XRB | Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Board Meeting Agenda

In-person Meeting — Wednesday, 29 June 2022

Est Time	Item	Topic	Objective		Page
NON-PUBLIC SESSION					
10.30 am	Morning tea break				
12.30 pm	Lunch break				
PUBLIC SESSION					
2.30 pm	**7**	**PBE Leases**	(GS)		
40 min	7.1	Cover memo	Note	Paper	2
	7.2	Draft Consultation Document	Consider	Paper	12
	7.3	Draft ED – PBE IPSAS 43 *Leases*	Consider	Paper	27
	7.4	IPSAS 43 *Leases*	Note	Link	–
3.10 pm	**8**	**PIR of IFRS 10, 11 and 12 – project update**	(CB)		
15 min	8.1	Cover memo	Note	Paper	98
3.25 pm 20 min	Afternoon tea break				
3.45 pm	**9**	**IPSAS 44 *Non-current Assets Held for Sale and Discontinued Operations***	(CB/TB)		
20 min	9.1	Cover memo: Application of the PBE Policy Approach to IPSAS 44	Consider	Paper	103
	9.2	IPSAS 44 *Non-current Assets Held for Sale and Discontinued Operations*	Note	Link	–
4.05 pm 1 min	**10**	**Standards approved (by circular resolution)** (GS)	Note	Verbal	–
4.06 pm	**11**	**Audit fees paid to Audit Firms**			
15 min	11.1	Outreach Plan	Feedback	Verbal	–
NON-PUBLIC SESSION					
4.36 pm	*Finish*				

Next NZASB meeting: 11 August 2022 in Wellington

Date:	17 June 2022
To:	NZASB Members
From:	Gali Slyuzberg
Subject:	**PBE IPSAS 43 *Leases*: Draft ED and Consultation Document**

Purpose and introduction[1]

1. The purpose of this paper is to seek the Board's feedback on the *working draft* of the Exposure Draft (ED) PBE IPSAS 43 *Leases*, and the accompanying Consultation Document (previously known as 'Invitation to Comment').

2. The draft ED and Consultation Document reflect the Board's discussion at the April 2022 meeting in relation to New Zealand modifications to IPSAS 43 *Leases* – but some of the Board's decisions in April are yet to be incorporated into the draft ED.

3. We plan to seek the Board's approval to issue the finalised ED and Consultation Document at the August meeting.

Recommendation

4. We recommend that the Board provides FEEDBACK on the ED PBE IPSAS 43 *Leases* (agenda item 7.3) and the accompanying Consultation Document (agenda item 7.2).

Structure of this memo

5. This memo includes the following sections.

   (a) Background

   (b) Draft ED and Consultation Document

      (i) Modifications included in the ED (scope clarification, RDR concessions, effective date)

      (ii) Modifications and Consultation Document sections in progress (relevant paragraphs from NZ IFRS 15, low value leases)

      (iii) Other notes on the draft ED and Consultation Document (rationale for the proposals, discount rates)

   (c) Next steps (ED updates, consultation period and outreach plan)

[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

Background

6. In January 2022, the IPSASB issued IPSAS 43 *Leases*. The requirements in IPSAS 43 are based on ED 75 *Leases* and are substantially aligned with the requirements in IFRS 16 for both lessees and lessors. IPSAS 43 requires lessees to account for all leases (with limited exception) using the 'right-of-use' (ROU) model. The ROU model requires the recognition of a ROU asset with respect to the right to use the leased asset for a specified period of time, and a lease liability with respect to the future lease payments. For lessors, IPSAS 43 continues to distinguish between operating and finance leases consistent with IFRS 16.

7. The IPSASB has a separate (but related) project on *Concessionary Leases and Other Arrangements Similar to Leases*. The IPSASB published a Request for Information (RFI) on this topic in September 2022. The IPSASB expects to publish an ED on this topic in December 2022, with a final pronouncement expected in March 2024.

8. At its February 2022 meeting, the Board applied the PBE Policy Approach to IPSAS 43. The Board agreed that it should:

   (a) propose incorporating the requirements in IPSASB 43 into PBE Standards; and

   (b) commence the development of a domestic ED based on IPSAS 43 now – rather than delaying this work until after the IPSASB finishes the abovementioned project on concessionary leases.

9. At its April 2022 meeting, the Board agreed to propose certain New Zealand modification text of IPSAS 43 – to enhance the appropriateness and usefulness of this standard for New Zealand PBEs and the users of their financial statements. These modifications are mainly based on the points raised by the Board in its submission to the IPSASB on ED 75 *Leases*.

10. At this meeting, we are seeking the Board's feedback on the working draft of the ED and accompanying Consultation Document for public consultation.

Working drafts of the ED and Consultation Document

11. The working draft of the ED is based on IPSAS 43 *Leases*, with modifications to clarify the scope of the ED and RDR concessions, as explained in the paragraphs that follow. New Zealand modifications are highlighted in blue in the Working Draft of the ED (agenda item 7.3).

12. The paragraphs that follow also explain ED modifications that we are still working on, as well as other considerations that we have taken into account or are currently considering in the development of the ED and Consultation Document.

13. Please note that the 'Basis for Conclusions' and 'Amendments to Other PBE Standards' sections of the ED are currently incomplete, as we are still considering any modifications that may be needed to these sections to align them with PBE Standards terminology, standard names, and interaction with other PBE Standards. We have only included those Basis for Conclusions paragraphs and consequential amendments paragraphs that relate to the scope clarification described below.

Modifications included in the ED

Scope clarification with respect to concessionary leases

14. As agreed by the Board in April 2022, we have included the following modifications in the ED.

    (a) Modifications to the scope section of ED (paragraphs 4.1–4.2), to clarify that:

        (i) Concessionary leases that meet the definition of a lease and are within the scope of the standard (unless specifically excluded from the scope by the existing paragraph 3); and

        (ii) PBEs should *not* measure the 'concessionary portion' of their concessionary leases at fair value, and instead they are only required to account for the actual lease payments (i.e. the consideration paid).

    (b) An explanation in the Basis for Conclusions that:

        (i) there are currently no requirements in PBE Standards for the accounting for the 'concessionary component' of concessionary leases, or for lease-like arrangements for no consideration.

        (ii) the New Zealand-specific scope paragraphs above will be reconsidered when the IPSASB finalises its project on concessionary leases and other lease-like arrangements.

15. Consequential amendments to PBE IPSAS 23 *Revenue from Non-Exchange Transactions*: scope exclusion for leases within the scope of PBE IPSAS 43 and for arrangements where no consideration is paid for the right to use an asset over a specified term – and an explanation in the Basis for Conclusions that this will be reconsidered when the IPSASB finalises its project on concessionary leases and other lease-like arrangements.

RDR concessions

16. We have proposed RDR concessions for Tier 2 PBEs, based on the RDR concessions included in NZ IFRS 16 *Leases*. These concessions are in paragraphs 57, 61, 89(b), 90 and AG51–AG53.

Effective date

17. As agreed at the Board's April 2022 meeting, we propose that PBE IPSAS 43 be effective for reporting periods beginning on or after 1 January 2027, with early application permitted.

18. This would give New Zealand PBEs enough time to prepare for the application of the standard. At the same time, those PBEs that wish to early adopt the new requirements will be able to do so.

Question for the Board

Q1. Does the Board have any comments on the modifications included in the ED in Agenda Item 7.3 (i.e. the scope clarification paragraphs, the RDR concessions or the effective date)?

ED modifications and Consultation Document sections in progress

Addition of relevant paragraphs from NZ IFRS 15 *Revenue from Contracts with Customers*

19. IPSAS 43 refers entities to the requirements of IFRS 15 in the following circumstances:

    (a) *Separating components of a contract – lessor:* When a contract contains more than one lease component, or a lease component and a non-lease component, a lessor applies IFRS 15 to allocate the consideration in the contract to the lease and/or non-lease components.

    (b) *Sale and leaseback transactions:* When a seller-lessee transfers an asset to a buyer-lessor, both entities need to determine whether the transfer is accounted for as a sale – which must be done by applying the requirements in IFRS 15 for determining when a performance obligation is satisfied.

20. The IPSASB included these references to IFRS 15 as a temporary measure, while the IPSASB finalises its *Revenue and Transfer Expenses* project.

21. At the April 2022 meeting, more Board Members preferred to include the relevant paragraphs from IFRS 15 in PBE IPSAS 43, rather than merely referring preparers to IFRS 15 – so that a PBE preparer would not need to refer to for-profit standards.

