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NZ ACCOUNTING STANDARDS BOARD

PUBLIC BENEFIT ENTITY INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 13 LEASES (PBE IPSAS 13)

Issued September 2014 and incorporates amendments to 31 January 2020 other than consequential amendments resulting from early adoption of PBE IFRS 9 *Financial Instruments*, PBE IPSAS 41 *Financial Instruments* and PBE IFRS 17 *Insurance Contracts.* PBE IFRS 9 is superseded by PBE IPSAS 41 and is available for early application if, and only if, the entity's initial date of application is before 1 January 2020.

This Standard was issued on 11 September 2014 by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 9 October 2014.

Reporting entities that are subject to this Standard are required to apply it in accordance with the effective dates in paragraphs 86.1 to 86.3.

In finalising this Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Tier 1 and Tier 2 PBE Standard has been issued as part of a revised full set of PBE Standards that incorporate enhancements for not-for-profit public benefit entities.

This Standard, when applied, supersedes PBE IPSAS 13 *Leases* issued in May 2013.

NZ PBE IPSAS 13 LEASES

ISBN 978-1-927292-34-1

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PBE IPSAS 13 LEASES

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Public Benefit Entity International Public Sector Accounting Standard 13 *Leases* is set out in paragraphs 1–87 and Appendices A–C. All the paragraphs have equal authority. PBE IPSAS 13 should be read in the context of its objective, the NZASB's Basis for Conclusions on PBE IPSAS 13, the IPSASB's Basis for Conclusions on IPSAS 13, the *Public Benefit Entities' Conceptual Framework* and Standard XRB A1 *Application of the Accounting Standards Framework*. PBE 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. The objective of this Standard is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures to apply in relation to finance and operating leases.

Scope

2. **An entity that prepares and presents financial statements shall apply this Standard in accounting for all leases other than:**

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

   (b) **Licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents, and copyrights.**

   However, this Standard shall not be applied as the basis of measurement for:

   (a) **Property held by lessees that is accounted for as investment property (see PBE IPSAS 16 *Investment Property*);**

   (b) **Investment property provided by lessors under operating leases (see PBE IPSAS 16);**

   (c) **Biological assets within the scope of PBE IPSAS 27 *Agriculture* held by lessees under finance leases; or**

   (d) **Biological assets within the scope of PBE IPSAS 27 provided by lessors under operating leases.**

3. [Not used]

3.1 **This Standard applies to Tier 1 and Tier 2 public benefit entities.**

3.2 **A Tier 2 entity is not required to comply with the requirements in this Standard denoted with an asterisk (*). Where a Tier 2 entity elects to apply a disclosure concession it shall comply with any RDR paragraphs associated with that concession.**

4. [Not used]

5. This Standard applies to agreements that transfer the right to use assets, even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. This Standard does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other. Public sector entities may enter into complex arrangements for the delivery of services, which may or may not include leases of assets. These arrangements are discussed in paragraphs 25–27.

6. This Standard does not apply to (a) lease agreements to explore for or use natural resources such as oil, gas, timber, metals, and other mineral rights, and (b) licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents, and copyrights. This is because these types of agreements have the potential to raise complex accounting issues that need to be addressed separately.

7. This Standard does not apply to investment property. Investment properties are measured by lessors and lessees in accordance with the provisions of PBE IPSAS 16.

Definitions

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

   The <u>commencement of the lease term</u> is the date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease (i.e., the recognition of the assets, liabilities, revenue, or expenses resulting from the lease, as appropriate).

   <u>Contingent rent</u> is that portion of the lease payments that is not fixed in amount, but is based on the future amount of a factor that changes other than with the passage of time (e.g., percentage of future sales, amount of future use, future price indices, future market rates of interest).

Economic life is either:

(a) **The period over which an asset is expected to yield economic benefits or service potential to one or more users; or**

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

A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.

Gross investment in the lease is the aggregate of:

(a) **The minimum lease payments receivable by the lessor under a finance lease; and**

(b) **Any unguaranteed residual value accruing to the lessor.**

Guaranteed residual value is:

(a) **For a lessee, that part of the residual value that is guaranteed by the lessee or by a party related to the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and**

(b) **For a lessor, that part of the residual value that is guaranteed by the lessee, or by a third party unrelated to the lessor, that is financially capable of discharging the obligations under the guarantee.**

The inception of the lease is the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. As at this date:

(a) **A lease is classified as either an operating or a finance lease; and**

(b) **In the case of a finance lease, the amounts to be recognised at the commencement of the lease term are determined.**

Initial direct costs are incremental costs that are directly attributable to negotiating and arranging a lease, except for such costs incurred by manufacturer or trader lessors.

The interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of:

(a) **The minimum lease payments; and**

(b) **The unguaranteed residual value**

to be equal to the sum of (i) the fair value of the leased asset, and (ii) any initial direct costs of the lessor.

A lease is an agreement whereby the lessor conveys to the lessee, in return for a payment or series of payments, the right to use an asset for an agreed period of time.

The lease term is the non-cancellable period for which the lessee has contracted to lease the asset, together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

The lessee's incremental borrowing rate of interest is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

Minimum lease payments are the payments over the lease term that the lessee is, or can be, required to make, excluding contingent rent, costs for services and, where appropriate, taxes to be paid by and reimbursed to the lessor, together with:

(a) **For a lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or**

(b) **For a lessor, any residual value guaranteed to the lessor by:**

   (i) **The lessee;**

(ii) **A party related to the lessee; or**

(iii) **An independent third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.**

However, if the lessee has an option to purchase the 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 of the lease, that the option will be exercised, the minimum lease payments comprise the minimum payments payable over the lease term to the expected date of exercise of this purchase option and the payment required to exercise it.

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

A non-cancellable lease is a lease that is cancellable only:

(a) **Upon the occurrence of some remote contingency;**

(b) **With the permission of the lessor;**

(c) **If the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or**

(d) **Upon payment by the lessee of such an additional amount that, at inception of the lease, continuation of the lease is reasonably certain.**

An operating lease is a lease other than a finance lease.

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 leased asset, the realisation of which by the lessor is not assured or is guaranteed solely by a party related to the lessor.

Useful life is the estimated remaining period, from the commencement of the lease term, without limitation by the lease term, over which the economic benefits or service potential embodied in the asset are expected to be consumed by the entity.

Terms defined in other PBE Standards are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.

Changes in Lease Payments between the Inception of the Lease and the Commencement of the Lease Term

9. A lease agreement or commitment may include a provision to adjust the lease payments (a) for changes in the construction or acquisition cost of the leased property, or (b) for changes in some other measure of cost or value, such as general price levels, or in the lessor's costs of financing the lease, during the period between the inception of the lease and the commencement of the lease term. If so, the effect of any such changes shall be deemed to have taken place at the inception of the lease for the purposes of this Standard.

Hire Purchase Contracts

10. The definition of a lease includes contracts for the hire of an asset that contain a provision giving the hirer an option to acquire title to the asset upon the fulfilment of agreed conditions. These contracts are sometimes known as hire purchase contracts.

Incremental Borrowing Rate of Interest

11. Where an entity has borrowings that are guaranteed by another entity (for example, the government), the determination of the lessee's incremental borrowing rate of interest reflects the existence of any government guarantee and any related fees. This will normally lead to the use of a lower incremental borrowing rate of interest.

Classification of Leases

12. The classification of leases adopted in this Standard is based on the extent to which risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibilities of (a) losses from idle capacity, technological obsolescence, or (b) changes in value because of changing economic conditions. Rewards may be represented by the expectation of service potential or profitable operation over the asset's economic life, and of gain from appreciation in value or realisation of a residual value.

13. **A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.**

14. Because the transaction between a lessor and a lessee is based on a lease agreement between them, it is appropriate to use consistent definitions. The application of these definitions to the differing circumstances of the lessor and lessee may result in the same lease being classified differently by them. For example, this may be the case if the lessor benefits from a residual value guarantee provided by a party unrelated to the lessee.

15. 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. Although the following are examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease, a lease does not need to meet all these criteria in order to be classified as a finance lease:

    (a) The lease transfers ownership of the asset to the lessee by the end of the lease term;

    (b) The lessee has the option to purchase the 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 of the lease, that the option will be exercised;

    (c) The lease term is for the major part of the economic life of the asset, even if title is not transferred;

    (d) At the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset;

    (e) The leased assets are of such a specialised nature that only the lessee can use them without major modifications; and

    (f) The leased assets cannot easily be replaced by another asset.

