states that the transaction price of an asset acquired in a non-exchange transaction does not provide information on operational or financial capacity that meets the qualitative characteristics while taking into account the constraints on information on financial reports;
 - (b) It is consistent with IPSAS as no IPSAS provides an accounting policy option to initially measure at cost or at fair value assets acquired through a non-exchange transaction;
 - (c) It is conceptually inconsistent to require measurement at fair value of an underlying asset acquired through a non-exchange transaction, but provide an accounting policy option to measure at cost or at fair value the right to use the very same underlying asset;
 - (d) Should the cost to obtain the market value of lease payments exceed the benefit, the proposals do not require an entity to recognize the right-of-use asset in a concessionary lease measured at market rates and instead should consider the contractual payments; and
 - (e) The benefits of providing information about the subsidy embedded in a concessionary lease outweigh the cost as long as the preparer does not incur unreasonable efforts and costs to obtain it.

Disclosures Instead of Recognition and Measurement

- BC160. Some respondents suggested that disclosures are enough, and that no recognition and measurement requirements are needed.
- BC161. The IPSASB considered this suggestion and decided to proceed with ED 84 proposals because according to IPSASB's Conceptual Framework, disclosure is not a substitute for display.

Measurement at Inception or at Commencement Date

- BC162. A respondent suggested measuring the right-of-use asset at the inception date, instead of at the commencement date to prevent reassessing all leases for a second time.
- BC163. The IPSASB considered this suggestion and decided to proceed with ED 84 proposals because:
- (a) A lessee does not obtain and control its right to use the underlying asset until the commencement date;
 - (b) Any changes to a lease that occur after the inception date and before the commencement date are taken into account when initially measuring the right-of-use asset and lease liability at the commencement date; and
 - (c) It is more consistent with the measurement date for other transactions, such as the acquisition of property, plant, and equipment.
- BC164. In order to prevent preparers from reassessing for a second time whether the transaction is at market terms or at below-market terms at the commencement date, the IPSASB clarified in *Concessionary Leases and Other Arrangements Conveying Rights over Assets* that the assessment is made at inception of the transaction and the measurement is made at the commencement date.

Application of IPSAS 46 Measurement Bases

- BC165. Some respondents suggested that the right-of-use asset should be initially measured applying a measurement basis presented in IPSAS 46 (current operational value and fair value), depending on whether the right-of-use asset is held for operational capacity or financial capacity, respectively, or at deemed cost.
- BC166. The IPSASB noted that the ED 84 proposal to measure the right-of-use asset is comprised of a measurement technique specifically developed for concessionary leases and is divided into four parts:
- (a) Part 1: "present value of payments for the lease"—This requirement applies the concept of the time value of money embedded in the lease because leases normally require a series of payments in the future, even if they are at below-market terms. The measurement technique "present value" is consistent with:
 - (i) Its applicability in IPSAS 43 for leases at market terms; and
 - (ii) The accounting principles in IPSAS 46, which measure the current value of assets and liabilities whether the cash flows occur at a point in time or in the future.
 - (b) Part 2: "at market rates"—This requirement obtains the market lease payments as if the lease was made at market terms. The term "market rates" can be seen as a way of estimating how much the lessee would have to pay for the lease if it was made at market rates.
 - (c) Part 3: "based on the current use of the underlying asset"—This requirement is a restriction in the assessment of market rates that serves as a cost-relief to preparers, as preparers do not need to search for the highest and best use of the underlying asset.
 - (d) Part 4: "as at the commencement date"—This requirement is consistent with the requirements in IPSAS 43 for leases at market terms and other items of property, plant, and equipment under IPSAS 45 (see paragraphs BC162–BC163).
- BC167. The IPSASB reiterated its reasoning during the development of IPSAS 46 that this Standard is not meant to determine measurement guidance in other IPSAS. The objective of IPSAS 46 is to focus on the definition of appropriate measurement bases and their derivation. IPSAS 46 does not establish requirements for which measurement bases should be used in IPSAS.
- BC168. The IPSASB concluded that the proposed measurement principles in ED 84 for right-of-use assets in concessionary leases for lessees are conceptually consistent with the measurement principles in IPSAS. Therefore, the IPSASB decided to carry over these principles to *Concessionary Leases and Other Arrangements Conveying Rights over Assets*.

Terminology

- BC169. Several respondents suggested:
- (a) Adding more guidance on reasonable level of effort in determining the present value of lease payments at market rates based on the current use of the underlying asset as at the commencement date of the concessionary lease;
 - (b) Replacing the wording "not readily available" with "impracticable" in context of measuring the market lease payments; and
 - (c) Adding more guidance on "market rates".
- BC170. The IPSASB decided to carry over the ED 84 proposals to *Concessionary Leases and Other Arrangements Conveying Rights over Assets* for consistency with IPSAS 43 because:
- (a) The term "reasonable level of effort" is dependent on the context in which it is applied as:

- (i) Paragraph AG15(a) of IPSAS 43 already uses the term "reasonable" in the context of identifying substantive substitution rights; and
- (ii) The term "reasonable" is a commonly used term in IPSAS without having additional guidance to explain it.
- (b) The wording "readily available" is already used in IPSAS 43 without the wording "reasonable level of effort";
- (c) The wording "impracticable":
 - (i) Sets a higher bar of effort to apply the exception, thus leading to more costs in applying the ED 84 proposals than what was intended by the IPSASB;
 - (ii) Creates an internal inconsistency in IPSAS 43 (i.e., separating components of a contract (see paragraph 15 of IPSAS 43), initial measurement of the lease liability (see paragraph 27 of IPSAS 43); reassessment of the lease liability (see paragraph 42 of IPSAS 43), and sale and leaseback transactions (see paragraph 101 of IPSAS 43)) for similar situations;
 - (iii) Is used normally in the context of retrospective application of accounting policies or retrospective restatements to correct an error under IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*; and

BC171. The Measurement-Application Phase project will clarify through proposed amendments to IPSAS 46 that market rates do not include concessions.

Reassessment of the Lease Liability

BC172. The IPSASB decided to provide a relief to preparers for the reassessment of the lease liability in concessionary leases by requiring entities to apply the original discount rate when reassessing the lease liability.

Responses to ED 84, Concessionary Leases and Right-of-Use Assets In-kind

BC173. A respondent suggested that the IPSASB consider the updated discount rate for a lease modification because the lessee may always apply the lessee's incremental borrowing rate in case of not knowing the revised interest rate implicit in the lease.

BC174. The IPSASB agreed with the respondent and decided not to modify the IPSAS 43 requirements related to reassessment of the lease liability in case of concessionary leases.

Recognition Exemptions

BC175. The IPSASB considered the applicability to lessees of the general model to account for concessionary leases that are short-term leases and leases for which the underlying asset is of low value.

BC176. The IPSASB decided not to require the general model to lessees' recognition exemptions because:

- (a) Leases for which the underlying asset is of low value are not material enough to warrant specific concessionary lease accounting; and
- (b) Short-term leases have a lease term of 12 months or less.

Disclosures

BC177. The IPSASB noted that IPSAS 43 already requires disclosures for leases at market terms. Therefore, the IPSASB decided to require additional disclosures that are specific to concessionary leases and related to the accounting model.