22. We are therefore attempting to include the relevant paragraphs from IFRS 15 with respect to allocating consideration to the components of a contract (for a lessor), and with respect to sale and leaseback transactions in the PBE *Leases* ED.

23. We note that identifying which NZ IFRS 15 paragraphs to include has been somewhat challenging, for the following reasons.

    (a) With respect to allocating consideration to the components of a contract: NZ IFRS 16 identifies the relevant NZ IFRS 15 paragraphs that a lessor should consider. These are paragraphs 73–90 of NZ IFRS 15. However, these paragraphs then include references to several other paragraphs within NZ IFRS 15, which in turn refer to other paragraphs.

    (b) With respect to sale and leaseback transactions: NZ IFRS 16 does not specify which NZ IFRS 15 paragraphs should be applied when determining whether a performance obligation is satisfied (and therefore whether a sale occurred). Paragraphs 31–45 of NZ IFRS 15 deal with the satisfaction of performance obligations. However, these paragraphs may not be understood without an explanation of what performance obligations are and how to identify them, which is explained in paragraphs 22–30 of NZ IFRS 15. Both sets of paragraphs include references to the application guidance in Appendix B of NZ IFRS 15.

24. We are therefore finding it challenging to determine where to 'draw the line' for the purpose of deciding which paragraphs to include in the ED. On one hand, we realise that it would not be desirable to include a large portion of NZ IFRS 15 in PBE IPSAS 43. On the other hand, including NZ IFRS 15 paragraphs without sufficient context could mean that these paragraphs are not useful to preparers.

25. We are also considering the following alternatives:

    (a) Include only those NZ IFRS 15 paragraphs that we consider most essential for the purpose of the requirements in the ED, and refer preparers to NZ IFRS 15 for the rest of the required paragraphs. This would still require preparers to refer to NZ IFRS 15 in some cases, but it may be a practical solution.

    (b) Instead of including specific NZ IFRS 15 paragraphs, describe the relevant key concepts that these paragraphs represent. This avoids the abovementioned challenge regarding paragraphs that refer to other paragraphs. On one hand, this will avoid the challenges of determining which specific paragraphs of NZ IFRS 15 to include. On the other hand, this option would require us to develop text that is not directly taken from either an IASB standard or an IPSASB standard.

    (c) Reverting back to the IPSASB's approach of requiring the preparer to refer to IFRS 15 for the abovementioned specific types of transactions. We have previously recommended this approach as a practical interim measure while the IPSASB completes its *Revenue and Transfer Expenses* project. We also note that most entities choosing to adopt the Standard early will likely be doing so to avoid mixed group issues, and will therefore already be familiar will using IFRS 15.

26. The results of our considerations above will be provided to the Board at the August meeting.

27. Given the abovementioned challenges, and that the Board was not unanimous on whether to include the relevant paragraphs from IFRS 15 in PBE IPSAS 43, we would like to check with the Board again about the preferred approach to this matter at the June meeting.

Question for the Board
Q2. Does the Board have any comments on their preferred approach regarding the inclusion of IFRS 15 paragraphs in the proposed PBE IPSAS 43?

Illustrative Examples

28. We are in the process of considering whether the Illustrative Examples in IPSAS 43 need to be modified to enhance their usefulness to New Zealand PBEs, including not-for-profit PBEs.

29. We will develop proposals in this area in time for the August meeting. However, we welcome any suggestions that Board Members may have at this meeting in this area. It is important to note that second phase of the IPSASB project on leases is addressing public sector specific issues and therefore it may be better to develop public sector specific examples at this stage.

Low value leases: absolute basis vs materiality

30. Paragraph AG5 of IPSAS 43 requires the assessment of whether a lease is of low value to be performed on an *absolute basis* (rather than based on materiality considerations) – meaning that different entities, regardless of their size and circumstances, are expected to reach a

similar conclusion as to whether a lease is of low value). Leases that are of low value are exempt from the ROU model, regardless of whether these leases are material to the lessee.

31. In April 2022, we asked the Board whether to include the following modifications in the ED with respect to low value leases.

   (a) Modify paragraph AG5, so that the 'low value lease' assessment is performed based on materiality – rather than on an absolute basis; or

   (b) Retain the requirement to perform the 'low value lease' assessment on an absolute basis – but add an indicative monetary threshold, like the IASB did in the Basis for Conclusions of IFRS 16 *Leases*.

32. The majority of Board Members preferred *not to modify* the abovementioned 'low value leases' requirement in IPSAS 43. That is, the preference was to retain in the ED the requirement that the low-value lease assessment should be performed on an absolute basis (not based on materiality) – without adding a reference to a monetary threshold. We have reflected this preference in the ED, by retaining AG5 unmodified and by not adding an indicative monetary threshold anywhere in the ED.

33. However, Board Members noted that in the Consultation Document, we could ask a question as to whether constituents think that the 'low value' assessment should be performed on the basis of materiality. We have added this question into the draft consultation document.

34. It was also noted that if we ask such a question in the Consultation Document, we will also need to consider whether the materiality assessment for 'low value leases' would need to be performed on an individual asset basis or on an aggregated basis. This matter is discussed in the next section.

<u>Low value leases: individual assets vs aggregated group of assets</u>

35. We understand that under IPSAS 43, the low-value lease assessment is performed (on an absolute basis) on an *individual asset basis* – rather than for a group of assets in aggregate, even if these assets are leased together (assuming that the assets are not highly interrelated with other assets, as per paragraph AG6). That is, if an entity leases 100 laptop computers, we understand that under IPSAS 43 the entity would assess whether each laptop individually meets the 'low value lease' criterion – rather than assessing whether the 100 laptops taken together meet the 'low value lease' criterion.

36. Our understanding is based on the following.

   (a) Paragraphs AG4–AG9 on the assessment of 'low value' leases refer to 'the value of an underlying asset [singular]'.

   (b) Example 11 at paragraph IE3 of IPSAS 43 considers the application of the 'low value lease' assessment to a number of leases – including a lease of IT equipment for use by individual employees, such as laptop computers and mobile devices. The example says that this lease of IT equipment would "qualify as a lease of low-value assets, on the basis that the underlying assets, when new, are *individually* of low value" [italics added for emphasis]. This implies that the assessment of whether a lease is of 'low value' is done on the basis of *individual assets*, and that there is no need to group similar leased assets (presumably even if they are leased together as part of the same contract).

37. Based on the above discussion, we asked the Board in April 2022 whether we should *clarify in the authoritative part of PBE IPSAS 43* that the low-value lease assessment is performed on an individual asset level, rather than on aggregate for similar leased assets, even if the assets are leased together. There were mixed views among Board Members on whether we should include such a clarification.

38. In addition, a Board member noted that whether the low-value lease assessment should be performed on an individual asset basis or in aggregate for a group of similar leased assets is linked to the decision on whether the low-value lease assessment is performed on an absolute basis or on a materiality basis. However, there were mixed views among Board members on this topic.

(a) In one Board Member's view, a materiality-based assessment of low value should be done on an aggregated basis, similarly to requirements in other standards.

(b) However, another Board Member considered that even if materiality is applied in the 'low value lease' assessment, this should still be done on the individual asset level – otherwise, entities could incur significant compliance costs.

39. As noted above, based on the Board's feedback in April 2022, the ED requires to perform the 'low value lease' assessment on an absolute basis, and we have included in the Consultation Document a question on whether constituents would prefer a materiality-based approach. We would like to confirm the Board's view on whether the 'low value lease' assessment should be performed on an individual asset basis or in aggregate for similar assets leased together – and we would like to confirm this for both the absolute value approach (the approach proposed in the ED) and the materiality-based approach (the alternative option mentioned in the Consultation Document).

40. Specifically, we would like to confirm the Board's view on the following.

If the low-value lease assessment is performed…	Then, should this assessment be performed…
(a) on an **absolute basis** *(i.e. as currently proposed in the ED)*:	(i) on an individual asset basis; or (ii) on an aggregate basis for similar assets leased together (if applicable)?
(b) based on **materiality** (i.e. the *alternative option* suggested in the *Consultation Document*)	(i) on an individual asset basis; or (ii) on an aggregate basis for similar assets leased together (if applicable)?

41. The Board's decision regarding point (a) above could affect the proposals included in the ED (Agenda Item 7.3). The Board's decision on point (b) above would be reflected in the Consultation Document (Agenda Item 7.2), as part of describing the alternative option of making the low value lease assessment based on materiality.

42. We consider it important to reach a conclusion on the above matters. However, if the Board prefers not to form a view on these matters, we could include questions in the Consultation Document to ask constituents as to their preference.