16. Other indicators 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 equalling 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.

17. The examples and indicators in paragraphs 15 and 16 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all risks and rewards incidental to ownership, the lease is classified as an operating lease. For example, this may be the case (a) if ownership of the asset transfers at the end of the lease for a variable payment equal to its then fair value, or (b) if there are contingent rents as a result of which the lessee does not have substantially all such risks and rewards.

18. Lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease under the criteria in paragraphs 12–17 if the changed terms had been in effect at the inception of the lease, the revised agreement is regarded as a new agreement over its term. However, changes in estimates (for example, changes in estimates of the economic life or the residual value of the leased property) or changes in circumstances (for example, default by the lessee), do not give rise to a new classification of a lease for accounting purposes.

19–20. [Deleted by IPSASB]

20A. When a lease includes both land and buildings elements, an entity assesses the classification of each element as a finance or an operating lease separately in accordance with paragraphs 12–18. In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life.

21. Whenever necessary in order to classify and account for a lease of land and buildings, the minimum lease payments (including any lump-sum upfront payments) are allocated 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 of the lease. If the lease payments cannot be allocated reliably[1] 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.

22. For a lease of land and buildings in which the amount that would initially be recognised for the land element, in accordance with paragraph 28, is immaterial, the land and buildings may be treated as a single unit for the purpose of lease classification and classified as a finance or operating lease in accordance with paragraphs 12–18. In such a case, the economic life of the buildings is regarded as the economic life of the entire leased asset.

23. Separate measurement of the land and buildings elements is not required when the lessee's interest in both land and buildings is classified as an investment property in accordance with PBE IPSAS 16, and the fair value model is adopted. Detailed calculations are required for this assessment only if the classification of one or both elements is otherwise uncertain.

24. In accordance with PBE IPSAS 16, it is possible for a lessee to classify a property interest held under an operating lease as an investment property. If it does, the property interest is accounted for as if it were a finance lease and, in addition, the fair value model is used for the asset recognised. The lessee shall continue to account for the lease as a finance lease, even if a subsequent event changes the nature of the lessee's property interest so that it is no longer classified as investment property. This will be the case if, for example, the lessee:

(a) Occupies the property, which is then transferred to owner-occupied property at a deemed cost equal to its fair value at the date of change in use; or

(b) Grants a sublease that transfers substantially all of the risks and rewards incidental to ownership of the interest to an unrelated third party. Such a sublease is accounted for by the lessee as a finance lease to the third party, although it may be accounted for as an operating lease by the third party.

Leases and Other Contracts

25. A contract may consist solely of an agreement to lease an asset. However, a lease may also be one element in a broader set of agreements with other entities to construct, own, operate, and/or transfer assets. Entities often enter into such agreements, particularly in relation to long-lived physical assets and infrastructure assets.

26. Other agreements may involve an entity leasing infrastructure such as a hospital. The entity determines whether the arrangement is a service concession arrangement, as defined in PBE IPSAS 32 *Service Concession Arrangements: Grantor*. Where an arrangement does not meet the conditions for recognition of a service concession asset in accordance with PBE IPSAS 32 and the arrangement contains an identifiable operating lease or finance lease as defined in this Standard, the provisions of this Standard are applied in accounting for the lease component of the arrangement.

27. Entities may also enter a variety of agreements for the provision of goods and/or services, which necessarily involve the use of dedicated assets. In some of these agreements, it may not be clear whether a service concession arrangement as defined in PBE IPSAS 32 or a lease, as defined by this Standard, has arisen. In these cases, professional judgement is exercised, and if a lease has arisen this standard is applied; if a lease has not arisen, entities account for those agreements by applying the provisions of other relevant PBE Standards, or in the absence thereof, other relevant international and/or national accounting standards.

[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 BC10 of PBE IPSAS 1 *Presentation of Financial Reports* discusses the transitional approach to the explanation of reliability.

Leases in the Financial Statements of Lessees

Finance Leases

28. **At the commencement of the lease term, lessees shall recognise assets acquired under finance leases as assets, and the associated lease obligations as liabilities in their statements of financial position. The assets and liabilities shall be recognised at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. The discount rate to be used in calculating the present value of the minimum lease payments is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate shall be used.**

29. Transactions and other events are accounted for and presented in accordance with their substance and financial reality, and not merely with legal form. Although the legal form of a lease agreement is that the lessee may acquire no legal title to the leased asset, in the case of finance leases the substance and financial reality are that the lessee acquires the economic benefits or service potential of the use of the leased asset for the major part of its economic life in return for entering into an obligation to pay for that right an amount approximating, at the inception of the lease, the fair value of the asset and the related finance charge.

30. If such lease transactions are not reflected in the lessee's financial statements, the assets and liabilities of an entity are understated, thereby distorting financial ratios. Therefore, it is appropriate for a finance lease to be recognised in the lessee's financial statements both as an asset and as an obligation to pay future lease payments. At the commencement of the lease term, the asset and the liability for the future lease payments are recognised in the financial statements at the same amounts, except for any initial direct costs of the lessee that are added to the amount recognised as an asset.

31. It is not appropriate for the liabilities for leased assets to be presented in the financial statements as a deduction from the leased assets.

32. If, for the presentation of liabilities on the face of the statement of financial position, a distinction is made between current and non-current liabilities, the same distinction is made for lease liabilities.

33. Initial direct costs are often incurred in connection with specific leasing activities, such as negotiating and securing leasing arrangements. The costs identified as directly attributable to activities performed by the lessee for a finance lease are added to the amount recognised as an asset.

34. **Minimum lease payments shall be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge shall be allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent rents shall be charged as expenses in the period in which they are incurred.**

35. In practice, in allocating the finance charge to periods during the lease term, a lessee may use some form of approximation to simplify the calculation.

36. **A finance lease gives rise to a depreciation expense for depreciable assets as well as a finance expense for each accounting period. The depreciation policy for depreciable leased assets shall be consistent with that for depreciable assets that are owned, and the depreciation recognised shall be calculated in accordance with PBE IPSAS 17 *Property, Plant and Equipment* and PBE IPSAS 31 *Intangible Assets* as appropriate. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term or its useful life.**

37. The depreciable amount of a leased asset is allocated to each accounting period during the period of expected use on a systematic basis consistent with the depreciation policy the lessee adopts for depreciable assets that are owned. If there is reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the asset is depreciated over the shorter of the lease term or its useful life.

38. The sum of the depreciation expense for the asset and the finance expense for the period is rarely the same as the lease payments payable for the period, and it is therefore inappropriate simply to recognise the lease payments payable as an expense. Accordingly, the asset and the related liability are unlikely to be equal in amount after the commencement of the lease term.

39. To determine whether a leased asset has become impaired, an entity applies relevant impairment tests in PBE IPSAS 21 *Impairment of Non-Cash-Generating Assets* and PBE IPSAS 26 *Impairment of Cash-Generating Assets*.

40. **Lessees shall disclose the following for finance leases:**

(a) **For each class of assets, the net carrying amount at the reporting date;**

*(b) **A reconciliation between the total of future minimum lease payments at the reporting date, and their present value;**

(c) **In addition, an entity shall disclose the total of future minimum lease payments at the reporting date, and their present value, for each of the following periods:**

(i) **Not later than one year;**

(ii) **Later than one year and not later than five years; and**

(iii) **Later than five years;**

*(d) **Contingent rents recognised as an expense in the period;**

*(e) **The total of future minimum sublease payments expected to be received under non-cancellable subleases at the reporting date; and**

(f) **A general description of the lessee's material leasing arrangements including, but not limited to, the following:**

(i) **The basis on which contingent rent payable is determined;**

(ii) **The existence and terms of renewal or purchase options and escalation clauses; and**

(iii) **Restrictions imposed by lease arrangements, such as those concerning return of surplus, return of capital contributions, dividends or similar distributions, additional debt, and further leasing.**

RDR 40.1 **A Tier 2 entity is not required to disclose the present value of future minimum lease payments at the reporting date in accordance with paragraph 40(c).**

41. In addition, the requirements for disclosure in accordance with PBE IPSAS 16, PBE IPSAS 17, PBE IPSAS 21, PBE IPSAS 26, and PBE IPSAS 31 that have been adopted by the entity are applied to the amounts of leased assets under finance leases that are accounted for by the lessee as acquisitions of assets.