Responses to ED 84, *Concessionary Leases and Right-of-Use Assets In-kind*

BC178. Some respondents made several detailed suggestions related to disclosures, such as:

- (a) To require disclosures of right-of-use assets by class of underlying asset;
- (b) Duplicate in IPSAS 23 the disclosures that exist in IPSAS 43; and
- (c) Require disclosures on lessee's dependency on the underlying asset.

BC179. The IPSASB agreed to require disclosures of right-of-use assets by class of underlying asset because it is consistent with IPSAS 43 for leases at market terms. However, the IPSASB decided not to duplicate disclosures for cost-benefit reasons and not to require disclosure on a lessee's dependency on the underlying asset because this topic impacts all leases and not only concessionary leases.

Lessor

Recognition and Measurement

BC180. IPSAS 43 requires lessors to classify leases as either an operating lease or a finance lease under a risks and rewards dual model. Operating leases are viewed as a service, and the net investment in finance leases is viewed as a financial instrument.

BC181. In a finance lease, the substance or main issue of the lease is the underlying asset being transferred with the attached financing (net investment in the lease). The accounting for the transfer of the underlying asset is made in accordance with IPSAS 16, IPSAS 31, and IPSAS 45 as appropriate. The accounting for the attached financing (net investment in the lease) is made in accordance with IPSAS 43, which includes the accounting for the lease payments and the residual value.

BC182. In an operating lease, the substance or main issue of the lease is the stream of cash flows received by the lessor in the form of lease payments, as the lessor continues to recognize the underlying asset.

BC183. As a consequence of the different economics of leases under the risks and rewards dual model, in a:

- (a) Concessionary finance lease, the concession is related to the price of the underlying asset transferred to the lessee; and
- (b) Concessionary operating lease, the concession component is related to the price of lease payments received from the lessee.

BC184. This means that lessors can have two types of concessionary leases:

- (a) Concessionary finance leases-which can be analogous to transferring a non-cash asset (the underlying asset) at below-market terms attached with financing for a portion of the value of the asset transferred (the net investment in the lease); and
- (b) Concessionary operating leases-which can be analogous to providing services at below-market terms, as the lessor continues to recognize the underlying asset and the accounting is similar by applying the principles in IPSAS 45 to the accounting of the underlying asset and IPSAS 47 to the accounting of the revenue.

BC185. For concessionary finance leases, the IPSASB decided to continue measuring the transfer of the underlying asset to the lessee at its carrying amount because it is:

- (a) The cost of the concession incurred by the lessor, being the economic benefits or service potential given up measured by the carrying amount of the underlying asset; and
- (b) Consistent with the derecognition principles in IPSAS 16, IPSAS 31, and IPSAS 45 for disposals.

- BC186. For concessionary operating leases, the IPSASB decided to continue measuring the lease payments received by the lessor in accordance with IPSAS 43 because:
- (a) No economic benefits or service potential associated with the transaction will flow to the lessor higher than the cash received by the lessor in the form of lease payments made by the lessee; and
 - (b) It is consistent with revenue recognition principles in IPSAS 23¹⁷.
- BC187. In reaching this decision, the IPSASB noted that the terms and conditions of the concessionary operating lease might help an entity assess whether there is an indication that the underlying asset may be impaired in accordance with IPSAS 21, *Impairment of Non-Cash-Generating Assets* or IPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate.
- BC188. Following a cost measurement basis for concessionary leases, the IPSASB noted that lessors recognize the loss related with the derecognition of the underlying asset in a concessionary finance lease in accordance with the applicable IPSAS. This means that the cost of the concession would be the difference between the value of the carrying amount of the underlying asset derecognized and the value of the recognition of the net investment in the lease.
- BC189. For concessionary operating leases, the IPSASB noted that lessors continue recognizing as revenue the cash received in the form of lease payments made by lessees and there would be no separate recognition of the concession. This situation occurs because the concession is related to the foregone revenue related to the lease payments. As foregone revenue is not recognized under IPSAS 9¹⁸, the IPSASB did not identify an economic reason to provide an exception to this principle in the context of concessionary operating leases.
- BC190. The IPSASB concluded that the cost of the concession will be the difference between the:
- (a) Depreciation of the underlying asset, other expenses related to the underlying asset, and the impairment charge related to the underlying asset, if any; and
 - (b) Revenue obtained in the lease payments received from the lessee.

Responses to ED 84, Concessionary Leases and Right-of-Use Assets In-kind

- BC191. The majority of respondents to ED 84 supported the ED 84 proposals on recognition and measurement for concessionary leases for lessors.
- BC192. Some respondents disagreed with ED 84 proposals because:
- (a) ED 84 appears to treat the leasing standard as somehow appropriate for use by lessors in a finance lease providing concessionary leases when there is no stream of cash flows;
 - (b) Consideration of impairment in a concessionary operating lease should not be contemplated;
 - (c) In a concessionary finance lease, the underlying asset should not be derecognized if it continues to embody service potential; and
 - (d) Inconsistency between concessionary operating leases and concessionary finance leases where there is a loss on commencement date of the concessionary finance lease and no loss arises on commencement date of the concessionary operating lease, while both can have service delivery or outcome objectives.
- BC193. The IPSASB considered these views and decided to proceed with ED 84 proposals because:

¹⁷ The IPSASB carried over this decision to ED 88 with proposals for IPSAS 47, which are broadly consistent with the principles in IPSAS 23.

¹⁸ The IPSASB carried over this decision to ED 88 with proposals for IPSAS 47, which are broadly consistent with the principles in IPSAS 9 on this topic.

- (a) The main issue in a concessionary finance lease is the underlying asset being transferred at below market terms. In this type of lease, the cost of the concession is the difference between the carrying amount of the underlying asset being transferred and the net investment in the lease. The accounting for the lease component is within the scope of IPSAS 43, and the accounting for the derecognition of the underlying asset is in accordance with IPSAS 16, IPSAS 31, and IPSAS 45, as appropriate.
- (b) The IPSASB did not change the requirements for impairment in IPSAS 26, as the principles in that Standard are still applicable assessing impairment of the underlying asset in concessionary operating leases.
- (c) The derecognition criteria and the accounting are in scope of IPSAS 16, IPSAS 31, and IPSAS 45, as appropriate, not in scope of IPSAS 43. IPSAS 43 provides several indicators of a finance lease that need to be taken into consideration in a holistic way. *Concessionary Leases and Other Arrangements Conveying Rights over Assets* does not amend the derecognition criteria and the accounting in other IPSAS nor the indicators of a finance leases in IPSAS 43, as these are related to all finance leases, not only concessionary finance leases.

Disclosures

- BC194. Similar to lessees, the IPSASB noted that IPSAS 43 already requires disclosures for leases at market terms for lessors. Therefore, the IPSASB decided to require additional disclosures that are specific to concessionary leases for both concessionary finance leases and concessionary operating leases and related to the dual accounting model.

Responses to ED 84, Concessionary Leases and Right-of-Use Assets In-kind

- BC195. The majority of respondents to ED 84 supported the ED 84 proposals on disclosures for concessionary leases for lessors.
- BC196. Some respondents were of the view that there was a lack of information in the disclosures on foregone revenue and costs associated with the underlying asset in concessionary operating leases.
- BC197. The IPSASB considered these views and decided not to require the disclosure of foregone revenue because the disclosures required are related to the accounting model¹⁹. Additionally, the IPSASB decided to require the disclosure of the costs associated with the underlying asset in concessionary operating leases for transparency reasons.