Question for the Board

Does the Board wish to form a view on the following matters, and to communicate these views to constituents in the Consultation Document:

Q3. If the 'low-value lease assessment' is performed on an *absolute basis* (as proposed in the ED), should this assessment be performed:

- on an individual asset basis; or
- on an aggregate basis for similar assets leased together (if applicable)?

Q4. If the 'low-value lease assessment' is performed on a *materiality basis* (the 'alternative option' mentioned in the Consultation Document), should this assessment be performed:

- on an individual asset basis; or
- on an aggregate basis for similar assets leased together (if applicable)?

Other matters noted in the Consultation Document

<u>Rationale for the proposals</u>

43. At its April meeting, the Board noted the importance of explaining to constituents why we are proposing to introduce the requirements from IPSAS 43 (which is aligned with IFRS 16) in New Zealand. We have included this explanation in the Consultation Document.

<u>Discount rate</u>

44. When we consulted on IPSASB ED 75 *Leases*, we received feedback that determining the appropriate discount rate for the purpose of determining the lease liability and ROU asset could be challenging for PBEs.

45. To address concerns and ensure that the cost of applying the new lease requirements do not exceed the benefit, in April 2022 we recommend considering the development of non-authoritative guidance for New Zealand PBEs on determining the discount rate for lease liabilities. We noted that such guidance could be included in the non-authoritative part of the standard, or it could be published as staff guidance. We recommended doing so after PBE IPSAS 43 is finalised.

46. The Board agreed that we should consider developing guidance on the discount rate for lessees. Board Members noted the following.

(a) If resources permit, it may be useful to develop this guidance concurrently with the development of the ED – as developing this guidance could be helpful for the development of the ED.

(b) On the other hand, given that the determination of the discount rate is a challenging area, and given resource constraints, we should be careful not to 'over-promise' to constituents in relation to this guidance.

47. To date, we have not had sufficient resources to consider the development of the abovementioned guidance. Therefore, we recommend considering the development of this guidance after the ED is published – we note the Standard will have a long implementation period

48. We have included in the draft Consultation Document a comment that we plan to consider the possibility of development of non-authoritative guidance on determining the discount rate for lessees.

Question for the Board
Q5. Does the Board have any other comments on:
(a) the draft ED PBE IPSAS 43 *Leases* (Agenda Item 7.3); and
(b) the accompanying draft Consultation Document (Agenda Item 7.2)?

Next steps

Finalisation of ED and Consultation Document

49. We will update the draft ED and Consultation Document for the Board's feedback at this meeting. We plan to bring an updated draft ED and Consultation Document to the Board's August meeting and to seek the Board's approval to issue those documents at that meeting.

Consultation period

50. We propose the standard consultation period of 90 days for the ED.

51. While the ED proposes significant accounting changes for PBE lessees, we note that this ED is closely based on IPSASB ED 75 *Leases* – on which we consulted with our constituents only last year. At that time, constituents broadly supported the proposals to introduce an IFRS 16-aligned right-of-use model for lessees for non-concessionary leases.

52. Therefore, we do not think that a consultation period longer than 90 days is necessary.

Outreach

53. We note that last year we conducted outreach in relation to IPSASB ED 75 *Leases*, on which the IPSAS 43 is based. This included co-presenting a webinar with an IPSASB staff member, as well as reaching out to specific interested stakeholders.

54. The following New Zealand constituents submitted comments to the XRB and/or to the IPSASB in relation to IPSASB ED 75 last year.

    (a) Auckland Council

    (b) Quadrent Limited

    (c) Ministry of Education

    (d) Office of the Auditor-General

    (e) The Treasury

    (f) CA ANZ and CPA Australia

55. In view of this previous outreach, which was undertaken relatively recently, we plan to undertake the following outreach in relation to the ED PBE IPSAS 43 *Leases*:

    (a) General outreach activities: We will make the ED available on our website and publicise the ED in our newsletter. In doing this, we plan to remind constituents about the webinar that we held last year in relation to IPSASB ED 75, and to provide a link to the recording of that webinar.

    (b) Targeted outreach activities: We will reach out to the abovementioned constituents who submitted comments to us or to the IPSASB on IPSAS ED 75. We will also reach out to other constituents who are likely to be interested in the proposals. In addition, we will seek the TRG's feedback on the ED.

56. We welcome the Board's feedback on our planned approach to outreach.

Questions for the Board
Q6. Does the Board agree that the consultation period for the ED should be 90 days?
Q7. Does the Board have any feedback on the proposed preliminary outreach plan?

Attachments

Agenda item 7.2: Working Draft Consultation Document – PBE IPSAS 43 *Leases*

Agenda item 7.3: Working Draft ED PBE IPSAS 43 *Leases*

Agenda item 7.2

WORKING DRAFT

Note for Board Members: Please note that this is a Working Draft of the Consultation Document, and that once the content is finalised, the formatting will be updated to reflect our most recent Consultation Document formatting.

XRB | Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

NZASB Exposure Draft 2022-X

PBE IPSAS 43 *Leases*

Consultation Document

August 2022

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New Zealand
http://www.xrb.govt.nz

Table of Contents [to be completed]

Information for respondents

Invitation to Comment

The New Zealand Accounting Standards Board (NZASB)[1] is seeking comments on the specific matters raised in this Invitation to Comment. We will consider all comments before finalising the proposals for *PBE IPSAS 43 Leases*.

If you want to comment, please supplement your opinions with detailed comments, whether supportive or critical of the proposals, as both supportive and critical comments are essential to a balanced view.

Comments are most useful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for an alternative. Feel free to comment on only those questions, or issues that are relevant to you.

Comments should be submitted electronically using our 'Accounting Standards open for consultation' page (under 'Domestic consultations') at: https://xrb.govt.nz/consultations/accounting-standards-open-for-consultation/.

Please include *PBE IPSAS 43 Leases* in the subject line and indicate whether the comments are made on your own behalf, or on behalf of a group of people, or an entity.

The closing date for submissions is **XX November 2022**.

Publication of submissions, the Official Information Act and the Privacy Act

We intend publishing all submissions on the XRB website (xrb.govt.nz), unless the submission may be defamatory. If you have any objection to publication of your submission, we will not publish it on the internet. However, it will remain subject to the Official Information Act 1982 and, therefore, it may be released in part or in full. The Privacy Act 1993 also applies.

If you have an objection to the release of any information contained in your submission, we would appreciate you identifying the parts of your submission to be withheld, and the grounds under the Official Information Act 1982 for doing so (e.g. that it would be likely to unfairly prejudice the commercial position of the person providing the information).

1 The NZASB is a sub-Board of the External Reporting Board (XRB Board), and is responsible for setting accounting standards.

List of abbreviations

The following abbreviations are used in this Invitation to Comment.

ED	Exposure Draft
IAS®	International Accounting Standard
IASB	International Accounting Standards Board
IFRS® Standard	International Financial Reporting Standard
ITC	Invitation to Comment
IPSASB	International Public Sector Accounting Standards Board
IPSAS	International Public Sector Accounting Standard
NZ IFRS	New Zealand equivalents to International Financial Reporting Standards
NZASB	New Zealand Accounting Standards Board, a sub-Board of the External Reporting Board
PBE	Public benefit entity
PBE IAS	Public Benefit Entity International Accounting Standard
PBE IPSAS	Public Benefit Entity International Public Sector Accounting Standard

Questions for respondents

		Paragraphs
1	Do you agree that the proposed requirements in ED 2022-X are appropriate for a new PBE Standard? If you disagree, please explain why not and outline any alternative proposals.	xx
2	Do you agree with the proposed scope clarification with respect to concessionary leases? If you disagree, please provide reasons.	xx
3	Do you think that the assessment of whether a lease is of 'low value' should be performed: • on an absolute value basis, as proposed in the ED; or • on the basis of materiality?	xx
4	[Question on individual basis vs aggregate basis could be added here]	xx
5	Do you agree that PBE IPSAS 43 should include the paragraphs from NZ IFRS 15 *Revenue from Contracts with Customers* that have been included in the ED?	xx
6	Do you agree with the proposed RDR concessions in the ED?	xx
7	Do you agree with the proposed effective date of 1 January 2027? If you disagree, please provide reasons.	xx
8	Do you have any other comments on ED 2022-X?	xx

1. Introduction

1.1 Background

1. In January 2022, the IPSASB issued IPSAS 43 *Leases*, which is aligned with NZ IFRS 16 *Leases*. IPSAS 43 introduces new accounting requirements for lessees. For lessees, IPSAS 43 removes the distinction between 'operating leases' and 'finance leases', and requires lessees to recognise a right-of-use asset and a lease liability in the statement of financial position for almost all leases. These requirements are aligned with the requirements in the for-profit standard NZ IFRS 16 *Leases*, which is based on the IASB's IFRS 16 *Leases*.