Operating Leases

42. **Lease payments under an operating lease shall be recognised as an expense on a straight-line basis over the lease term, unless another systematic basis is representative of the time pattern of the user's benefit.**

43. For operating leases, lease payments (excluding costs for services such as insurance and maintenance) are recognised as an expense on a straight-line basis, unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis.

44. **Lessees shall disclose the following for operating leases:**

(a) **The total of future minimum lease payments under non-cancellable operating leases for each of the following periods:**

(i) **Not later than one year;**

(ii) **Later than one year and not later than five years; and**

(iii) **Later than five years;**

*(b) **The total of future minimum sublease payments expected to be received under non-cancellable subleases at the reporting date;**

(c) **Lease and sublease payments recognised as an expense in the period, with separate amounts for minimum lease payments, contingent rents, and sublease payments; and**

(d) **A general description of the lessee's significant leasing arrangements including, but not limited to, the following:**

(i) **The basis on which contingent rent payments are determined;**

(ii) **The existence and terms of renewal or purchase options and escalation clauses; and**

(iii) **Restrictions imposed by lease arrangements, such as those concerning return of surplus, return of capital contributions, dividends or similar distributions, additional debt, and further leasing.**

RDR 44.1 **A Tier 2 entity is not required to disclose separate amounts for minimum lease payments, contingent rents and sublease payments in accordance with paragraph 44(c).**

Leases in the Financial Statements of Lessors

Finance Leases

45. This Standard describes the treatment of finance revenue earned under finance leases. The term "manufacturer or trader lessor" is used in this Standard to refer to all entities that manufacture or trade assets and also act as lessors of those assets, regardless of the scale of their leasing, trading, and manufacturing activities. With respect to an entity that is a manufacturer or trader lessor, the Standard also describes the treatment of gains or losses arising from the transfer of assets.

46. Entities may enter into finance leases as a lessor under a variety of circumstances. Some public sector entities may trade assets on a regular basis. For example, governments may create special purpose entities that are responsible for the central procurement of assets and supplies for all other entities. Centralisation of the purchasing function may provide greater opportunity to obtain trade discounts or other favourable conditions. In some jurisdictions, a central purchasing entity may purchase items on behalf of other entities, with all transactions being conducted in the name of the other entities. In other jurisdictions, a central purchasing entity may purchase items in its own name, and its functions may include:

(a) Procuring assets and supplies;

(b) Transferring assets by way of sale or finance lease; and/or

(c) Managing a portfolio of assets, such as a motor vehicle fleet, for use by other entities, and making those assets available for short or long-term lease, or purchase.

47. Other entities may enter into lease transactions on a more limited scale and at less frequent intervals. In particular, in some jurisdictions, public sector entities that have traditionally owned and operated infrastructure assets such as roads, dams, and water treatment plants are no longer automatically assuming complete ownership and operational responsibility for these assets. Public sector entities may transfer existing infrastructure assets to public or private sector entities by way of sale or by way of finance lease. In addition, public sector entities may construct new long-lived physical and infrastructure assets in partnership with other entities, with the intention that the other entity will assume responsibility for the assets by way of outright purchase or by way of finance lease once they are completed. In some cases, the arrangement provides for a period of control by the private sector before reversion of title and control of the asset to the public sector – for example, a local government may build a hospital and lease the facility to a not-for-profit entity for a period of twenty years, after which time the facility reverts to public control.

48. **Lessors shall recognise lease payments receivable under a finance lease as assets in their statements of financial position. They shall present such assets as a receivable at an amount equal to the net investment in the lease.**

49. Under a finance lease, substantially all the risks and rewards incidental to legal ownership are transferred by the lessor, and thus the lease payment receivable is treated by the lessor as repayment of principal and finance revenue to reimburse and reward the lessor for its investment and services.

Initial Recognition

50. Initial direct costs are often incurred by lessors, and include amounts such as commissions, legal fees, and internal costs that are incremental and directly attributable to negotiating and arranging a lease. They exclude general overheads, such as those incurred by a sales and marketing team. For finance leases other than those involving manufacturer or trader lessors, initial direct costs are included in the initial

measurement of the finance lease receivable, and reduce the amount of revenue recognised 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 finance lease receivable; there is no need to add them separately. Costs incurred by manufacturer or trader lessors in connection with negotiating and arranging a lease are excluded from the definition of initial direct costs. As a result, they are excluded from the net investment in the lease, and are recognised as an expense when the gain or loss on sale is recognised, which for a finance lease is normally at the commencement of the lease term.

51. **The recognition of finance revenue shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease.**

52. A lessor aims to allocate finance revenue over the lease term on a systematic and rational basis. This revenue allocation is based on a pattern reflecting a constant periodic return on the lessor's net investment in the finance lease. Lease payments relating to the accounting period, excluding costs for services, are applied against the gross investment in the lease to reduce both the principal and the unearned finance revenue.

53. Estimated unguaranteed residual values used in computing the lessor's gross investment in a lease are reviewed regularly. If there has been a reduction in the estimated unguaranteed residual value, the revenue allocation over the lease term is revised, and any reduction in respect of amounts already accrued is recognised immediately.

53.1 An asset under a finance lease that is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with PBE IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* shall be accounted for in accordance with that Standard.

54. **Manufacturer or trader lessors shall recognise gains or losses on sale of assets in the period, in accordance with the policy followed by the entity for outright sales.**

55. **If artificially low rates of interest are quoted, any gains or losses on sale of assets shall be restricted to what would apply if a market rate of interest were charged. Costs incurred by manufacturer or trader lessors in connection with negotiating and arranging a lease shall be recognised as an expense when the gain or loss is recognised.**

56. Entities that manufacture or trade assets may offer to potential purchasers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or trader lessor gives rise to two types of revenue:

(a) The gain or loss equivalent to the gain or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts; and

(b) The finance revenue over the lease term.

57. The sales revenue recognised at the commencement of the lease term by a manufacturer or trader lessor is the fair value of the asset or, if lower, the present value of the minimum lease payments accruing to the lessor, computed at a commercial rate of interest. The cost of sale of an asset recognised at the commencement of the lease term is the cost, or carrying amount if different, of the leased property, less the present value of the unguaranteed residual value. The difference between the sales revenue and the cost of sale is the gain or loss on sale that is recognised in accordance with the entity's policy for outright sales.

58. Manufacturer or trader lessors may sometimes offer customers lower rates of interest than their normal lending rates. The use of such a rate would result in an excessive portion of the total revenue from the transaction being recognised at the time of sale. If artificially low rates of interest are quoted, revenue recognised as gain or loss on sale is restricted to what would apply if the entity's normal lending rate for that type of transaction were charged.

59. Initial direct costs are recognised as an expense at the commencement of the lease term because they are mainly related to earning the manufacturer's or trader's gain or loss on sale.

60. **Lessors shall disclose the following for finance leases:**

(a) **A reconciliation between the total gross investment in the lease at the reporting date, and the present value of minimum lease payments receivable at the reporting date. In addition, an**

entity shall disclose the gross investment in the lease and the present value of minimum lease payments receivable at the reporting date, for each of the following periods:

(i) **Not later than one year;**

(ii) **Later than one year and not later than five years; and**

(iii) **Later than five years;**

(b) **Unearned finance revenue;**

(c) **The unguaranteed residual values accruing to the benefit of the lessor;**

(d) **The accumulated allowance for uncollectible minimum lease payments receivable;**

(e) **Contingent rents recognised as revenue in the period; and**

(f) **A general description of the lessor's material leasing arrangements.**

*61. As an indicator of growth in leasing activities, it is often useful to also disclose the gross investment less unearned revenue in new business added during the accounting period, after deducting the relevant amounts for cancelled leases.

Operating Leases

62. **Lessors shall present assets subject to operating leases in their statements of financial position according to the nature of the asset.**

63. **Lease revenue from operating leases shall be recognised as revenue on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which benefits derived from the leased asset is diminished.**

64. Costs, including depreciation, incurred in earning the lease revenue are recognised as an expense. Lease revenue (excluding receipts for services provided, such as insurance and maintenance) is recognised as revenue on a straight-line basis over the lease term, even if the receipts are not on such a basis, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.