Sale and Leaseback Transactions

- BC198. The IPSASB considered whether to amend the requirements in IPSAS 43 on sale and leaseback transactions at below-market terms to be consistent with the requirements of concessionary leases.
- BC199. The IPSASB noted that, in principle, from a conceptual perspective, concessionary leases and leasebacks at below-market terms have two key differences:
- (a) Different starting points—A leaseback at below-market terms is linked to a previous sale with the same party as interdependent transactions, while a concessionary lease is not linked to a previous sale with the same party; and
 - (b) Different objectives—A sale and leaseback transaction has the objective of obtaining cash through the sale of the underlying asset and refunding the cash proceeds in the form of lease payments, while a

¹⁹ The IPSASB carried over this decision to ED 88 with proposals for IPSAS 47, which are broadly consistent with the principles in IPSAS 9 on this topic.

concessionary lease has the objective of conveying a concession through the right to use an underlying asset at below-market terms.

- BC200. However, leasebacks at below-market terms might exist in the public sector with an identifiable concession embedded because there is no actual prepayment of the leaseback, as the agreed purchase price of the underlying asset is the same as its fair value.
- BC201. The IPSASB noted that this may be a public sector-specific situation because normally in the private sector both the sale and leaseback are either at above-market terms or at below-market terms, not the leaseback alone being at below-market terms.
- BC202. Therefore, the IPSASB decided to amend IPSAS 43 requirements on sale and leaseback transactions to address the situation where the below-market terms of the leaseback are not linked to a prepayment.

Transition

- BC203. The IPSASB considered the transition requirements for concessionary leases. The IPSASB decided to propose transition requirements on concessionary leases similar to leases at market terms, where applicable, in order not to require extra efforts by preparers in applying the new proposed guidance on concessionary leases.
- BC204. The IPSASB encourages preparers to apply IPSAS 3, Accounting Policies, Changes in Accounting Estimates and Errors on transition because of the prevalence in the public sector of concessionary leases with long contract terms.

Responses to ED 84, Concessionary Leases and Right-of-Use Assets In-kind

- BC205. Several respondents suggested easing the transition requirements for lessees by requiring measurement of the right-of-use asset at the present value of the remaining payments for the lease at market rates based on the current use of the underlying asset and discounted using the lessee's incremental borrowing rate at the date of initial application.
- BC206. The IPSASB agreed with this suggestion for cost-benefit reasons.

Effective Date

- BC207. The IPSASB considered the effective date of the amendments to IPSAS 43 in the context of effective dates of IPSAS 43 to IPSAS 49.
- BC208. The IPSASB decided that the effective date of the amendments to IPSAS 43 should be January 1, 2027, with earlier application permitted, because it:
- (a) Is broadly consistent with the three-year application period of IPSAS 43;
 - (b) Does not overwhelm preparers with more changes to be effective at the same time as IPSAS 43 to IPSAS 49; and
 - (c) Allows preparers an additional year for planning and implementation of the amendments to IPSAS 43 and IPSAS 47 after implementing IPSAS 43 to IPSAS 49 in the previous years.
- BC209. The IPSASB also considered postponing the effective date of IPSAS 43 for two years to align with the effective date of the amendments to IPSAS 43 and decided not to do so because:
- (a) It is more important to require the application of the new principles in IPSAS 43 sooner rather than later; and

- (b) Entities always have the possibility of early adopting the new requirements in *Concessionary Leases and Other Arrangements Conveying Rights over Assets* to a subset of lease transactions in the context of early adopting IPSAS 43 to align the effective dates.

Revisions of IPSAS 43 as a result of Amendments to IPSAS Standards: Specific IFRIC Interpretations

- BC210. In September 2023, the IPSASB initiated a narrow scope project to consider seven IFRIC and SIC Interpretations that were issued by the IFRS Interpretations Committee, but had not yet been considered by the IPSASB, to determine their applicability to the public sector. In its assessment, the IPSASB considered whether public sector entities may face similar application issues, and whether incorporating guidance based on the Interpretations into IPSAS would help clarify the application of existing accounting principles.
- BC211. The IPSASB reviewed the requirements of IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*, first issued by the IASB in 2004, and the IFRS Interpretations Committee's considerations in reaching its consensus as set out in its Basis for Conclusions. The IPSASB generally concurred that there was no public sector specific reason for not incorporating these requirements into IPSAS 19, Provisions, Contingent Liabilities and Contingent Assets.
- BC212. In April 2024, the IPSASB published Exposure Draft (ED) 89, *Amendments to Consider IFRIC Interpretations*, which proposed to add guidance to IPSAS 43 to direct users to relevant guidance in IPSAS 19. The IPSASB received strong constituent support for these proposals. Therefore, it decided to amend IPSAS 43 to incorporate the proposed guidance.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 43.

IG1. The purpose of this Implementation Guidance is to illustrate certain aspects of the requirements of IPSAS 43.

Difference between services, service concession arrangements, and leases

IG2. The diagram below summarizes some differences between a service, a service concession arrangement and a lease and the respective guidance in IPSAS.

Classification Type of control	Service	Service concession arrangement	Lease
Control of an identified asset	Supplier: Yes Customer: No	Grantor: Yes Operator: No	Lessor: • Finance Lease: No • Operating Lease: Yes Lessee: No
Control of the right to use an identified asset	Supplier: Yes Customer: No	Grantor: Yes Operator: No	Lessor: No Lessee: Yes
Control of the right to access to operate an identified asset	Supplier: Yes Customer: No	Grantor: No Operator: Yes	Lessor: No Lessee: Yes
IPSAS	47, Revenue	32, Service Concession Arrangements: Grantor	43, Leases

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Illustrative Examples

These examples accompany, but are not part of, IPSAS 43.

- IE1. These examples portray hypothetical situations illustrating how an entity might apply some of the requirements in IPSAS 43 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 industry 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 IPSAS 43.

Identifying a Lease (see paragraphs 10–12 and AG10–AG31)

- 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 AG19). 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 or service potential 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 AG25(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 AG15(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 AG15(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 or service potential 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—Allocated 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 AG15(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 AG15(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—Fiber-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 fibers within a larger cable connecting Hong Kong to Tokyo. Customer makes the decisions about the use of the fibers by connecting each end of the fibers to its electronic equipment (i.e., Customer 'lights' the fibers and decides what data, and how much data, those fibers will transport). If the fibers are damaged, Supplier is responsible for the repairs and maintenance. Supplier owns extra fibers, but can substitute those for Customer's fibers only for reasons of repairs, maintenance or malfunction (and is obliged to substitute the fibers in these cases).

The contract contains a lease of dark fibers. Customer has the right to use the three dark fibers for 15 years. There are three identified fibers. The fibers are explicitly specified in the contract and are physically distinct from other fibers within the cable. Supplier cannot substitute the fibers other than for reasons of repairs, maintenance or malfunction (see paragraph AG19).

Customer has the right to control the use of the fibers throughout the 15-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the fibers over the 15-year period of use. Customer has exclusive use of the fibers throughout the period of use.
- (b) Customer has the right to direct the use of the fibers because the conditions in paragraph AG25(a) exist. Customer makes the relevant decisions about how and for what purpose the fibers are used by deciding (i) when and whether to light the fibers and (ii) when and how much output the fibers will produce (i.e., what data, and how much data, those fibers 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 fibers are essential to their efficient use, those decisions do not give Supplier the right to direct how and for what purpose the fibers are used. Consequently, Supplier does not control the use of the fibers 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 fiber strands within the cable (the cable contains 15 fibers with similar capacities). Supplier makes decisions about the transmission of data (i.e., Supplier lights the fibers, makes decisions about which fibers are used to transmit Customer's traffic and makes decisions about the electronic equipment that Supplier owns and connects to the fibers).