2. IPSAS 43 superseded the IPSASB's old leasing standard, IPSAS 13 *Leases*. Under IPSAS 13, lessees classified leases as 'operating leases' or 'finance leases' – finance leases were recognised as assets and a liabilities on the balance sheet, whereas 'operating leases' leases were not. Instead, operating lease payments were treated as expenses in surplus/deficit over the lease term.

3. In New Zealand, PBEs currently apply the PBE Standard PBE IPSAS 13 *Leases*, which is based on the old requirements of IPSAS 13.

4. PBE Standards are primarily based on IPSAS. In accordance with the Accounting Standards Framework, the NZASB is proposing to issue a PBE Standard based on IPSAS 43 which would be applicable to Tier 1 and Tier 2 PBEs.

Note on concessionary leases

5. IPSAS 43 does not include specific requirements for the accounting for the 'concessionary portion' of concessionary leases and similar arrangements. The same is true for the proposed PBE IPSAS 43.

6. The IPSASB has a separate project on the accounting for concessionary leases (i.e. leases with below-market terms) and other lease-like arrangements, such as arrangement where an entity has a right to use an asset over a specified period for *no* consideration. The IPSASB expects to issue an ED on *Other Lease-type Arrangements* in December 2022.

7. The ED proposals clarify that while concessionary leases that involve the lessee paying consideration are within the scope of the standard (as they meet the definition of a lease), such leases are accounted for by taking into account the agreed lease payments as per the lease agreement, rather than what the lease payments would have been had the lease been on market terms. That is, the proposals in the ED do *not* require a PBE to measure the concessionary portion of a concessionary lease at fair value. This clarification will be reconsidered when the IPSASB finalises its project on *Other Lease-type Arrangements*.

Benefits of the proposals

8. The proposed PBE IPSAS 43 is expected to result in the following benefits. These benefits are consistent with those that led to the introduction of NZ IFRS 16 *Leases* in the for-profit sector.

   (a) **Increased transparency:** The proposals require lessees to recognise a 'right of use' asset and a lease liability with respect to all leases, with limited exceptions. Recognition of these assets and liabilities on the balance sheet would increase transparency in relation to the resources available to the entity as a result of lease agreements, and the entity's obligations to make lease payments. This also means that for users of financial statements, the statement of financial position will provide a 'fuller picture' of the resources that an entity uses in its operations – and which generate service potential and/or economic benefit for the entity – and the entity's obligations for future payments.

(b) **Eliminate information asymmetry:** Under the current requirements, if a user of financial statements wants to know the entity's financial position including the impact of operating leases, the user would need to make adjustment to the amounts shown in the statement of financial position, based on the lease commitments disclosures in the notes. However, different users would use different techniques to make such adjustments, and the level of detail provided in lease commitment disclosure notes may vary. The recognition of (almost all) leases on the statement of financial position would mean that users no longer need to make such adjustments using different techniques. Therefore, from a user perspective, there would be less 'information asymmetry' under the proposals.

(c) **Increased comparability:** By requiring lessees to recognise a right-of-use asset and a lease liability for (almost all) leases, the proposals would increase comparability between the financial statements of PBEs that lease assets and those that purchase assets. At the same time, the proposals still reflect the economic differences between the two types of transactions (for example, the lessee recognises the right to use the leased asset, rather than the underlying asset itself).

(d) **Alignment with the latest international thinking**: The proposals are based on the IPSASB's latest standard on leases, IPSAS 43 – which is in turn substantially aligned with the IASB's IFRS 16 *Leases*. Thus, the proposals reflect the latest international thinking on lease accounting.

(e) **Easier reporting for 'mixed groups':** The proposed PBE IPSAS 43 is substantially aligned with NZ IFRS 16 *Leases.* For PBEs with for-profit subsidiaries – sometimes called 'mixed groups' – this means that fewer accounting adjustments are needed when preparing the consolidated group financial statements.

9. We also note that in 2021, we consulted with New Zealand constituents on IPSASB ED 75 *Leases*, which contained the proposals now finalised in IPSAS 43. New Zealand constituents did not raise with us any significant concerns in relation to the IPSASB's proposals. While we are aware of concerns in New Zealand regarding the accounting for concessionary leases, we note that the proposed PBE IPSAS 43 does not require PBEs to account for the concessionary portion of a concessionary lease at fair value, and does not contain specific requirements for concessionary leases.

1.2 Purpose of this Consultation Document

10. The purpose of this Consultation Document is to seek comments on the proposed amendments set out in the ED.

1.3 Timeline and next steps

11. Submissions on NZASB ED 2022-2 are due by **XX November 2022**. Information on how to make submissions is provided on page 4 of this Invitation to Comment.

12. After the consultation period ends, we will consider the submissions received, and subject to the comments in those submissions, we expect to finalise and issue the amendments.

2. Overview of ED PBE IPSAS 43 *Leases*

2.1 Summary

14. In this section, we highlight the key aspects of the proposals and those areas where we are particularly interested in your feedback. This section is organised as follows.

    (a) Approach to developing PBE IPSAS 43

    (b) Main differences between PBE IPSAS 13 and the proposed PBE IPSAS 43;

    (c) Scope clarification for concessionary leases;

    (d) Low-value leases: whether we should modify the requirements in IPSAS 43;

    (e) Paragraphs from NZ IFRS 15 *Revenue from Contracts with Customers*; and

    (f) RDR concessions

2.2 Approach to developing PBE IPSAS 43

15. The proposed PBE IPSAS 43 is closely based on IPSAS 43 which, in turn, is closely based on IFRS 16. In accordance with its usual approach to developing a PBE Standard based on an IPSAS the NZASB has:

    (a) aligned terminology with that used in PBE Standards (for example, PBE Standards include the concept of other comprehensive revenue and expense);

    (b) ensured coherence within PBE Standards by considering the existence of New Zealand specific standards or requirements;

    (c) considered whether there is a need for any enhancements to make the standard more appropriate for PBEs in New Zealand. There are no specific NFP enhancements in the proposed standard; and

    (d) identified RDR concessions for Tier 2 PBEs, with respect to disclosure requirements (aligned with the RDR concessions in NZ IFRS 16 *Leases*).

2.3 Main differences between PBE IPSAS 13 and the proposed PBE IPSAS 43

The right-of use model for lessees

16. The proposed PBE IPSAS 43 *Leases* introduces changes to *lessee* accounting.

17. Currently, PBE IPSAS 13 *Leases* requires lessees to distinguish between the following two types of leases, based on the 'risks and rewards' model:

    (a) Finance leases: A lease that is economically similar to purchasing the leased asset is classified as a *finance lease* and is recognised on the lessee's statement of financial position as a liability and an asset; and

    (b) Operating leases: All other leases are classified as *operating leases* and are not recognised on the statement of financial position. Rather, they are recognised as an annual operating expense through surplus or deficit over the lease term, usually on a straight-line basis – with the total amount of future lease payments disclosed in the notes only. For this reason, operating leases are sometimes referred to as 'off-balance sheet' leases.

18. In both a finance lease and an operating lease, the lessee has a right to use the underlying asset for a specified period of time, and an obligation to make lease payments as per the lease

agreement. However, as explained above, only finance leases are recognised as assets and liabilities in the statement of financial positions.

19. In contrast, the proposed PBE IPSAS 43 introduces the 'right of use' model for lessees. Under these proposals, lessees are required to recognise all leases on the statement of financial position (except for leases with a lease term shorter than 12 months and those defined as 'low value' leases). This means that lessees would need to bring on to their balance sheet those leases that are currently classified as 'operating' leases.

20. The new requirements in the proposed PBE IPSAS 43 and their impact on the financial statements are summarised in the table below.