65. **Initial direct costs incurred by lessors in negotiating and arranging an operating lease shall be added to the carrying amount of the leased asset, and recognised as an expense over the lease term on the same basis as the lease revenue.**

66. **The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets, and depreciation shall be calculated in accordance with PBE IPSAS 17 or PBE IPSAS 31, as appropriate.**

67. To determine whether a leased asset has become impaired, an entity applies relevant impairment tests in PBE IPSAS 21 and PBE IPSAS 26.

68. A manufacturer or trader lessor does not recognise any gain on sale on entering into an operating lease because it is not the equivalent of a sale.

69. **Lessors shall disclose the following for operating leases:**

(a) **The future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods:**

(i) **Not later than one year;**

(ii) **Later than one year and not later than five years; and**

(iii) **Later than five years;**

(b) **Total contingent rents recognised as revenue in the period; and**

(c) **A general description of the lessor's leasing arrangements.**

RDR 69.1 **A Tier 2 entity is not required to disclose future minimum lease payments under non-cancellable operating leases in the aggregate in accordance with paragraph 69(a).**

Sale and Leaseback Transactions

70. A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The lease payment and the sale price are usually interdependent, because they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends upon the type of lease involved.

71. **If a sale and leaseback transaction results in a finance lease, any excess of sales proceeds over the carrying amount shall not be immediately recognised as revenue by a seller-lessee. Instead, it shall be deferred and amortised over the lease term.**

72. If the leaseback is a finance lease, the transaction is a means whereby the lessor provides finance to the lessee, with the asset as security. For this reason, it is not appropriate to regard an excess of sales proceeds over the carrying amount as revenue. Such excess is deferred and amortised over the lease term.

73. **If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any gain or loss shall be recognised immediately. If the sale price is below fair value, any gain or loss shall be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it shall be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value shall be deferred and amortised over the period for which the asset is expected to be used.**

74. If the leaseback is an operating lease, and the lease payments and the sale price are at fair value, there has in effect been a normal sale transaction and any gain or loss is recognised immediately.

75. **For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value shall be recognised immediately.**

76. For finance leases, no such adjustment is necessary unless (a) there has been an impairment in value, and (b) that impairment is required to be recognised by any international and/or national accounting standard on impairment that has been adopted by the entity.

77. Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of the material leasing arrangements leads to disclosure of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.

78. Sale and leaseback transactions may be required to be separately disclosed in accordance with PBE IPSAS 1 *Presentation of Financial Reports*.

Transitional Provisions

79–84A. [Not used]

Effective Date

85–86. [Not used]

86.1 **A public benefit entity shall apply this Standard for annual financial statements covering periods beginning on or after 1 April 2015. Earlier application is permitted for not-for-profit public benefit entities as long as the full suite of PBE Standards is applied at the same time.**

86.2 ***2016 Omnibus Amendments to PBE Standards,* issued in January 2017, amended paragraph B6 and added a footnote to paragraph 21. An entity shall apply those amendments for annual financial statements covering periods beginning on or after 1 January 2017.**

86.3 ***2016 Omnibus Amendments to PBE Standards,* issued in January 2017, amended paragraph 2. An entity shall apply those amendments for annual financial statements covering periods beginning on or after 1 January 2018. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.**

86.4 [See PBE IFRS 9 *Financial Instruments*.]

Withdrawal and Replacement of PBE IPSAS 13 (May 2013)

87. This Standard, when applied, supersedes PBE IPSAS 13 *Leases* issued in May 2013.

Appendix A

Application Guidance *Operating Leases—Incentives*

This Appendix is an integral part of PBE IPSAS 13

Issue

A1. In negotiating a new or renewed operating lease, the lessor may provide incentives for the lessee to enter into the agreement. Examples of such incentives are an up-front cash payment to the lessee or the reimbursement or assumption by the lessor of costs of the lessee (such as relocation costs, leasehold improvements and costs associated with a pre-existing lease commitment of the lessee). Alternatively, initial periods of the lease term may be agreed to be rent-free or at a reduced rent.

A2. The issue is how incentives in an operating lease should be recognised in the financial statements of both the lessee and the lessor.

Consensus

A3. All incentives for the agreement of a new or renewed operating lease shall be recognised as an integral part of the net consideration agreed for the use of the leased asset, irrespective of the incentive's nature or form or the timing of payments.

A4. The lessor shall recognise the aggregate cost of incentives as a reduction of rental income over the lease term, on a straight-line basis unless another systematic basis is representative of the time pattern over which the benefit of the leased asset is diminished.

A5. The lessee shall recognise the aggregate benefit of incentives as a reduction of rental expense over the lease term, on a straight-line basis unless another systematic basis is representative of the time pattern of the lessee's benefit from the use of the leased asset.

A6. Costs incurred by the lessee, including costs in connection with a pre-existing lease (for example costs for termination, relocation or leasehold improvements), shall be accounted for by the lessee in accordance with the PBE Standards applicable to those costs, including costs which are effectively reimbursed through an incentive arrangement.

Appendix B

Application Guidance *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*

This Appendix is an integral part of PBE IPSAS 13

Issue

B1. An entity may enter into a transaction or a series of structured transactions (an arrangement) with an unrelated party or parties (an Investor) that involves the legal form of a lease. For example, an entity may lease assets to an Investor and lease the same assets back, or alternatively, legally sell assets and lease the same assets back. The form of each arrangement and its terms and conditions can vary significantly. In the lease and leaseback example, it may be that the arrangement is designed to achieve a tax advantage for the Investor that is shared with the entity in the form of a fee, and not to convey the right to use an asset.

B2. When an arrangement with an Investor involves the legal form of a lease, the issues are:

(a) How to determine whether a series of transactions is linked and should be accounted for as one transaction;

(b) Whether the arrangement meets the definition of a lease under this Appendix; and, if not,

(i) Whether a separate investment account and lease payment obligations that might exist represent assets and liabilities of the entity;

(ii) How the entity should account for other obligations resulting from the arrangement; and

(iii) How the entity should account for a fee it might receive from an Investor.

Consensus

B3. A series of transactions that involve the legal form of a lease is linked and shall be accounted for as one transaction when the overall economic effect cannot be understood without reference to the series of transactions as a whole. This is the case, for example, when the series of transactions are closely interrelated, negotiated as a single transaction, and takes place concurrently or in a continuous sequence.

B4. The accounting shall reflect the substance of the arrangement. All aspects and implications of an arrangement shall be evaluated to determine its substance, with weight given to those aspects and implications that have an economic effect.

B5. This Standard applies when the substance of an arrangement includes the conveyance of the right to use an asset for an agreed period of time. Indicators that individually demonstrate that an arrangement may not, in substance, involve a lease under this Standard include:

(a) An entity retains all the risks and rewards incident to ownership of an underlying asset and enjoys substantially the same rights to its use as before the arrangement;

(b) The primary reason for the arrangement is to achieve a particular tax result, and not to convey the right to use an asset; and

(c) An option is included on terms that make its exercise almost certain (e.g., a put option that is exercisable at a price sufficiently higher than the expected fair value when it becomes exercisable).

B6. The definitions and guidance in the *Public Benefit Entities' Conceptual Framework* shall be applied in determining whether, in substance, a separate investment account and lease payment obligations represent assets and liabilities of the entity. Indicators that collectively demonstrate that, in substance, a separate investment account and lease payment obligations do not meet the definitions of an asset and a liability and shall not be recognised by the entity include:

(a) The entity is not able to control the investment account in pursuit of its own objectives and is not obligated to pay the lease payments. This occurs when, for example, a prepaid amount is placed in a separate investment account to protect the Investor and may only be used to pay the Investor, the Investor agrees that the lease payment obligations are to be paid from funds in the investment account, and the entity has no ability to withhold payments to the Investor from the investment account;

(b) The entity has only a remote risk of reimbursing the entire amount of any fee received from an Investor and possibly paying some additional amount, or, when a fee has not been received, only a remote risk of paying an amount under other obligations (e.g., a guarantee). Only a remote risk of payment exists when, for example, the terms of the arrangement require that a prepaid amount is invested in risk-free assets that are expected to generate sufficient cash flows to satisfy the lease payment obligations; and

(c) Other than the initial cash flows at inception of the arrangement, the only cash flows expected under the arrangement are the lease payments that are satisfied solely from funds withdrawn from the separate investment account established with the initial cash flows.