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 AG21). 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 tourist office to sell or provide its services 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 services sold or provided from the unit, the pricing of the services sold or provided and the number of employees working. 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 services sold or provided from Office Unit A.

Supplier provides cleaning and security 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 AG17).

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 or service potential 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 services sold or provided 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 or service potential from use of Office Unit A.
- (b) Customer has the right to direct the use of Office Unit A because the conditions in paragraph AG25(a) exist. The contractual restrictions on the services that can be provided or 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 services that will be provided from or sold in the office unit and the sale price for those services. 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 or service potential 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 AG25(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 or service potential 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 or service potential 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 or service potential 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 AG25(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 AG15(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 or service potential 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 AG25(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 producer (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 or service potential 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 or service potential 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 public sector entity (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 or service potential 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 AG25(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 or service potential 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 or service potential 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 AG25(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 AG19).

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 or service potential 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 AG25(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.

Example 10A—Access Rights

A Government Agency (Entity) enters into a contract with a public sector entity (Customer) to convey the right of access to land in a forest and to small station cabins for use by the Customer's employees in the course of its operations for a period of five years. The Customer uses the land to feed sheep and cows that are to be sold in the course of its operations. From season to season, the Entity has the discretion to change the portion of land and the small station cabins used by the Customer depending on other Entity's activities that take place on the land. The Customer pays the transaction consideration upfront to the Entity for the use of the land and small station cabins.

The contract does not contain a lease of land or of small station cabins.

Although the land used by Customer is specified in the contract, there is no identified asset. The contract is to use land and small station cabins, and this can change without much impact on both Entity's and Customer's operations.

The Customer does not have the right to obtain substantially all of the economic benefits of service potential from the use of the land and of the small station cabins because the Entity can still obtain much more economic benefit and service potential from other operations.

The Customer does not have the right to direct the use because the Entity can change the land and the small station cabins that the Customer is allowed to use.

Example 10B—Shared Properties

Municipality A (Entity) enters into a contract with Government Agency B (Customer) to share the use of a floor in an office building for three years. The Entity will continue to use the floor for the majority of the time and coordinates with the Customer the dates that each can use it for its own activities. The Customer pays transaction consideration upfront to the Entity each month, based on the number of days it plans to use the office space.

The contract does not contain a lease of the floor.

Although the Customer has the right to direct the use of the floor in the days that it is using it, the Customer does not have the right to obtain substantially all of the economic benefits or service potential from the use of the floor because the Entity continues to use the floor for the majority of the time during the contract term and, therefore, obtaining substantially all of the economic benefits or service potential from the use of the floor.

Assessing Whether the Lease is at Market Terms or at Below-Market Terms (see paragraphs 18A–18D, AG32A, and AG60–AG62)

- IE2A. The following examples illustrate how an entity assesses whether a lease is at market terms or at below-market terms.

Example 10C—Assessing Whether the Lease is at Market Terms or at Below-Market Terms

Municipality A (Lessee) enters into a lease contract with Government Agency B (Lessor) to use ten units in a building for its office operations for a ten-year period. The lease contract states that the Lessee agrees to pay the Lessor CU100,000 per month. The Lessor usually leases those units for CU185,000 per month,

which is the current market rate, to private sector entities for the same purpose. The Lessor decided to lease those units at below-market terms because the Lessee is running a specific sports program for youth.

The lease is at below-market terms at inception and at commencement dates.

Lease Incentives and Lease Concessions (see paragraphs 5, 18A–18D, AG32A, and AG60–AG62)

IE2B. The following examples illustrate how an entity distinguishes a lease incentive from a lease concession.

Example 10D–Lease Incentives

Private sector entity Y (Lessor) has for lease ten units in a building for office operations for CU110,000 per month. Government agency X (Lessee) is interested in leasing those ten units for a prolonged period of time and has lesser credit risk. The Lessee ended up entering into the lease because the Lessor reduced the price of the lease payments by CU5,000 per month, to match market rates at inception.

The CU5,000 per month reduction is a lease incentive at inception and at commencement dates.

Example 10E–Lease Concessions

Government agency Z (Lessor) has built and has for lease a multi-purpose sports complex for youth. The local sports club W (Lessee) wants to expand its activities in terms of numbers of athletes and types of sports being offered by the club. The Lessor intends to expand the sports activity among youth in the area of the multi-purpose sports complex as a way to support its goals in terms of youth from low-income households. By leasing out the sports complex to the Lessee, it would meet its policy objectives. The lease payments at market rates for a similar multi-purpose sports complex are CU150,000. However, the Lessee does not have the financial capacity to pay the lease payments, and pay, at the same time, the costs of managing such a large facility. The Lessor and Lessee ended up signing up the lease contract for CU45,000 per month because the Lessee was the right partner to achieve the Lessor's goals.

The CU105,000 per month reduction is a lease concession at inception and at commencement dates.

Leases of Low-Value Assets and Portfolio Application (see paragraphs 6–7, AG1 and AG4–AG9)

IE3. The following example illustrates how a lessee might (a) apply paragraphs AG4–AG9 of IPSAS 43 to leases of low-value assets; and (b) determine portfolios of leases to which it would apply the requirements in IPSAS 43.

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 hospital equipment.*
- (c) Leases of cars, both for services personnel and senior management and of varying quality, specification and value.*
- (d) Leases of trucks and vans used for service 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 7 of IPSAS 43 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 IPSAS 43 to its leases of real estate, hospital equipment, cars, trucks and vans, servers and high-capacity multifunction photocopier devices. In doing so, Lessee groups its 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 IPSAS 43 to each master lease agreement would not result in a materially different effect than applying the requirements of IPSAS 43 to each individual lease within the master lease agreement. Consequently, Lessee concludes that it can apply the requirements of IPSAS 43 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 IPSAS 43 to the combined portfolio of leases within the two master lease agreements would not differ materially from applying IPSAS 43 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 IPSAS 43 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 IPSAS 43 to different portfolios of truck and van leases, rather than to 6,500 individual leases.

Allocating Consideration to Components of a Contract (see paragraphs 13–17 and AG33–AG34)

- 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 medical ventilator 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 13 of IPSAS 43. Lessee does not elect the practical expedient in paragraph 16 of IPSAS 43. Lessee considers the requirements in paragraph AG33 of IPSAS 43 and concludes that the lease of the server, the lease of the *medical ventilator* 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 medical ventilator 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 14–15 of IPSAS 43 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 medical ventilator. 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 medical ventilator 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 machines. Nonetheless, Lessor provides four-year maintenance service contracts to customers that purchase similar computed tomography machine 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 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	Medical ventilator	Computed tomography machine	Total
Lease	170.000	102.000	224.000	496.000
Non-lease				104.000

Total fixed consideration				600.000
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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 IPSAS 43, 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 19–42, AG35–AG42, and AG60–AG61)

IE5. The following example illustrates how a lessee measures right-of-use assets, lease liabilities, and concessionary leases. 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.

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 the lease incentive 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

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 or service potential 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.

Year	Lease liability			Right-of-use asset			
	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.