Table 1 Summary of proposed requirements and their impact

PBE IPSAS 43: proposed lessee accounting requirements for all leases (except for short-term and low value leases)	Impact on financial statements of lessees with 'operating' leases
Initial recognition of lease on the balance sheet: • a lease liability, for the obligation to make future lease payments as per the lease agreement, discounted to present value; and • a right-of-use (ROU) asset, for the right to use the underlying asset over the lease term, in exchange for the lease payments. **Accounting after initial recognition:** • The lease liability decreases as the lessee makes payments. • Interest accrues on the lease liability (i.e. the discount unwinds); The interest is recognised as an expense through profit or loss, and is included in finance costs. • Generally, the ROU asset is depreciated through profit or loss, usually on a straight-line basis.	**Statement of financial position** Liabilities ↑ Assets ↑ **Statement of financial performance** Operating expenses (excluding depreciation and amortisation) ↓ Depreciation and amortisation ↑ Finance costs ↑ Plus: <u>Change in the pattern of expense recognition</u>: The ROU is usually depreciated on a straight-line basis. However, the interest expense on the lease is higher at the start of the lease term and lower at the end of it, because the 'principal' of the lease liability decreases as the lessee makes payments (similar to a table mortgage). In contrast, under the current requirements the operating lease expense is generally recognised evenly throughout the lease term. Ultimately, the impact on surplus or deficit would depend on factors such as the size of the agreed lease payments, how far the leases are into their respective lease terms, and what method the lessee uses to transition to PBE IPSAS 43.

Discount rates:

21. The lease liability and right-of-use asset amounts are calculated based on the agreed future lease payments, *discounted* to present value. The proposed PBE IPSAS 43 contains requirements for determining the discount rate. We expect that under the proposed PBE IPSAS 43, in most cases a PBE lessee would determine the discount rate under PBE IPSAS 43 as the lessee's incremental borrowing rate – i.e. "the interest rate that the 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".

22. The IPSASB's Basis for Conclusions for IPSAS 43 notes 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 IPSAS 43.

23. We are aware of concerns among New Zealand constituents that PBEs may find it challenging to determine their 'incremental borrowing rate' for the purpose of measuring lease liabilities and right-of-use assets. We will consider the possibility of developing non-authoritative guidance to assist New Zealand PBEs in determining their incremental borrowing rate under PBE IPSAS 43.

Exemptions from the right-of-use model

24. Under the proposed PBE IPSAS 43, the following lease types will be exempted from the requirement to recognise a right-of-use asset and a lease liability on the statement of financial position:
    (a) Short-term leases (where the lease term is shorter than 12 months); and
    (b) Low-value leases (where the underlying leased asset is of low value).

25. Under the proposals, a lessee may choose to account for short-term leases and low value leases by recognising the associated payments as an expense over the lease term – similarly to the current accounting for 'operating leases'.

What changes for lessors?

26. Under the proposed PBE IPSAS 43, the requirements for lessors are generally similar to the current requirements under PBE IPSAS 13. That is, lessors would still apply the 'risks and rewards' model, meaning that they would still distinguish between operating leases and finance leases.

27. However, the proposed PBE IPSAS 43 includes the following specific changes for lessors:
    (a) Lease modifications: The proposals require modification to a finance lease to be treated as a separate lease if certain conditions are met, and modifications to an operating lease to be treated as a new lease from the effective date of the modifications. PBE IPSAS 13 does not contain specific requirements relating to lease modifications.

(b) Sub-leases: The proposals require an intermediate lessor to classify subleases by reference to the right-of-use asset – rather than by reference to the underlying asset, as per the current requirements in PBE IPSAS 13.

(c) Disclosures: The proposals include enhanced disclosure for lessors about the timing and uncertainty of cash flows relating to leases.

Sale and leaseback transactions

28. Under the current requirements of PBE IPSAS 13, an entity is able to report fewer assets and less debt by selling an asset and leasing it back as through an 'operating lease'. However, in substance, the entity continues to have a right to use the sold asset.

29. The proposed PBE IPSAS 43 requires a seller-lessee to assess whether the transfer of an asset is accounted for as a sale of that asset, which then impacts the accounting for the transaction. If the transfer of the asset is determined to be a sale, then PBE IPSAS 43 requires a seller-lessee to recognise the right to use the sold asset (and the related lease liability), and restricts the amount of gain that can be recognised in a sale and leaseback transaction. If the transfer of the asset is not a sale then PBE IPSAS 43 requires a seller-lessee to continue to recognise the transferred asset and to recognise a financial liability equal to the transfer proceeds. It shall account for the financial liability applying PBE IPSAS 41.

Question for respondents

1. Do you agree that the proposed requirements in ED PBE IPSAS 43 *Leases* are appropriate for a new PBE Standard? If you disagree, please explain why not and outline any alternative proposals.

2.4 Scope clarification for concessionary leases

30. The scope of the proposed PBE IPSAS 43 includes all leases, which are defined as "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." A contract is defined as an agreement between two or more parties that creates enforceable rights and obligations.

31. Concessionary leases are leases with below-market terms. In issuing IPSAS 43, the IPSASB did not provide a scope exclusion from the standard with respect to concessionary leases. We understand that concessionary leases in which the lessee pays consideration meet the definition of a lease, and therefore are in the scope of IPSAS 43.

32. We note that the IPSASB has a separate project on developing accounting requirements for concessionary leases and other lease-like arrangements (including agreements that give an entity the right to use an asset for a specified period of time for no consideration). It is not yet clear whether the IPSASB will require fair value measurement for the 'concessionary component' of concessionary leases and lease-like arrangements. There are no such requirements in IPSAS 43. Similarly, there are no such requirements in the proposed PBE IPSAS 43. The proposed PBE IPSAS 43 does not include any requirements on the accounting for the 'concessionary component' of concessionary leases.

33. We understand that many New Zealand constituents have concerns about the possibility of having to measure concessionary leases and lease-like arrangements at fair value. We have therefore included in the ED paragraphs 4.1 – 4.2, which clarify the following.

(a) Concessionary leases where the lessee pays consideration meet the definition of a lease and are within the scope of the proposed standard; but

(b) PBEs should *not* measure the 'concessionary portion' of their concessionary leases at fair value. That is, when accounting for leases under the proposed standard, a PBE should take into account the amounts of lease payments as per the lease agreement, and not what the payments would have been had the lease been on market terms.

34. In our understanding, an arrangement that conveys the right to use an asset for a period of time *for no consideration* does not meet the definition of a lease in proposed PBE IPSAS 43. However, we note that such arrangements are expected to be covered by the IPSASB's project on concessionary leases and other lease-like arrangements. There are currently no specific requirements for such arrangements in PBE Standards. For the avoidance of doubt, we propose to clarify that a PBE does *not* need to recognise revenue at fair value with respect to such arrangements under PBE IPSAS 23 *Revenue from Non-exchange Transactions*. We have included this in the ED as a consequential amendment to PBE IPSAS 23.

Question for respondents

2. Do you agree with the proposed scope clarification with respect to concessionary leases? If you disagree, please provide reasons.

2.5 Low value leases

Note to Board Members: The content of this section may change based on the Board's discussion on low value leases in agenda item 7.1

35. The following requirements from IPSAS 43 have been replicated in the proposed PBE IPSAS 43.

(a) As noted above, IPSAS 43 provides a recognition exemption for 'lease for which the underlying asset is of low value' (hereafter referred to as 'low value leases'). An entity need not recognise a ROU asset and a lease liability for low value leases. Instead, the lease payments relating to such leases may be accounted for as expenses on a straight-line basis.

(b) IPSAS 43 requires entities to determine whether a leased asset is of 'low value' on an *absolute basis* – and *not based on whether the asset is material* to the entity. Paragraph AG5 of IPSAS 43 notes that the determination of whether a lease is of 'low value' is unaffected by the size, nature or circumstances of the lessee. Therefore, *different lessees are expected to arrive at the same conclusion as to whether a leased asset is of 'low value'*.

(c) As noted in paragraph AG9, examples of 'low value' underlying assets can include tablet and personal computers, small items of office furniture and telephones (but not cars).

36. The above requirements are consistent with the IASB's requirements in IFRS 16 *Leases*. However, unlike the IASB, the IPSASB did not provide an indicative figure that would constitute a 'low value' lease. The Basis for Conclusion of IFRS 16 states that when developing the recognition exemption for 'low value' leases, the IASB had in mind leases of assets whose value (when new) is "in the order of magnitude of US $5,000 or less". In the Basis for Conclusions of IPSAS 43, the IPSASB explains that it decided not to refer to a specific monetary

threshold for 'low value' leases, noting that the application guidance in AG4–AG9 provides sufficient guidance on how to determine 'low value'.