B7. Other obligations of an arrangement, including any guarantees provided and obligations incurred upon early termination, shall be accounted for under this Standard, PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*, PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* or PBE IFRS 4 *Insurance Contracts*, depending on the terms.

B8. The criteria in paragraph 19 of PBE IPSAS 9 shall be applied to the facts and circumstances of each arrangement in determining when to recognise a fee as income that an entity might receive. Factors such as whether there is continuing involvement in the form of significant future performance obligations necessary to earn the fee, whether there are retained risks, the terms of any guarantee arrangements, and the risk of repayment of the fee, shall be considered. Indicators that individually demonstrate that recognition of the entire fee as income when received, if received at the beginning of the arrangement, is inappropriate include:

(a) Obligations either to perform or to refrain from certain significant activities are conditions of earning the fee received, and therefore execution of a legally binding arrangement is not the most significant act required by the arrangement;

(b) Limitations are put on the use of the underlying asset that have the practical effect of restricting and significantly changing the entity's ability to use (e.g., deplete, sell or pledge as collateral) the asset;

(c) The possibility of reimbursing any amount of the fee and possibly paying some additional amount is not remote. This occurs when, for example,

(i) The underlying asset is not a specialised asset that is required by the entity to conduct its business, and therefore there is a possibility that the entity may pay an amount to terminate the arrangement early; or

(ii) The entity is required by the terms of the arrangement, or has some or total discretion, to invest a prepaid amount in assets carrying more than an insignificant amount of risk (e.g., currency, interest rate or credit risk). In this circumstance, the risk of the investment's value being insufficient to satisfy the lease payment obligations is not remote, and therefore there is a possibility that the entity may be required to pay some amount.

B9. The fee shall be presented in the statement of comprehensive revenue and expense based on its economic substance and nature.

Disclosure

*B10. All aspects of an arrangement that does not, in substance, involve a lease under this Standard shall be considered in determining the appropriate disclosures that are necessary to understand the arrangement and the accounting treatment adopted. An entity shall disclose the following in each period that an arrangement exists:

(a) A description of the arrangement including:

(i) The underlying asset and any restrictions on its use;

(ii) The life and other significant terms of the arrangement;

(iii) The transactions that are linked together, including any options; and

(b) The accounting treatment applied to any fee received, the amount recognised as income in the period, and the line item of the statement of comprehensive revenue and expense in which it is included.

*B11 The disclosures required in accordance with paragraph 10 of this Appendix shall be provided individually for each arrangement or in aggregate for each class of arrangement. A class is a grouping of arrangements with underlying assets of a similar nature (e.g., power plants).

Appendix C

Application Guidance *Determining Whether an Arrangement Contains a Lease*

This Appendix is an integral part of PBE IPSAS 13

Background

C1. An entity may enter into an arrangement, comprising a transaction or a series of related transactions, that does not take the legal form of a lease but conveys a right to use an asset (e.g., an item of property, plant or equipment) in return for a payment or series of payments. Examples of arrangements in which one entity (the supplier) may convey such a right to use an asset to another entity (the purchaser), often together with related services, include:

(a) Outsourcing arrangements (e.g., the outsourcing of the data processing functions of an entity).

(b) Arrangements in the telecommunications industry, in which suppliers of network capacity enter into contracts to provide purchasers with rights to capacity.

(c) Take-or-pay and similar contracts, in which purchasers must make specified payments regardless of whether they take delivery of the contracted products or services (e.g., a take-or-pay contract to acquire substantially all of the output of a supplier's power generator).

C2. This Appendix provides guidance for determining whether such arrangements are, or contain, leases that should be accounted for in accordance with this Standard. It does not provide guidance for determining how such a lease should be classified under this Standard.

C3. In some arrangements, the underlying asset that is the subject of the lease is a portion of a larger asset. This Appendix does not address how to determine when a portion of a larger asset is itself the underlying asset for the purposes of applying this Standard. Nevertheless, arrangements in which the underlying asset would represent a unit of account in either PBE IPSAS 17 or PBE IPSAS 31 are within the scope of this Appendix.

Scope

C4. This Appendix does not apply to arrangements that:

(a) Are, or contain, leases excluded from the scope of this Standard; or

(b) Are public-to-private service concession arrangements within the scope of PBE IPSAS 32.

Issues

C5. The issues addressed in this Appendix are:

(a) How to determine whether an arrangement is, or contains, a lease as defined in this Standard;

(b) When the assessment or a reassessment of whether an arrangement is, or contains, a lease should be made; and

(c) If an arrangement is, or contains, a lease, how the payments for the lease should be separated from payments for any other elements in the arrangement.

Consensus

Determining Whether an Arrangement is, or Contains, a Lease

C6. Determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement and requires an assessment of whether:

(a) Fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and

(b) The arrangement conveys a right to use the asset.

Fulfilment of the Arrangement is Dependent on the Use of a Specific Asset

C7. Although a specific asset may be explicitly identified in an arrangement, it is not the subject of a lease if fulfilment of the arrangement is not dependent on the use of the specified asset. For example, if the supplier is obliged to deliver a specified quantity of goods or services and has the right and ability to provide those goods or services using other assets not specified in the arrangement, then fulfilment of the arrangement is not dependent on the specified asset and the arrangement does not contain a lease. A warranty obligation that permits or requires the substitution of the same or similar assets when the specified asset is not operating properly does not preclude lease treatment. In addition, a contractual provision (contingent or otherwise) permitting or requiring the supplier to substitute other assets for any reason on or after a specified date does not preclude lease treatment before the date of substitution.

C8. An asset has been implicitly specified if, for example, the supplier owns or leases only one asset with which to fulfil the obligation and it is not economically feasible or practicable for the supplier to perform its obligation through the use of alternative assets.

Arrangement Conveys a Right to Use the Asset

C9. An arrangement conveys the right to use the asset if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying asset. The right to control the use of the underlying asset is conveyed if any one of the following conditions is met:

(a) The purchaser has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.

(b) The purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.

(c) Facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than an insignificant amount of the output or other utility that will be produced or generated by the asset during the term of the arrangement, and the price that the purchaser will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output.

Assessing or Reassessing Whether an Arrangement is, or Contains, a Lease

C10. The assessment of whether an arrangement contains a lease shall be made at the inception of the arrangement, being the earlier of the date of the arrangement and the date of commitment by the parties to the principal terms of the arrangement, on the basis of all of the facts and circumstances. A reassessment of whether the arrangement contains a lease after the inception of the arrangement shall be made only if any one of the following conditions is met:

(a) There is a change in the contractual terms, unless the change only renews or extends the arrangement.

(b) A renewal option is exercised or an extension is agreed to by the parties to the arrangement, unless the term of the renewal or extension had initially been included in the lease term in accordance with paragraph 8 of this Standard. A renewal or extension of the arrangement that does not include modification of any of the terms in the original arrangement before the end of the term of the original arrangement shall be evaluated under paragraphs C6–C9 of this Appendix only with respect to the renewal or extension period.

(c) There is a change in the determination of whether fulfilment is dependent on a specified asset.

(d) There is a substantial change to the asset, for example a substantial physical change to property, plant or equipment.

C11. A reassessment of an arrangement shall be based on the facts and circumstances as of the date of reassessment, including the remaining term of the arrangement. Changes in estimate (for example, the estimated amount of output to be delivered to the purchaser or other potential purchasers) would not trigger a reassessment. If an arrangement is reassessed and is determined to contain a lease (or not to contain a lease), lease accounting shall be applied (or cease to apply) from:

(a) In the case of (a), (c) or (d) in paragraph C10 of this Appendix, when the change in circumstances giving rise to the reassessment occurs;

(b) In the case of (b) in paragraph C10, the inception of the renewal or extension period.

Separating Payments for the Lease from Other Payments

C12. If an arrangement contains a lease, the parties to the arrangement shall apply the requirements of this Standard to the lease element of the arrangement, unless exempted from those requirements in accordance with paragraph 2 of this Standard. Accordingly, if an arrangement contains a lease, that lease shall be classified as a finance lease or an operating lease in accordance with paragraphs 12–24 of this Standard. Other elements of the arrangement not within the scope of this Standard shall be accounted for in accordance with other PBE Standards.