Year	Lease liability			Right-of-use asset			
	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)	-

Example 13A—Concessionary Lease (Lessee)—Concession Results from 30% Lower Contractual Payments than Payments for the Lease at Market Rates

Public sector not-for-profit entity X (Lessee) enters into a lease with Municipality Y (Lessor) to use a building to provide medical services to the population over a period of five years. The Lessor does not regulate the types of medical services provided to the population.

The annual payment for the lease at market rates based on the current use of the underlying asset is CU5,312,420.

- The lease stipulates that the lease should be paid over the five-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

This represents an agreed reduction of 30% to the lease payments at market rates. The lessee's incremental borrowing rate is 5 percent per annum which is readily determinable by the lessee.

- The lease includes a compliance obligation, specifically to use the building to provide medical services to the population for five years. To the extent the compliance obligation is not met, the lease is cancelled, and the right to use the underlying asset returns to the lessor. The compliance obligation is met on a straight-line basis.
- Depreciation of the right-of-use asset is not considered in the example for simplification purposes.

Analysis

It is a concessionary lease, as the present value of payments for the lease at market rates based on the current use of the underlying asset is higher than the present value of the contractual payments. The lessee has effectively received a concession of CU6,900,000, which is the difference between the present value of the payments for the lease at market rates—see Table 1 below—and the present value of the contractual

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 concession component of CU6,900,000 is accounted for in accordance with IPSAS 47, and the present value of annual contractual payments of CU16,100,000 in accordance with this Standard.

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

1. On initial recognition, the lessee recognizes the following (the lessee subsequently measures the lease liability at amortized cost):

Dr	Right-of-use asset	CU23,000,000	
	Cr Lease liability (refer to Table 1 below)		CU16,100,00
	Cr Liability (refer to Table 1 below)		CU6,900,000

Recognition of the lease at the present value of payments for the lease at market rates based on the current use of the asset.

IPSAS 47 is considered in recognizing either a liability or revenue for the concession component of the lease. Paragraph IE308 of that Standard provides journal entries for the recognition and measurement of the concession component of the lease.

2. Year 1: The lessee recognizes the following:

Dr	Interest expense (refer to Table 2 below)	CU805,000	
	Cr Lease liability		CU805,000

Recognition of interest using the effective interest method (CU16,100,000 × 5%)

Dr	Lease liability (refer to Table 2 below)	CU3,718,694	
	Cr Bank		CU3,718,694

Recognition of lease payment

3. Year 2: The lessee recognizes the following:

Dr	Interest expense	CU659,315	
	Cr Lease liability		CU659,315

Recognition of interest using the effective interest method (CU13,186,306 × 5%)

Dr	Lease liability	CU3,718,694	
	Cr Bank		CU3,718,694

Recognition of lease payment

4. Year 3: The lessee recognizes the following:

Dr	Interest expense	CU506,346	
	Cr Lease liability		CU506,346

*Recognition of interest using the effective interest method
(CU10,126,927 × 5%)*

Dr	Lease liability	CU3,718,694	
	Cr Bank		CU3,718,694

Recognition of lease payment

5. Year 4: The lessee recognizes the following:

Dr	Interest expense	CU345,729	
	Cr Lease liability		CU345,729

*Recognition of interest using the effective interest method
(CU6,914,579 × 5%)*

Dr	Lease liability	CU3,718,694	
	Cr Bank		CU3,718,694

Recognition of lease payment

6. Year 5: The lessee recognizes the following:

Dr	Interest expense	CU177,081	
	Cr Lease liability		CU177,081

*Recognition of interest using the effective interest method
(CU3,541,614 × 5%)*

Dr	Lease liability	CU3,718,694	
	Cr Bank		CU3,718,694

Recognition of lease payment

Calculations:

Table 1: Annual Payments (Using Market Interest Rate at 5%)

	Undiscounted Annual Payments for the Lease at Market Rates	Present Value of Payments for the Lease at Market Rates	Undiscounted Annual Contractual Payments	Present Value of Annual Contractual Payments	Concession component of the lease to be recognized as 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	4,162,421	3,718,694	2,913,694	1,248,726
Total	26,562,100	23,000,000	18,593,470	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
Beginning balance	16,100,000	13,186,306	10,126,927	6,914,579	3,541,614	
Interest expense	805,000	659,315	506,346	345,729	177,081	2,493,471
Contractual payments	(3,718,694)	(3,718,694)	(3,718,694)	(3,718,694)	(3,718,694)	
Ending 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 (lease liability on initial recognition)						16,100,000
Concession component of the lease to be recognized as revenue over five years.						6,900,000

Variable Lease Payments (see paragraphs 28, 40, 43(b) and 44)

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 surplus or deficit in the first year of the lease.

Lease Modifications (see paragraphs 45–47)

IE7. Examples 15–19 illustrate the requirements of IPSAS 43 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 meters 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 meters 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 meters 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 meters of office space. Accordingly, at the commencement date of the new lease (at the end of the second quarter of Year 6), Lessee recognizes a right-of-use asset and a lease liability relating to the lease of the additional 3,000 square meters of office space. Lessee does not make any adjustments to the accounting for the original lease of 2,000 square meters 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 meters 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 meters 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 meters 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 meters 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 meters 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 meters 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 meters 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 meters 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 meters 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.

Year	Lease liability				Right-of-use asset		
	Beginning balance	6% interest expense	Lease payment	Ending balance	Beginning balance	Depreciation charge	Ending balance
	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.

Decrease in the lease term

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 meters 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 meters of office space is CU220,802 (i.e., $CU368,004 \div 5 \times 3$ 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 meters 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 recognizes 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 meters 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.

Year	Lease liability				Right-of-use asset		
	Beginning balance	7% interest expense	Lease payment	Ending balance	Beginning balance	Depreciation charge	Ending balance
	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 meters 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 recognizes 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 AG59)

IE8. Examples 20–21 illustrate the application of the requirements in IPSAS 43 for an intermediate lessor that enters into a head lease and a sublease of the same underlying asset.

Example 20—Sublease Classified as a Finance Lease

Head lease—An intermediate lessor enters into a five-year lease for 5,000 square meters of office space (the head lease) with Entity A (the head lessor).

Sublease—At the beginning of Year 3, the intermediate lessor subleases the 5,000 square meters of office space for the remaining three years of the head lease to a sublessee.

The intermediate lessor classifies the sublease by reference to the right-of-use asset arising from the head lease. The intermediate lessor classifies the sublease as a finance lease, having considered the requirements in paragraphs 65–70 of IPSAS 43.

When the intermediate lessor enters into the sublease, the intermediate lessor:

- (a) Derecognizes the right-of-use asset relating to the head lease that it transfers to the sublessee and recognizes the net investment in the sublease;
- (b) Recognizes any difference between the right-of-use asset and the net investment in the sublease in surplus or deficit; and
- (c) Retains the lease liability relating to the head lease in its statement of financial position, which represents the lease payments owed to the head lessor.

During the term of the sublease, the intermediate lessor recognizes both finance revenue on the sublease and interest expense on the head lease (Entity A).

Example 21—Sublease Classified as Operating Lease

Head lease—An intermediate lessor enters into a five-year lease for 5,000 square meters 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 meters of office space for two years to a sublessee.

The intermediate lessor classifies the sublease by reference to the right-of-use asset arising from the head lease. The intermediate lessor classifies the sublease as an operating lease, having considered the requirements in paragraphs 65–70 of IPSAS 43.