37. We have considered whether it would be more beneficial to require PBEs to perform the 'low value lease' assessment based on *materiality*, rather than on an absolute basis (particularly when no indicative monetary threshold is provided). Such an approach appears to be more consistent with how entities generally decide whether to apply measurement and recognition requirements in PBE Standards. In addition, PBE IPSAS 1 includes guidance on materiality, and further guidance is likely to become available as the IPSASB considers recent IASB clarifications relating to materiality. On the other hand, the requirement to perform the 'low value lease' assessment on an absolute basis is consistent with the requirements for for-profit lessees under NZ IFRS 16. Furthermore, despite the existing guidance on materiality, some PBEs may find performing the 'low value lease' assessment on a materiality basis equally as challenging as performing this assessment on an absolute basis.

38. On balance, we did not modify the requirement in IPSAS 43 to perform the 'low value lease' assessment on an absolute basis. However, we are interested in your views as to whether you would prefer this assessment to be performed on the basis of materiality.

To add content about whether the 'low value lease' assessment is to be performed on an individual asset basis vs on an aggregate basis for similar assets leased together – based on the Board's discussion under agenda item 7.1.

Question for respondents

3. Do you think that the assessment of whether a lease is of 'low value' should be performed:

   - on an absolute value basis, as proposed in the ED; or
   - on the basis of materiality?

4. [Question on individual basis vs aggregate basis could be added here]

2.6 Paragraphs from NZ IFRS 15 Revenue from Contracts with Customers

39. [This section is a work in progress]

2.7 RDR concessions

40. We have included proposed disclosure concessions for PBEs in Tier 2. These disclosure concessions are aligned with those provided to Tier 2 for-profit entities under NZ IFRS 16 *Leases*.

Question for respondents

4. Do you agree with the proposed RDR concessions in ED PBE IPSAS 43 *Leases*? If you disagree, please explain why.

2.8 Effective date and other comments

41. The ED proposes that the amendments be effective for annual financial statements covering periods beginning on or after 1 January 2027, with early adoption permitted. This date is tentative and would be reviewed prior to issuing the finalised amendments.

42. We believe that an effective date of 1 January 2027 would allow PBEs sufficient time to prepare for the application of the standard. Furthermore, we proposed this effective date with a view to ensure that the requirements of PBE IPSAS 43 do not become mandatory in New Zealand before the requirements for concessionary leases (to be developed after the IPSASB finalises its project on the topic) become mandatory.

43. On the other hand, with early application permitted, those PBE who wish to adopt PBE IPSAS 43 early will be able to do so.

Questions for respondents

5. Do you agree with the proposed effective date of 1 January 2027, with early adoption permitted? If you disagree, please explain why.

6. Do you have any other comments on the ED?

EXPOSURE DRAFT NZASB 202X-X

PUBLIC BENEFIT ENTITY INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 43 LEASES (PBE IPSAS 43)

Issued [date]

This [draft] Standard was issued on [Date] by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This [draft] Standard is secondary legislation for the purposes of the Legislation Act 2019, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on [Date].

Reporting entities that are subject to this [draft] Standard are required to apply the [draft] Standard in accordance with the effective date set out in paragraph xx.

In finalising this [draft] 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 [draft] Tier 1 and Tier 2 PBE Standard has been issued as a result of a new International Public Sector Accounting Standard – IPSAS 43 *Leases*. This Standard, when applied, supersedes PBE IPSAS 13 *Leases*.

Note to Board Members: This is a Working Draft of the ED. Some parts of the ED are therefore incomplete. Areas where we are considering further modifications/deletions are highlighted in yellow.
New Zealand modifications included to date in the Working Draft are highlighted in blue

PBE IPSAS 43 LEASES

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PBE IPSAS 43 LEASES

CONTENTS [TO BE COMPLETED]

Public Benefit Entity International Public Sector Accounting Standard 43 *Leases* is set out in paragraphs 1–xx and Appendices A and B. All the paragraphs have equal authority. PBE IPSAS 43 should be read in the context of its objective, the NZASB's Basis for Conclusions on PBE IPSAS 43, the IPSASB's Basis for Conclusions on IPSAS 43, 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. **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

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

2.2. 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.

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 PBE IPSAS 27 *Agriculture* held by a lessee;

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

   (d) Rights held by a lessee under licensing agreements within the scope of PBE 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).

4.1 Leases with below-market terms, sometimes described as concessionary leases, are in the scope of this Standard (provided that they are not excluded from the scope of this Standard under paragraph 3). Arrangements where no consideration is paid for the right to use an asset over a specified period of time do not meet the definition of a lease in this Standard.

4.2 In applying the measurement requirements in this Standard, an entity takes into account the amount of lease payments as per the lease agreement, and not the amount of lease payments that would have been charged had the lease been on market terms.

Definitions

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

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

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

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

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

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

   The <u>effective date of the modification</u> 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;**

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

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

(c) **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 fulfil a contract with a customer (including any non-consecutive periods of time).

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

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

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

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

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

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 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. The defined term useful life is used in this Standard with the same meaning as in PBE IPSAS 17, *Property, Plant, and Equipment*.

Recognition Exemptions (see paragraphs AG4–AG9)

6. A lessee may elect not to apply the requirements in paragraphs 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 recognise 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)

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 PBE 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 NZ IFRS 15 *Revenue from Contracts with Customers*.

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 recognise 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 recognise 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 PBE 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 PBE IPSAS 12 are recognised and measured applying PBE IPSAS 19, *Provisions, Contingent Liabilities, and Contingent Assets*.

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.

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**.

Cost Model

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

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

    (b) Adjusted for any remeasurement of the lease liability specified in paragraph 37(c).

32. A lessee shall apply the depreciation requirements in PBE IPSAS 17 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 PBE IPSAS 21, *Impairment of Non-Cash-Generating Assets* or PBE 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 model in PBE IPSAS 16, *Investment Property* to its investment property, the lessee shall also apply that fair value model to right-of-use assets that meet the definition of investment property in PBE IPSAS 16.

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

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 recognise 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 recognise 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 recognise 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 recognise 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 PBE 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 PBE 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 55–64 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.

RDR 57.1 The amounts disclosed in accordance with paragraph 56 shall include costs that a Tier 2 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 PBE 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 PBE IPSAS 17, the lessee shall disclose the information required by paragraph 92 of PBE IPSAS 17 for those right-of-use assets.

*61. A lessee shall disclose a maturity analysis of lease liabilities applying paragraphs 46 and AG12 of PBE 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 recognised 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.

Lessor

Classification of Leases (see paragraphs AG54–AG59)

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 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.

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

Recognition and Measurement

71. **At the commencement date, a lessor shall recognise 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.**

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 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 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 recognise 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 PBE 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 recognise 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 the relevant national or international accounting standard dealing with 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 PBE IPSAS 41.

Operating Leases

Recognition and Measurement

81. **A lessor shall recognise 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.**

82. A lessor shall recognise 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 recognise 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 PBE IPSAS 17 and PBE IPSAS 31.

85. A lessor shall apply PBE IPSAS 21 or PBE 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.

RDR 89.1 For operating leases, a Tier 2 entity shall disclose lease income.

*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 PBE IPSAS 17. In applying the disclosure requirements in PBE IPSAS 17, 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 PBE IPSAS 17 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 PBE IPSAS 16, PBE IPSAS 21 or PBE IPSAS 26, as appropriate, PBE IPSAS 27 and PBE 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.

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.

Assessing Whether the Transfer of the Asset is a Sale

98. An entity shall apply the requirements for determining when a performance obligation is satisfied in NZ IFRS 15 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 NZ IFRS 15 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 recognise 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.

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 NZ IFRS 15 to be accounted for as a sale of the asset:

   (a) The seller-lessee shall continue to recognise the transferred asset and shall recognise a financial liability equal to the transfer proceeds. It shall account for the financial liability applying PBE IPSAS 41.

   (b) The buyer-lessor shall not recognise the transferred asset and shall recognise a financial asset equal to the transfer proceeds. It shall account for the financial asset applying PBE IPSAS 41.

Effective Date and Transition

Effective Date

103. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after 1 January 2027. Earlier application is permitted. If an entity applies this Standard earlier, it shall disclose that fact.**

104. ***[Please note: We are considering whether to delete this paragraph or to adapt it with respect to PBE FRS 47 First-time Adoption of PBE Standards]*** When an entity adopts the accrual basis PBE IPSASs of accounting as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* 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 IPSASs.

105. ***[Please note: we are considering deleting this paragraph]*** 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 103–123, 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 PBE 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 PBE 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 PBE IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*; or

(b) Retrospectively with the cumulative effect of initially applying the Standard recognised at the date of initial application in accordance with paragraphs 111–117.

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 recognise 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) Recognise a lease liability at the date of initial application for leases previously classified as an operating lease applying PBE 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) Recognise a right-of-use asset at the date of initial application for leases previously classified as an operating lease applying PBE 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 recognised in the statement of financial position immediately before the date of initial application.