C13. For the purpose of applying the requirements of this Standard, payments and other consideration required by the arrangement shall be separated at the inception of the arrangement or upon a reassessment of the arrangement into those for the lease and those for other elements on the basis of their relative fair values. The minimum lease payments as defined in paragraph 8 of this Standard include only payments for the lease (i.e., the right to use the asset) and exclude payments for other elements in the arrangement (e.g., for services and the cost of inputs).

C14. In some cases, separating the payments for the lease from payments for other elements in the arrangement will require the purchaser to use an estimation technique. For example, a purchaser may estimate the lease payments by reference to a lease agreement for a comparable asset that contains no other elements, or by estimating the payments for the other elements in the arrangement by reference to comparable agreements and then deducting these payments from the total payments under the arrangement.

C15. If a purchaser concludes that it is impracticable to separate the payments reliably, it shall:

(a) In the case of a finance lease, recognise an asset and a liability at an amount equal to the fair value of the underlying asset that was identified in paragraphs C7 and C8 of this Appendix as the subject of the lease. Subsequently the liability shall be reduced as payments are made and an imputed finance charge on the liability recognised using the purchaser's incremental borrowing rate of interest.[2]

(b) In the case of an operating lease, treat all payments under the arrangement as lease payments for the purposes of complying with the disclosure requirements of this Standard, but

(i) Disclose those payments separately from minimum lease payments of other arrangements that do not include payments for non-lease elements, and

(ii) State that the disclosed payments also include payments for non-lease elements in the arrangement.

[2] i.e., the lessee's incremental borrowing rate of interest as defined in paragraph 8 of PBE IPSAS 13

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, PBE IPSAS 13.

BC1. The New Zealand Accounting Standards Board (NZASB) has modified IPSAS 13 *Leases* for application by Tier 1 and Tier 2 public benefit entities. Where applicable, disclosure concessions have been identified for Tier 2 entities and the language generalised for use by public benefit entities. The NZASB considered that the requirements of IPSAS 13 are generally appropriate for application by public benefit entities.

Integral Guidance

BC2. The NZASB considered that the certain lease-related IFRS interpretations forming part of NZ IFRSs should be included in PBE IPSAS 13. The NZASB determined that it was important that entities applying PBE Standards can continue to apply the guidance in NZ SIC-15 *Operating Leases—Incentives*, NZ SIC-27 *Evaluation the Substance of Transactions Involving the Legal Form of a Lease* and NZ IFRIC 4 *Determining whether an Arrangement contains a Lease.* These interpretations have therefore been included as integral Appendices A, B and C in PBE IPSAS 13.

Implementation Guidance

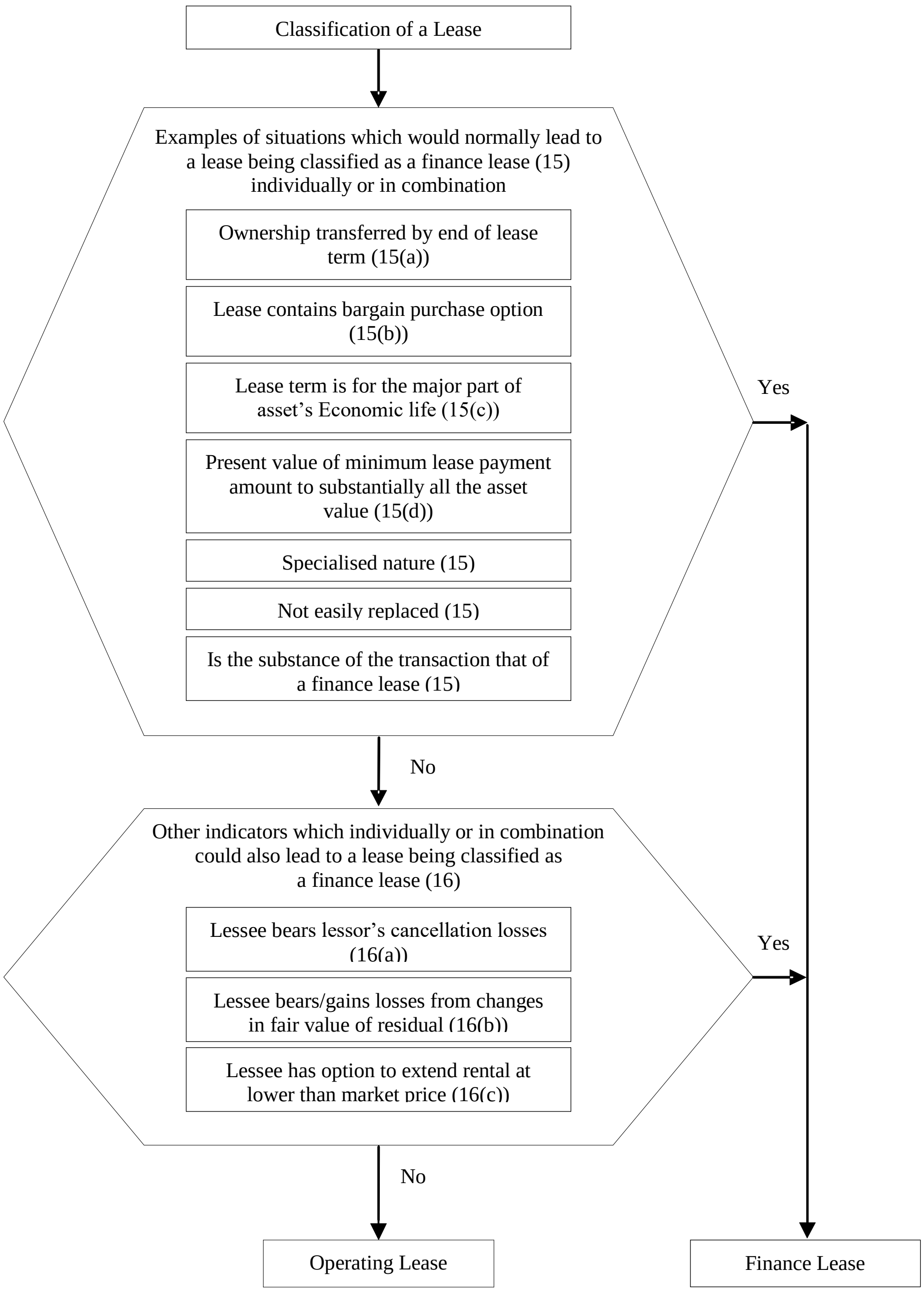
This guidance accompanies, but is not part of, PBE IPSAS 13.

Classification of a Lease

IG1. The objective of the chart on the next page is to assist in classifying a lease as either a finance lease or an operating lease. A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. An operating lease is a lease other than a finance lease.