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.

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 sublease.

Lessee Disclosure (see paragraphs 62 and AG50–AG51)

- IE9. Example 22 illustrates how a lessee with different types of lease portfolios might comply with the disclosure requirements described in paragraphs 62 and AG50 of IPSAS 43 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 22–Variable Payment Terms

Lessee with a High Volume of Leases with Some Consistent Payment Terms

Example 22A: City XYZ (Lessee) operates four tourism outlets selling touristic merchandise about the city—A, B, C and D. Lessee has a high volume of property leases. Lessee’s policy is to negotiate variable payment terms for newly established tourism outlets. 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 tourism outlet. Variable payment terms are used, when possible, in newly established tourism outlets in order to link rental payments to tourism outlet cash flows and minimize fixed costs. Fixed and variable rental payments by tourism outlet for the period ended 31 December 20X0 are summarized below.

	Tourism outlet	Fixed payments	Variable payments	Total payments	Estimated annual impact on total tourism outlet rent of a 1% increase in sales
	No.	CU	CU	CU	%
A	4,522	3,854	120	3,974	0.03%
B	965	865	105	970	0.11%
C	124	26	163	189	0.86%
D	652	152	444	596	0.74%
	6,263	4,897	832	5,729	0.15%

Refer to the management commentary for tourism outlet information presented on a like-for-like basis and to Note X for segmental information applying IPSAS 18, *Segment Reporting* relating to Tourism Outlets A–D.

Example 22B: City XYZ (Lessee) has a high volume of property leases of tourism outlets 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 City XYZ contain variable payment terms that are linked to the volume of sales made from leased tourism outlets. These terms are used, when possible, in order to match lease payments with tourism outlets generating higher cash flows. For individual tourism outlets, 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.

	Tourism outlets	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 tourism outlets in the public sector entity 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 tourism outlets in the public sector entity 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 22C: City XYZ (Lessee) has a high volume of property leases of tourism outlets 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 are 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 minimising the fixed cost base for newly established tourism outlets or for reasons of margin control and operational flexibility. Variable lease payment terms vary widely across the city:

- (a) The majority of variable payment terms are based on a range of percentages of tourism outlet 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 tourism outlet with higher sales. This facilitates the management of margins across the city's tourism outlets.

Variable rent expenses are expected to continue to represent a similar proportion of store sales in future years.

- IE10. Example 23 illustrates how a lessee with different types of lease portfolios might comply with the disclosure requirements described in paragraphs 62 and AG51 of IPSAS 43 about extension options and termination options. This example shows only current period information. IPSAS 1 requires an entity to present comparative information.

Example 23–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 23A: 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 23B: 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 recognized (discounted) CU	Potential future lease payments not included in lease liabilities (undiscounted)		
		Payable during 20X1–20X5	Payable during 20X6–20Y0	Total
		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 23C: 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 city 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 recognized (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%

Lessor Measurement (see paragraphs 71A, 81A, AG60, and AG62)

IE10A. The following example illustrates how a lessor measures and accounts for concessionary leases.

Example 23A—Concessionary Operating Lease (Lessor)—Concession Results from 30% Lower Contractual Payments than Payments for the Lease at Market Rates

Municipality Y (Lessor) enters into an operating lease with public sector not-for-profit entity X (Lessee) to use a building over a period of five years with the condition to use it for providing medical services to the population in general. The Lessor does not regulate the types of medical services provided to the population.

The annual payment for the lease at market rates based on the current use of the underlying asset is CU5,000,000.

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

Year 1: CU3,500,000

Year 2: CU3,500,000

Year 3: CU3,500,000

Year 4: CU3,500,000

Year 5: CU3,500,000

This represents an agreed reduction of 30% to the lease payments at market rates. The interest rate implicit in the lease is 5 percent per annum which is readily determinable by the lessee.

- *Depreciation of the underlying asset is not considered in the example because it is within the scope of other IPSAS.*
- *The annual expenses (depreciation and maintenance) of the building are CU4,200,000.*

Analysis

It is a concessionary lease, as the present value of payments for the lease at market rates based on the current use of the underlying asset is higher than the present value of the contractual payments. The concessionary operating lease has two distinct components:

- 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 in the form of lease payments and accounted for as revenue (CU3,500,000 per year); and
- A foregone revenue component—Representing the foregone revenue by the lessor, which is not recognized as revenue (CU1,500,000 (CU5,000,000 – CU3,500,000)).

The contractual payments are accounted for in accordance with IPSAS 43.

The annual journal entries⁽¹⁾ to account for the concessionary lease are as follows:

Dr Cash	CU3,500,000	
		Cr Lease revenue
		CU3,500,000

⁽¹⁾ As revenue in an operating lease is recognized on either a straight-line basis or another systematic basis, there is no need to discount the lease payments.

Example 23B—Concessionary Finance Lease (Lessor)—Concession Results from 30% Lower Contractual Payments than Payments for the Lease at Market Rates

Municipality Y (Lessor) enters into a finance lease with public sector not-for-profit entity X (Lessee) to use a building over a period of five years with the condition to use it for providing medical services to the population in general. The Lessor does not regulate the types of medical services provided to the population.

The annual payment for the lease at market rates based on the current use of the underlying asset is CU5,312,420.

- *The agreement stipulates that the lease should be paid over the five-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

This represents an agreed reduction of 30% to the lease payments at market rates. The interest rate implicit in the lease is 5 percent per annum which is readily determinable by the lessor.

- *The carrying amount of the underlying asset is CU20,000,000.*
- *The residual value is CU0 (zero) for simplification purposes.*
- *The lease includes compliance obligations. 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

It is a concessionary finance lease, as the present value of payments for the lease at market rates based on the current use of the underlying asset is higher than the present value of the contractual payments. The concessionary finance lease has two distinct 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 in the form of lease payments and accounted for as the net investment in the lease (CU16,100,000); and
- (b) A foregone revenue component—Representing the foregone revenue by the lessor, which is not recognized as revenue (CU6,900,000 (CU23,000,000 – CU16,100,000)).

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

1. On initial recognition, the lessor recognizes the following (the lessor subsequently measures the lease receivable (net investment in the lease) at amortized cost):

Dr	Lease receivable (refer to Table 1 below)	CU16,100,000	
Dr	Surplus or deficit	CU3,900,000	
	Cr Derecognition of the underlying asset		CU20,000,00 ⁽²⁾

⁽²⁾ Net of accumulated depreciation.

Recognition of the contractual payments for the lease and derecognition of the underlying asset.