(c) Apply PBE IPSAS 21 or PBE 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 PBE 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 model in PBE IPSAS 16. The lessee shall account for the right-of-use asset and the lease liability arising from those leases applying PBE 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 PBE IPSAS 13 and that will be accounted for as investment property using the fair value model in PBE 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 PBE 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 PBE 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 PBE 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 recognised 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 PBE 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 PBE 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 PBE IPSAS 3, except for the information specified in paragraph 33(f) of PBE IPSAS 3. Instead of the information specified in paragraph 33(f) of PBE IPSAS 3, the lessee shall disclose:

(a) The weighted average lessee's incremental borrowing rate applied to lease liabilities recognised 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 PBE 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 recognised 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.

Lessors

118. Except as described in paragraph 119, a lessor is not required to make any adjustments on transition for 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 PBE 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 PBE 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 the transfer of the underlying asset satisfies the requirements in NZ IFRS 15 to be accounted for as a sale.

121. If a sale and leaseback transaction was accounted for as a sale and a finance lease applying PBE 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 PBE 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 recognised in the statement of financial position immediately before the date of initial application.

Amounts Previously Recognised in Respect of Public Sector Combinations

123. If a lessee previously recognised an asset or a liability applying PBE IPSAS 40, *Public Sector Combinations* relating to favourable or unfavourable terms of an operating lease acquired as part of a public sector combination, the lessee shall derecognise 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 PBE 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.

Withdrawal and Replacement of PBE IPSAS 13

127. This Standard supersedes PBE IPSAS 13 issued in 2014. PBE 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 PBE 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 PBE 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 fibre optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits 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-leasing 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

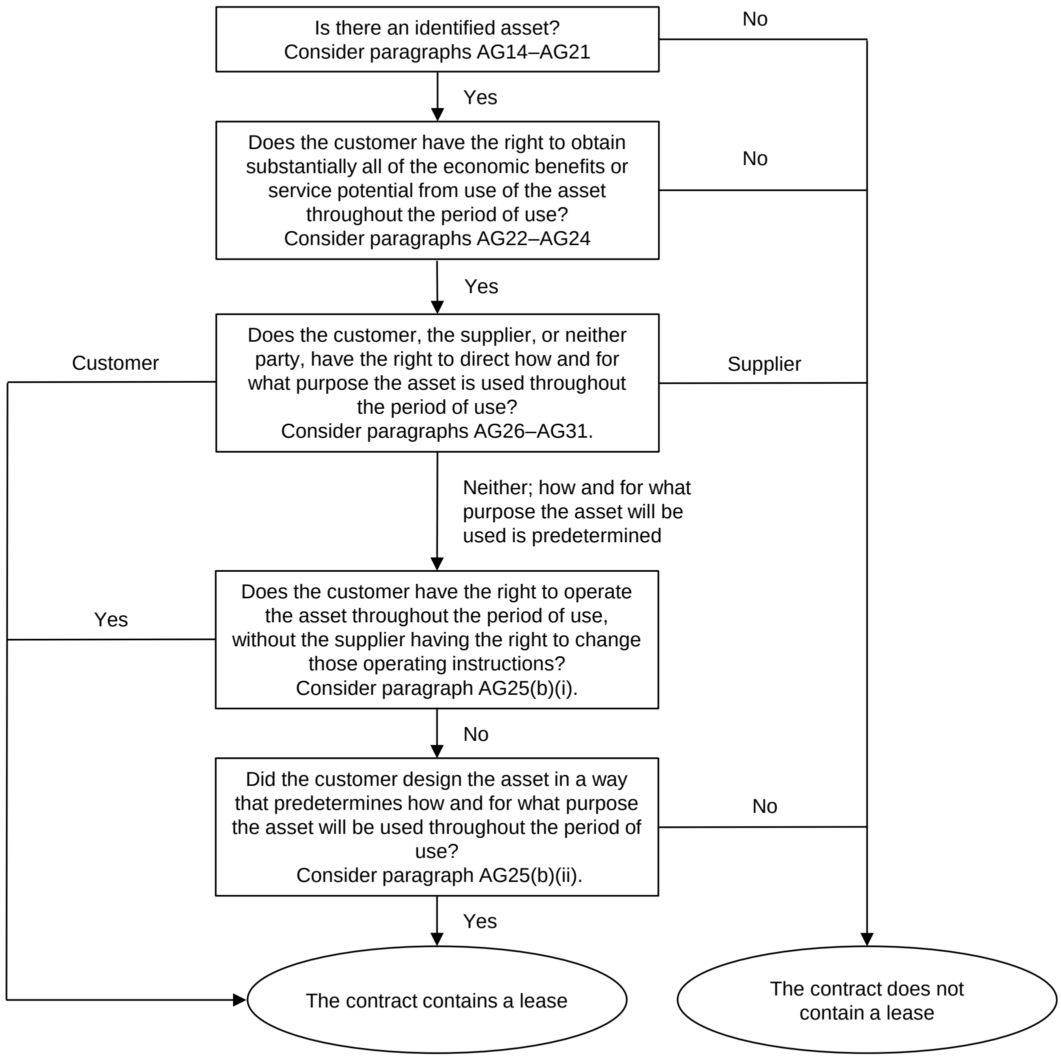
AG29. The relevant decisions about how and for what purpose the asset is used can be predetermined in a number of ways. For example, the relevant decisions can be predetermined by the design of the asset or by contractual restrictions on the use of the asset.

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.



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 PBE IPSAS 17. Costs relating to the construction or design of an underlying asset do not include payments made by the lessee for the right to use the underlying asset. Payments for the right to use an underlying asset are payments for a lease, regardless of the timing of those payments.

Legal Title to the Underlying Asset

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 favourable 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 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.

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).

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[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 expected to represent. Paragraph BC16 of IPSAS 1 discusses the transitional approach to the explanation of reliability.

Appendix B

Amendments to Other PBE Standards

[Please note: We are still considering the consequential amendments as set out in IPSAS 43. Some of these consequential amendments would need to be modified. For example, the consequential amendments relating to IPSAS 33 would need to either be deleted or used as a basis for consequential amendments to PBE FRS 47 *First-time Application of PBE Standards*. We have shown here the consequential amendments for PBE IPSAS 23 Revenue from Non-exchange Transactions, as it relates to the scope clarification paragraphs in the core text of the ED, which are included in this Working Draft.]

Amendments to PBE IPSAS 23 *Revenue from Non-exchange Transactions*

Paragraph 1.1 is added. New text is underlined.

Scope

1. **An entity that prepares and presents financial statements shall apply this Standard in accounting for revenue from non-exchange transactions. This Standard does not apply to a PBE combination that is a non-exchange transaction.**

1.1 Leases within the scope of PBE IPSAS 43 *Leases*, including concessionary leases, are excluded from the scope of this Standard. For the avoidance of doubt, arrangements that confer the right to use an asset for a specified period of time for no consideration are also excluded from the scope of this Standard.

Basis for Conclusions

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

[The BC section is a work in progress. We have included the relevant BC paragraphs for those New Zealand modifications that are included in the core text of this Working Draft]

Scope clarification: concessionary leases and leases for no consideration

BCX. The NZASB added paragraphs 4.1–4.2 to clarify the scope of the Standard with respect to concessionary leases. A concessionary lease that meets the definition of a lease in this Standard is within the scope of this Standard (provided that it is not specifically excluded from the Standard's scope under paragraph 3).

BCX. However, there are no accounting requirements in this Standard (or in other PBE Standards) for the 'concessionary component' of a concessionary lease, or for arrangements to use an asset for a specified period of time for no consideration. Such requirements will be developed after the IPSASB finalises its project on concessionary leases and other public sector-specific lease-like arrangements. Until such requirements are developed, this Standard requires concessionary leases to be measured based on the lease payments as per the lease agreement, and not the amounts of lease payments that would have been charged had the lease been on market terms.

BCX. Furthermore, paragraph 4.1 clarifies that arrangements where no consideration is paid for the right to use an asset over a specified term do not meet the definition of a lease in this Standard and are therefore outside the scope of this Standard.

BCX. The abovementioned scope clarifications will be reconsidered after the IPSASB completes its project on concessionary leases and other public sector-specific lease-type arrangements.

Amendments to Basis for Conclusions in Other PBE Standards

[…]

PBE IPSAS 23 Revenue from Non-exchange Transactions

Basis for Conclusion

[…]

Scope clarification: concessionary leases and leases for no consideration

BC25. In January 2022, the IPSASB issued IPSAS 43 *Leases*. In [Date], the NZASB issued PBE IPSAS 43 *Leases*, based on IPSAS 43.