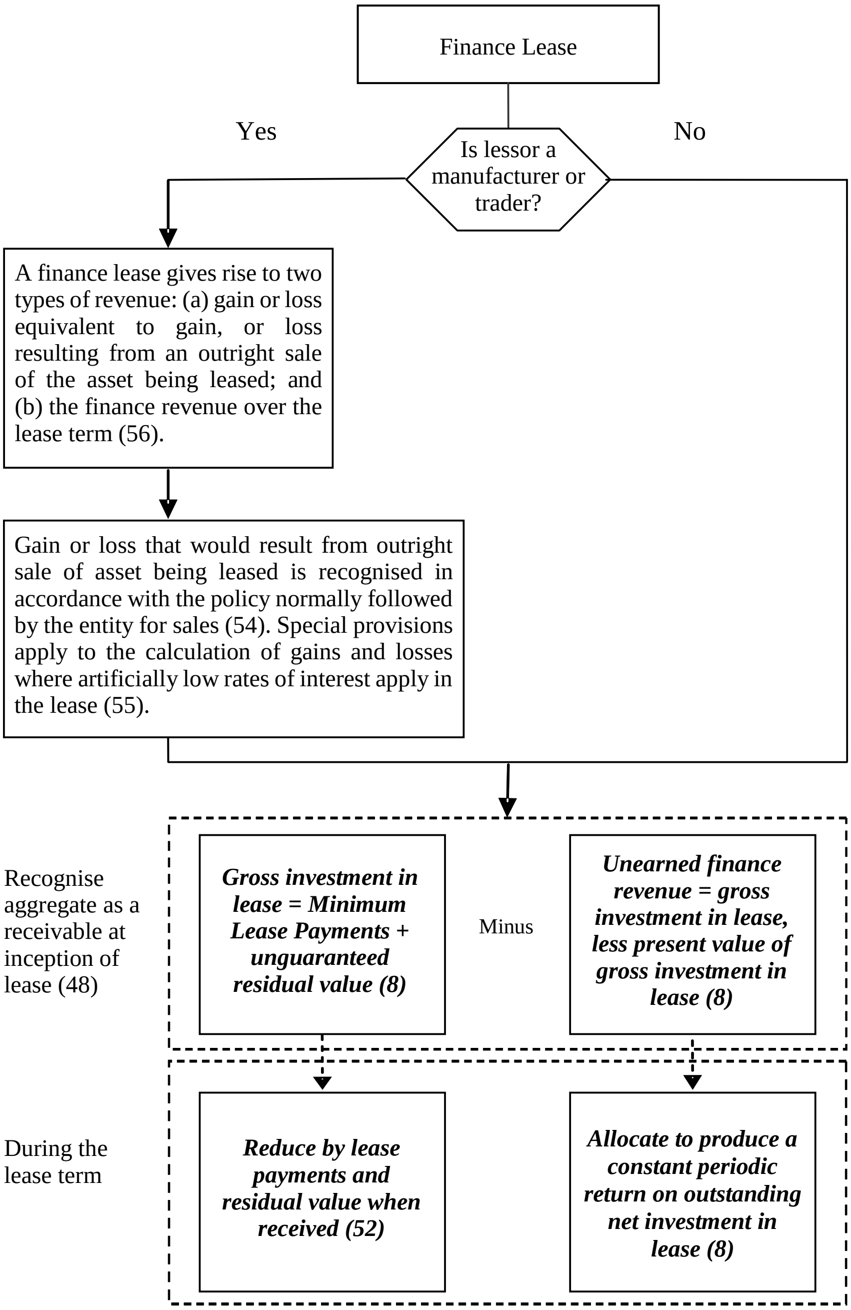
IG2. The examples contained in this chart do not necessarily reflect all possible situations in which a lease may be classified as a finance lease, nor should a lease necessarily be classified as a finance lease by virtue of the route followed in this chart. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract (paragraph 15).

IG3. In the flowchart, the numbers in parentheses refer to paragraph numbers in this Standard.



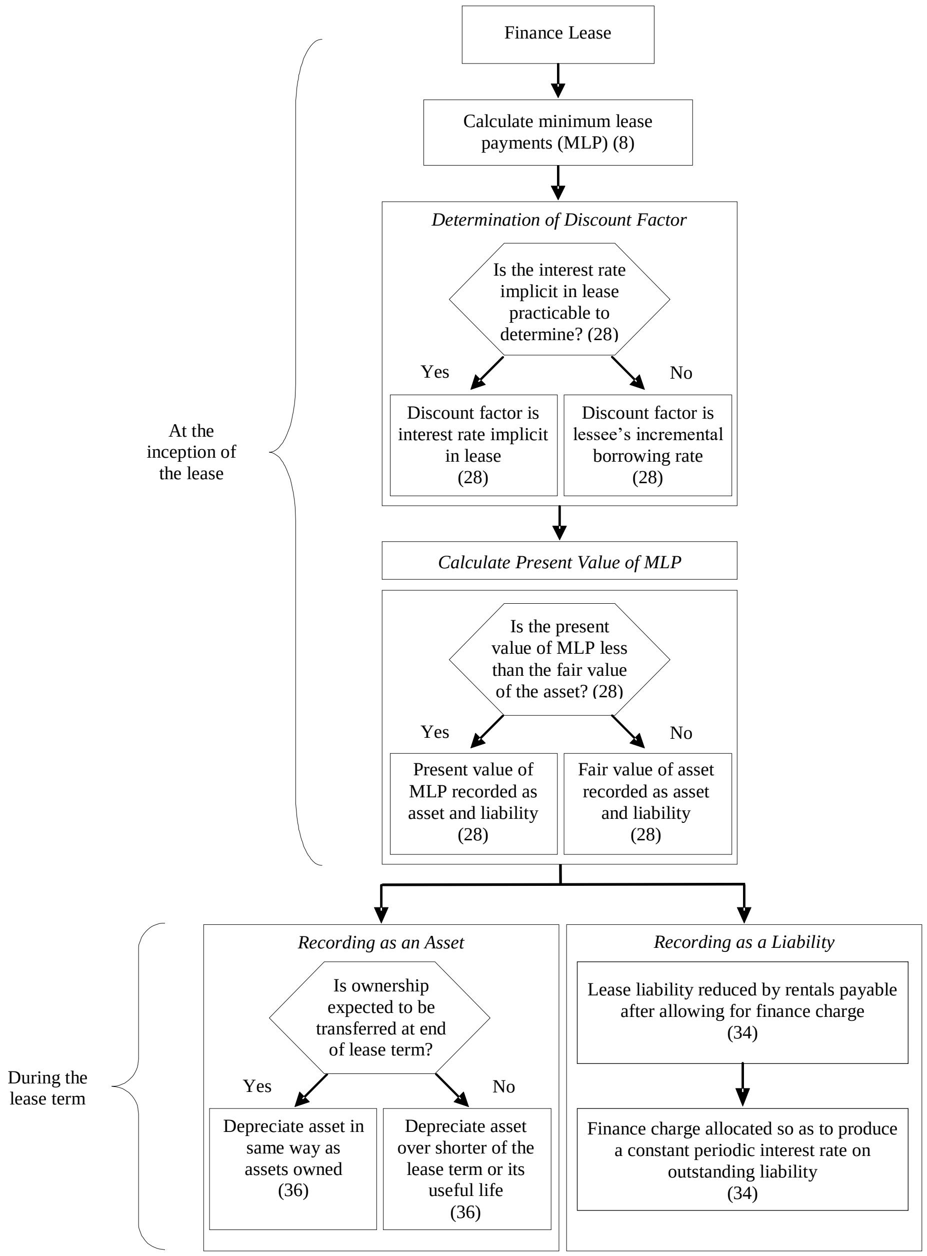
Accounting for a Finance Lease by a Lessor

IG4. In the flowchart, the numbers in parentheses refer to paragraph numbers in the Standard.



Accounting for a Finance Lease by a Lessee

IG5. In the flowchart, the numbers in parentheses refer to paragraph numbers in the Standard.



Sale and Leaseback Transactions that Result in Operating Leases

IG6. A sale and leaseback transaction that results in an operating lease may give rise to a gain or a loss, the determination and treatment of which depends upon the leased asset's carrying amount, fair value, and selling price. The table on the following page shows the requirements of this Standard in various circumstances.

Sale price established at fair value (paragraph 65)	**Carrying amount equal to fair value**	**Carrying amount less than fair value**	**Carrying amount above fair value**
Gain	no gain	recognise gain immediately	no gain
Loss	no loss	no loss	recognise loss immediately

Sale price below fair value (paragraph 65)	**Carrying amount equal to fair value**	**Carrying amount less than fair value**	**Carrying amount above fair value**
Gain	no gain	recognise gain immediately	no gain (note 1)
Loss not compensated by future lease payments at below market price	recognise loss immediately	recognise loss immediately	(note 1)
Loss compensated by future lease payments at below market price	defer and amortise loss	defer and amortise loss	(note 1)

Sale price above fair value (paragraph 65)	**Carrying amount equal to fair value**	**Carrying amount less than fair value**	**Carrying amount above fair value**
Gain	defer and amortise gain	defer and amortise gain (note 2)	defer and amortise gain (note 3)
Loss	no loss	no loss	(note 1)

Note 1 These parts of the table represent circumstances that would have been dealt with under paragraph 75 of this Standard. Paragraph 75 requires the carrying amount of an asset to be written down to fair value where it is subject to a sale and leaseback.

Note 2 If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used (paragraph 73).

Note 3 The gain would be the difference between fair value and sale price, as the carrying amount would have been written down to fair value in accordance with paragraph 75.