2. Year 1: The lessor recognizes the following:

Dr	Lease receivable	CU805,000	
	Cr Interest revenue (refer to Table 2 below)		CU805,000

Recognition of interest using the effective interest method (CU16,100,000 × 5%)

Dr	Bank	CU3,718,694	
	Cr Lease receivable (refer to Table 2 below)		CU3,718,694

Recognition of lease payment

3. Year 2: The lessor recognizes the following:

Dr	Lease receivable	CU659,315	
	Cr Interest revenue		CU659,315

Recognition of interest using the effective interest method (CU13,186,306 × 5%)

Dr	Bank	CU3,718,694	
	Cr Lease receivable		CU3,718,694

Recognition of lease payment

4. Year 3: The lessor recognizes the following:

Dr	Lease receivable	CU506,346	
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Cr Interest revenue CU506,346

Recognition of interest using the effective interest method (CU10,126,927 × 5%)

Dr Bank CU3,718,694

Cr Lease receivable CU3,718,694

Recognition of lease payment

5. Year 4: The lessor recognizes the following:

Dr Lease receivable CU345,729

Cr Interest revenue CU345,729

Recognition of interest using the effective interest method (CU6,914,579 × 5%)

Dr Bank CU3,718,694

Cr Lease receivable CU3,718,694

Recognition of lease payment

6. Year 5: The lessor recognizes the following:

Dr Lease receivable CU177,081

Cr Interest revenue CU177,081

Recognition of interest using the effective interest method (CU3,541,614 × 5%)

Dr Bank CU3,718,694

Cr Lease receivable CU3,718,694

Recognition of lease payment

Calculations:

Table 1: Annual Payments (Using Market Interest Rate at 5%)

	Undiscounted Annual Payments for the Lease at Market Rates	Present Value of Payments for the Lease at Market Rates	Undiscounted Annual Contractual Payments	Present Value of Annual Contractual Payments
	(1)	(2)	(3)	(4)
Year 1	5,312,420	5,059,448	3,718,694	3,541,614
Year 2	5,312,420	4,818,522	3,718,694	3,372,965
Year 3	5,312,420	4,589,068	3,718,694	3,212,348
Year 4	5,312,420	4,370,541	3,718,694	3,059,379
Year 5	5,312,420	4,162,420	3,718,694	2,913,694
Total	26,562,100	23,000,000	18,593,470	16,100,000

Table 2: Calculation of Lease Receivable Balance and Interest Using the Effective Interest Rate

	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU	Total
Beginning balance	16,100,000	13,186,306	10,126,927	6,914,579	3,541,614	
Interest revenue	805,000	659,315	506,346	345,729	177,081	2,493,471
Contractual payments	(3,718,694)	(3,718,694)	(3,718,694)	(3,718,694)	(3,718,694)	
Ending balance	13,186,306	10,126,927	6,914,579	3,541,614	0	

Carrying amount of the derecognized underlying asset	20,000,000
Less: Present value of cash inflows (lease receivable on initial recognition)	16,100,000
Loss component with concessionary finance lease.	3,900,000

Sale and Leaseback Transactions (see paragraphs 97–102)

IE11. Examples 24 and 25 illustrate the application of the requirements in paragraphs 98–101 of IPSAS 43 for a seller-lessee and a buyer-lessor.

Example 24—Sale and Leaseback Transaction with fixed payments and above-market terms

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 a 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 47, Revenue to be accounted for as a sale of the building. Accordingly, Seller-lessee and Buyer-lessor account for the transaction as a sale and leaseback.

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. Applying paragraph 100(b) of IPSAS 43, 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) is 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.

Seller-lessee

Applying paragraph 99(a) of IPSAS 43, 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. Seller-lessee calculates this amount as: CU1,000,000 (the carrying amount of the building) × CU1,259,200 (the discounted lease payments for the 18-year right-of-use asset) ÷ CU1,800,000 (the fair value of the building).

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 the building amounts to CU800,000 (CU1,800,000 – CU1,000,000), of which:

- (a) CU559,645 (CU800,000 × CU1,259,200 ÷ CU1,800,000) relates to the right to use the building retained by Seller-lessee; and

- (b) $\text{CU}240,355 (\text{CU}800,000 \times (\text{CU}1,800,000 - \text{CU}1,259,200) \div \text{CU}1,800,000)$ 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

Buyer-lessor

At the commencement date, Buyer-lessor accounts for the transaction as follows.

Building	CU1,800,000	
Financial asset	CU200,000 (18 payments of CU16,447, discounted at 4.5 per cent per annum)	
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.

- IE12. Example 25 illustrates the application of the requirements in paragraph 101A and paragraphs 30–47 of IPSAS 43 in a sale and leaseback transaction with variable lease payments that do not depend on an index or rate.

Example 25—Subsequent measurement of a right-of-use asset and lease liability in a sale and leaseback transaction with variable lease payments that do not depend on an index or rate

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of CU1,800,000 (the fair value of the building at the date of sale). 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 five years. Lease payments—payable annually—comprise fixed payments and variable payments that do not depend on an index or rate.

The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements of IPSAS 47 to be accounted for as a sale of the building. Accordingly, Seller-lessee accounts for the transaction as a sale and leaseback.

The interest rate implicit in the lease cannot be readily determined. Seller-lessee's incremental borrowing rate is 3 percent per annum.

Applying paragraph 99(a) of IPSAS 43, Seller-lessee determines the proportion of the building transferred to Buyer-lessor that relates to the right of use it retains as 25 percent.^(a) Consequently, at the commencement date Seller-lessee accounts for the transaction as follows.

Cash	CU1,800,000
Right-of-use asset (CU1,000,000 × 25 per cent)	CU250,000

<i>Building</i>	<i>CU1,000,000</i>
<i>Lease liability</i>	<i>CU450,000</i>
<i>Gain on rights transferred ((CU1,800,000 – CU1,000,000) × 75 per cent)</i>	<i>CU600,000</i>

Seller-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.

In measuring the lease liability applying paragraphs 37–47 of IPSAS 43, Seller-lessee develops an accounting policy for determining 'lease payments' in a way that it would not recognize any amount of the gain that relates to the right of use it retains. Depending on the circumstances (including the method Seller-lessee used—applying paragraph 99(a) of IPSAS 43—for determining the measurement of the right-of-use asset and the gain recognized on the transaction at the commencement date), either Approach 1 or Approach 2 could meet the requirements in paragraph 101A.

Approach 1—Expected lease payments at the commencement date

Applying paragraph 101A of IPSAS 43, Seller-lessee determines 'lease payments' to reflect the expected lease payments at the commencement date that, when discounted using its incremental borrowing rate, result in the carrying amount of the lease liability at that date of CU450,000.

The lease liability and the right-of-use asset arising from the leaseback are:

Year	Lease liability				Right-of-use asset		
	Beginning balance	Lease payments ^(b)	3 percent interest expense ^(c)	Ending balance	Beginning balance	Depreciation charge	Ending balance
	CU	CU	CU	CU	CU	CU	CU
1	450,000	(95,902)	13,500	367,598	250,000	(50,000)	200,000
2	367,598	(98,124)	11,028	280,502	200,000	(50,000)	150,000
3	280,502	(99,243)	8,415	189,674	150,000	(50,000)	100,000
4	189,674	(100,101)	5,690	95,263	100,000	(50,000)	50,000
5	95,263	(98,121)	2,858	0	50,000	(50,000)	0

In applying paragraph 101A and paragraph 39(b) of IPSAS 43, Seller-lessee recognizes in surplus or deficit the difference between the payments made for the lease and the lease payments that reduce the carrying amount of the lease liability. For example, if Seller-lessee pays CU99,321 for the use of the building in Year 2, it recognizes CU1,197 (CU99,321 – CU98,124) in surplus or deficit.

Approach 2—Equal lease payments over the lease term

Applying paragraph 101A of IPSAS 43, Seller-lessee determines 'lease payments' to reflect equal periodic payments over the lease term that, when discounted using its incremental borrowing rate, result in the carrying amount of the lease liability at the commencement date of CU450,000.

The lease liability and the right-of-use asset arising from the leaseback are:

Year	Lease liability				Right-of-use asset		
	Beginning balance	Lease payments ^(d)	3 percent interest expense ^(c)	Ending balance	Beginning balance	Depreciation charge	Ending balance
	CU	CU	CU	CU	CU	CU	CU
1	450,000	(98,260)	13,500	365,240	250,000	(50,000)	200,000
2	365,240	(98,260)	10,957	277,937	200,000	(50,000)	150,000
3	277,937	(98,260)	8,338	188,015	150,000	(50,000)	100,000
4	188,015	(98,260)	5,640	95,395	100,000	(50,000)	50,000
5	95,395	(98,260)	2,865	0	50,000	(50,000)	0

In applying paragraph 101A and paragraph 39(b) of IPSAS 43, Seller-lessee recognizes in surplus or deficit the difference between the payments made for the lease and the lease payments that reduce the carrying amount of the lease liability. For example, if Seller-lessee pays CU99,321 for the use of the building in Year 2, it recognizes CU1,061 (CU99,321 – CU98,260) in surplus or deficit.

- (a) Applying paragraph 99(a) of IPSAS 43, Seller-lessee determines the proportion of the building transferred to Buyer-lessor that relates to the right of use retained by comparing, at the commencement date, the right of use it retains via the leaseback to the rights comprising the entire building. Paragraph 99(a) does not prescribe a particular method for determining that proportion.
- (b) Applying paragraph 101A and paragraph 37(b) of IPSAS 43, Seller-lessee reduces the carrying amount of the lease liability with 'lease payments' that reflect the expected lease payments estimated at the commencement date and, when discounted, result in the carrying amount of the lease liability at that date of CU450,000.
- (c) Applying paragraph 101A and paragraph 37(a) of IPSAS 43, Seller-lessee increases the carrying amount of the lease liability to reflect interest on the lease liability using its incremental borrowing rate.
- (d) Applying paragraph 101A and paragraph 37(b) of IPSAS 43, Seller-lessee reduces the carrying amount of the lease liability with 'lease payments' that reflect equal periodic payments over the lease term that, when discounted, result in the carrying amount of the lease liability at the commencement date of CU450,000.

IE13. Example 26 illustrates the application of the requirements in paragraphs 97A–97B of IPSAS 43 in a sale and leaseback transaction with an embedded concession at the inception of the lease.

Example 26–Sale at Market Terms and Leaseback at Below-Market Terms

Museum A (Seller-lessee) has faced some financial difficulties due to expected increasing maintenance costs to fulfill new safety measures required for their architecturally unique building. Therefore, Seller-lessee sells the building to local government X (Buyer-lessor) at its current market price. Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 18 years with an annual payment which is at below-market terms. Buyer-lessor ensures, with this contract, that the main tourist attraction in the region keeps open for all visitors.

Seller-lessee sells the building, which has a total useful life of 25.5 years, to Buyer-lessor at its current market price (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 transfer of the building by Seller-lessee satisfies the requirements of IPSAS 47, Revenue. This example ignores any initial direct costs. The annual payment at market rates is CU120,000.

As the sale is at fair value, the sale is at market terms. As the lease payments are at below-market terms, the leaseback has an embedded concession.

Accordingly, Seller-lessee and Buyer-lessor account for the transaction as a sale at market terms and a leaseback at below-market terms.

The interest rate implicit in the lease is 4.5 percent per annum, which is readily determinable by Seller-lessee. The present value of the contractual annual payments (18 payments of CU103,553 discounted at 4.5 percent per annum), amounts to CU1,259,204.

There are no compliance obligations attached to the leaseback transaction.

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) × CU1,459,199 (the discounted payments for the lease at market rates 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 CU151,467 calculated as follows. The gain on sale of the building amounts to CU800,000 (CU1,800,000 – CU1,000,000), of which:

- (a) CU648,533 (CU1,459,200 × CU800,000 ÷ CU1,800,000) relates to the right to use the building retained by Seller-lessee; and
- (b) CU151,467 (CU340,801 × CU800,000 ÷ CU1,800,000) relates to the rights transferred to Buyer-lessor.

Further calculations:

- (a) CU340,801 (CU1,800,000-CU1,459,199) related to rights retained by the Buyer-lessor (unguaranteed residual value at the beginning of the lease).
- (b) CU199,995 (CU1,459,199-CU1,259,204) related to the concession.

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

Dr Cash	CU1,800,000	
Dr Right-of-use asset	CU810,666	
Cr Building		CU1,000,000
Cr Lease liability		CU1,259,204
Cr Revenue		CU199,995
Cr Gain on rights transferred		CU151,467

Buyer-lessor

The Buyer-lessor classifies the lease as a finance lease.

At the commencement date, Buyer-lessor accounts for the transaction as follows.

Dr Building	CU1,800,000
Dr Financial asset	CU1,600,005 (18 payments of CU103,553, discounted at 4.5 per cent per annum (CU1,259,204) + unguaranteed residual value (CU340,801))

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Dr Surplus or deficit (Concession expense)	CU199.995	
Cr Cash		CU1,800,000
Cr Building (value of the rights transferred to the Seller-lessee)		CU1,459,199
Cr Building (unguaranteed residual value)		CU340,801

After the commencement date, the Seller-lessee and Buyer-lessor account for the lease by treating CU103,553 as lease payments.

COMPARISON WITH IFRS 16

IPSAS 43, *Leases* is drawn primarily from IFRS 16 (2016) *Leases*, including amendments up to March 2021.

The main differences between IPSAS 43 and IFRS 16 are as follows:

- IPSAS 43 uses different terminology from IFRS 16. For example, IPSAS 43 uses the terms “revenue”, “operation”, “accumulated surpluses/(deficits)” and “segment”, while IFRS 16 uses the terms “income”, “business unit”, “retained earnings” and “business segment”, respectively.
- IPSAS 43 refers to both “economic benefits” and “service potential”, where appropriate, in the section on identifying a lease, while IFRS 16 refers only to “economic benefits”.
- IPSAS 43 does not include specific requirements for manufacturer or dealer lessors, whereas IFRS 16 does.
- IPSAS 43 includes specific measurement requirements on concessionary leases for lessees, whereas IFRS 16 does not.
- IPSAS 43 includes specific disclosure requirements on concessionary leases for both lessees and lessors, whereas IFRS 16 does not.

COMPARISON WITH GFS

In developing IPSAS 43, *Leases*, the IPSASB considered Government Finance Statistics (GFS) reporting guidelines.

Key similarities and differences with GFS are as follows:

- IPSAS 43 applies a right-of-use model for lessees and a risks and rewards model for lessors, while GFS applies a risks and rewards model for both lessees and lessors.
- Under IPSAS 43, lessors classify leases as finance lease or operating lease and lessees do not classify leases as finance lease or operating lease. Under GFS, leases are classified as financial lease, operating lease, or resource lease.
- Under IPSAS 43, lessees recognize a right-of use asset and a lease liability. Under GFS, an underlying asset and a loan are recognized in a financial lease and lease payments from operating leases are recognized as use of goods and services.
- IPSAS 43 provides an optional recognition exemption for lessees on short-term leases and leases for which the underlying asset is of low value. GFS does not provide such recognition exemption.
- IPSAS 43 includes specific measurement requirements on concessionary leases for lessees, whereas GFS does not.
- IPSAS 43 includes specific disclosure requirements on concessionary leases for both lessees and lessors, whereas GFS does not.

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