Calculating the Interest Rate Implicit in a Finance Lease

IG7. The Standard (paragraph 28) requires the lessees of assets acquired under finance leases to calculate the interest rate implicit in a lease, where practical. Paragraph 34 requires the lessees to apportion lease payments between the finance charge and the reduction of the outstanding liability, using the interest rate implicit in the lease. Many lease agreements explicitly identify the interest rate implicit in the lease, but some do not. If a lease agreement does not identify the interest rate implicit in the lease the lessee needs to calculate the rate, using the present value formula. Financial calculators and spreadsheets will automatically calculate the interest rate implicit in a lease. Where these are not available, entities can use the present value formula to manually calculate the rate. This guidance illustrates the following two common methods for calculating the interest rate: trial and error, and interpolation. Both methods use the present value formula to derive the interest rate.

IG8. Derivations of present value formulas are widely available in accounting and finance textbooks. The present value (PV) of minimum lease payments (MLP) is calculated by means of the following formula:

$$PV(MLP) = \frac{S}{(1+r)^n} + \frac{A}{r}\left[1 - \frac{1}{(1+r)^n}\right]$$

Where:

"S" is the guaranteed residual value

"A" is the regular periodical payment

"r" is the periodic interest rate implicit in the lease expressed as a decimal

"n" is the number of periods in the term of the lease

Example

IG8. Entity X enters into an agreement to acquire a motor vehicle on a finance lease. The fair value of the motor vehicle at the inception of the lease is 25,000 currency units; the annual lease payments are 5,429 currency units payable in arrears; the lease term is four years; and the guaranteed residual value is 10,000 currency units. The lease agreement does not provide for any services additional to the supply of the motor vehicle. Entity X is responsible for all the running costs of the vehicle, including insurance, fuel, and maintenance. The lease agreement does not specify the interest rate implicit in the lease. The Entity's incremental borrowing rate is 7% per annum. Several financial institutions are advertising loans secured by motor vehicles at rates varying between 7.5% and 10%.

Trial and Error Method

IG9. The calculation is an iterative process – that is, the lessee must make a "best guess" of the interest rate and calculate the present value of the minimum lease payments and compare the result to the fair value of the leased asset at the inception of the lease. If the result is less than the fair value, the interest rate selected was too high; if the result is greater than the fair value, the interest rate selected was too low. The interest rate implicit in a lease is the rate used when the present value of the minimum lease payments is equal to the fair value of the leased asset at the inception of the lease.

IG10. Entity X would begin calculations using a best estimate – for example its incremental borrowing rate of 7% per annum, which is too low. It would then use the maximum feasible rate – for example the 10% per annum rate offered for loans secured by a motor vehicle, which would prove too high. After several calculations, it would arrive at the correct rate of 8.5% per annum.

IG11. To calculate the interest rate, the Entity uses the PV(MLP) formula above, where:

S = 10,000 n = 4 r = Annual interest rate expressed as a decimal

A = 5,429 Target PV(MLP) = 25,000

IG12. At Entity X's incremental borrowing rate of 7% (0.07) per annum (figures are rounded):

$$PV(MLP) = \frac{10{,}000}{(1+0.07)^4} + \frac{5{,}429}{0.07}\left[1 - \frac{1}{(1+0.07)^4}\right]$$

= 7,629 + 18,390

= 26,019

IG13. The PV(MLP) using the incremental borrowing rate is greater than the fair value of the leased asset, therefore a higher rate is implicit in the lease. The Entity must make calculations at other rates to determine the actual rate (figures are rounded):

PV(MLP) at 7.5%	= 25,673	Interest rate too low
PV(MLP) at 10%	= 24,040	Interest rate too high
PV(MLP) at 9%	= 24,674	Interest rate too high
PV(MLP) at 8%	= 25,333	Interest rate too low
PV(MLP) at 8.5%	= 25,000	Correct interest rate

IG14. The Entity will now use the interest rate of 8.5% to apportion the lease payments between the finance charge and the reduction of the lease liability, as shown in the table below.

Interpolation Method

IG15. Calculating the interest rate implicit in a lease requires lessees to initially calculate the present value for an interest rate that is too high, and one that is too low. The differences (in absolute terms) between the results obtained and the actual net present value are used to interpolate the correct interest rate. Using the data provided above, and the results for 7% and 10%, the actual rate can be interpolated as follows (figures are rounded):

PV at 7% = 26,019, difference = 1,019 (i.e., 26,019 – 25,000)

PV at 10% = 24,040, difference = 960 (i.e., 24,040 – 25,000)

$$r = 7\% + (10\% - 7\%)\frac{1{,}019}{(1{,}019 + 960)}$$

$= \quad 7\% + (3\% \times 0.5)$

$= \quad 7\% + 1.5\%$

$= \quad 8.5\%$

IG16. Entity X will now use the interest rate of 8.5% to record the lease in its books and apportion the lease payments between the finance charge and the reduction of the lease liability, as shown in the table below.

Apportionment of Lease Payment (figures are rounded)

	Year 0	**Year 1**	**Year 2**	**Year 3**	**Year 4**
Opening PV of Lease Liability	25,000	25,000	21,696	18,110	14,221
Interest Expense	–	2,125	1,844	1,539	1,209
Reduction of Liability	–	3,304	3,585	3,890	14,221*
Closing Lease Liability	25,000	21,696	18,110	14,221	–

* Includes payment of guaranteed residual value.

Comparison with IPSAS 13

PBE IPSAS 13 *Leases* is drawn from IPSAS 13 *Leases.*

The significant differences between PBE IPSAS 13 and IPSAS 13 are:

(a) Three interpretations that formed part of NZ IFRSs have been included as integral guidance in PBE IPSAS 13. These three interpretations are:

   (i) NZ SIC-15 *Operating Leases—Incentives;*

   (ii) NZ SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease;* and

   (iii) NZ IFRIC 4 *Determining whether an Arrangement contains a Lease.*

(b) PBE Standards require the presentation of a statement of comprehensive revenue and expense. IPSASs require the presentation of a statement of financial performance.

History of Amendments

PBE IPSAS 13 *Leases* was issued in September 2014.

This table lists the pronouncements establishing and substantially amending PBE IPSAS 13. The table is based on amendments issued as at 31 January 2020 other than consequential amendments resulting from early adoption of PBE IFRS 9 *Financial Instruments*, PBE IPSAS 41 *Financial Instruments and* PBE IFRS 17 *Insurance Contracts*.

Pronouncements	**Date issued**	**Early operative date**	**Effective date (annual financial statements … on or after …)**
PBE IPSAS 13 *Leases*	Sept 2014	Early application is permitted for not-for-profit public benefit entities	1 April 2015
2016 Omnibus Amendments to PBE Standards	Jan 2017	Varies	Various: 1 Jan 2017 and 1 Jan 2018
PBE IFRS 9 *Financial Instruments*[1]	Jan 2017	Early application is permitted	1 Jan 2022
PBE FRS 48 *Service Performance Reporting*	Nov 2017	Early application is permitted	1 Jan 2021
PBE IPSAS 41 *Financial Instruments*[2]	Mar 2019	Early application is permitted	1 Jan 2022
PBE IFRS 17 *Insurance Contracts*[3]	July 2019	Early application is permitted	1 Jan 2022

Table of Amended Paragraphs in PBE IPSAS 13		
Paragraph affected	**How affected**	**By … [date]**
Paragraph 2	Amended	*2016 Omnibus Amendments to PBE Standards* [Jan 2017]
Paragraph 21	Amended	*2016 Omnibus Amendments to PBE Standards* [Jan 2017]
Paragraph 21	Amended	PBE FRS 48 [Nov 2017]
Paragraph 78	Amended	PBE FRS 48 [Nov 2017]
Paragraph 86.2	Added	*2016 Omnibus Amendments to PBE Standards* [Jan 2017]
Paragraph 86.3	Added	*2016 Omnibus Amendments to PBE Standards* [Jan 2017]
Paragraph B6	Amended	*2016 Omnibus Amendments to PBE Standards* [Jan 2017]

1 PBE IFRS 9 has not been compiled. PBE IFRS 9 is superseded by PBE IPSAS 41 and the effective date of PBE IFRS 9 has been changed to 1 January 2022.

2 PBE IPSAS 41 has not been compiled.

3 PBE IFRS 17 has not been compiled.