BC26. Concessionary leases (described as leases that meet the definition of a lease in PBE IPSAS 43 but have below-market terms) are within the scope of PBE IPSAS 43. However, PBE IPSAS 43 does not include specific accounting requirements for the 'concessionary portion' of concessionary leases. Furthermore, arrangements to use an asset for a specified period of time for no consideration are outside the scope of PBE IPSAS 43, and there are currently no accounting requirements for such arrangements in PBE Standards. The IPSASB is developing accounting requirements for concessionary leases and the abovementioned arrangements as a separate project. Once the IPSASB finishes this work, the NZASB will consider the development of requirements on this topic. Until such requirements are developed, it is not appropriate to require fair value measurement for the concessionary component of a concessionary lease or for arrangements to use an asset for a specified period of time for no consideration.

BC27. Therefore, on issuing PBE IPSAS 42 on [Date], the NZASB clarified that leases within the scope of PBE IPSAS 43 *Leases* (including concessionary leases) and arrangements that confer the right to use an asset for a specified period of time for no consideration are specifically excluded from the scope of PBE IPSAS 23. This will be reconsidered after the IPSASB completes its project on concessionary leases and other public sector-specific lease-type arrangements.

These examples are yet to be reviewed by staff. We have included the examples here to check with the Board whether any amendments to the examples are required to make them more useful for New Zealand PBEs, including not-for-profit PBEs.

ILLUSTRATIVE EXAMPLES

CONTENTS

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–Fibre-Optic Cable

Example 3A: Customer enters into a 15-year contract with a utilities company (Supplier) for the right to use three specified, physically distinct dark fibres within a larger cable connecting Hong Kong to Tokyo. Customer makes the decisions about the use of the fibres by connecting each end of the fibres to its electronic equipment (i.e., Customer 'lights' the fibres and decides what data, and how much data, those fibres will transport). If the fibres are damaged, Supplier is responsible for the repairs and maintenance. Supplier owns extra fibres, but can substitute those for Customer's fibres only for reasons of repairs, maintenance or malfunction (and is obliged to substitute the fibres in these cases).

The contract contains a lease of dark fibres. Customer has the right to use the three dark fibres for 15 years.

There are three identified fibres. The fibres are explicitly specified in the contract and are physically distinct from other fibres within the cable. Supplier cannot substitute the fibres other than for reasons of repairs, maintenance or malfunction (see paragraph AG19).

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

(a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the fibres over the 15-year period of use. Customer has exclusive use of the fibres throughout the period of use.

(b) Customer has the right to direct the use of the fibres because the conditions in paragraph AG25(a) exist. Customer makes the relevant decisions about how and for what purpose the fibres are used by deciding (i) when and whether to light the fibres and (ii) when and how much output the fibres will produce (i.e., what data, and how much data, those fibres will transport). Customer has the right to change these decisions during the 15-year period of use.

Although Supplier's decisions about repairing and maintaining the fibres are essential to their efficient use, those decisions do not give Supplier the right to direct how and for what purpose the fibres are used. Consequently, Supplier does not control the use of the fibres during the period of use.

Example 3B: Customer enters into a 15-year contract with Supplier for the right to use a specified amount of capacity within a cable connecting Hong Kong to Tokyo. The specified amount is equivalent to Customer having the use of the full capacity of three fibre strands within the cable (the cable contains 15 fibres with similar capacities). Supplier makes decisions about the transmission of data (i.e. Supplier lights the fibres, *makes decisions about which fibres are used to transmit Customer's traffic and makes decisions about the electronic equipment that Supplier owns and connects to the fibres).*

The contract does not contain a lease.

Supplier makes all decisions about the transmission of its customers' data, which requires the use of only a portion of the capacity of the cable for each customer. The capacity portion that will be provided to Customer is not physically distinct from the remaining capacity of the cable and does not represent substantially all of the capacity of the cable (see paragraph 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 favourable 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.

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**

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 and AG35–AG42)

IE5. The following example illustrates how a lessee measures right-of-use assets and lease liabilities. It also illustrates how a lessee accounts for a change in the lease term.

Example 13–Measurement by a Lessee and Accounting for a Change in the Lease Term

Part 1—Initial Measurement of the Right-of-Use Asset and the Lease Liability

Lessee enters into a 10-year lease of a floor of a building, with an option to extend for five years. Lease payments are CU50,000 per year during the initial term and CU55,000 per year during the optional period, all payable at the beginning of each year. To obtain the lease, Lessee incurs initial direct costs of CU20,000, of which CU15,000 relates to a payment to a former tenant occupying that floor of the building and CU5,000 relates to a commission paid to the real estate agent that arranged the lease. As an incentive to Lessee for entering into the lease, Lessor agrees to reimburse to Lessee the real estate commission of CU5,000.

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 recognises 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.

	Lease liability				**Right-of-use asset**		
Year	**Beginning balance CU**	**Lease payment CU**	**5% interest expense CU**	**Ending balance CU**	**Beginning balance CU**	**Depreciation charge CU**	**Ending balance CU**
1	**355,391**	-	17,770	**373,161**	**420,391**	(42,039)	**378,352**
2	**373,161**	(50,000)	16,158	**339,319**	**378,352**	(42,039)	**336,313**
3	**339,319**	(50,000)	14,466	**303,785**	**336,313**	(42,039)	**294,274**
4	**303,785**	(50,000)	12,689	**266,474**	**294,274**	(42,039)	**252,235**
5	**266,474**	(50,000)	10,823	**227,297**	**252,235**	(42,039)	**210,196**
6	**227,297**	(50,000)	8,865	**186,162**	**210,196**	(42,039)	**168,157**

At the end of the sixth year, before accounting for the change in the lease term, the lease liability is CU186,162 (the present value of four remaining payments of CU50,000, discounted at the original interest rate of 5 per cent per annum). Interest expense of CU8,865 is recognised 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, recognised as follows.

Right-of-use asset	CU192,012	
Lease liability		CU192,012

Following the remeasurement, the carrying amount of Lessee's right-of-use asset is CU360,169 (i.e. CU168,157 + CU192,012). From the beginning of Year 7 Lessee calculates the interest expense on the lease liability at the revised discount rate of 6 per cent per annum.

The right-of-use asset and the lease liability from Year 7 to Year 15 are as follows.

	Lease liability				**Right-of-use asset**		
Year	**Beginning balance CU**	**Lease payment CU**	**6% interest expense CU**	**Ending balance CU**	**Beginning balance CU**	**Depreciation charge CU**	**Ending balance CU**
7	**378,174**	(50,000)	19,690	**347,864**	**360,169**	(40,019)	**320,150**
8	**347,864**	(50,000)	17,872	**315,736**	**320,150**	(40,019)	**280,131**
9	**315,736**	(50,000)	15,944	**281,680**	**280,131**	(40,019)	**240,112**
10	**281,680**	(50,000)	13,901	**245,581**	**240,112**	(40,019)	**200,093**
11	**245,581**	(55,000)	11,435	**202,016**	**200,093**	(40,019)	**160,074**
12	**202,016**	(55,000)	8,821	**155,837**	**160,074**	(40,019)	**120,055**
13	**155,837**	(55,000)	6,050	**106,887**	**120,055**	(40,019)	**80,036**
14	**106,887**	(55,000)	3,113	**55,000**	**80,036**	(40,018)	**40,018**
15	**55,000**	(55,000)	-	-	**40,018**	(40,018)	-

Variable Lease Payments (see paragraphs 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 recognises 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 recognises 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 recognises 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, recognised 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 recognises 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 recognised 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 recognises 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 recognises 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 recognises 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 recognises 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 recognises 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.

	Lease liability				**Right-of-use asset**		
Year	**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.

<u>Decrease in the lease term</u>

At the effective date of the modification (at the beginning of Year 6), the pre-modification right-of-use asset is CU368,004. Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset based on the remaining right-of-use asset for the original 2,000 square 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 ÷ 5 × 3 years).

At the effective date of the modification (at the beginning of Year 6), the pre-modification lease liability is CU421,236. The remaining lease liability for the original 2,000 square 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 recognises the difference between the decrease in the lease liability and the decrease in the right-of-use asset (CU153,935 – CU147,202 = CU6,733) as a gain in surplus or deficit at the effective date of the modification (at the beginning of Year 6).

Lease liability	CU153,935	
Right-of-use asset		CU147,202
Gain		CU6,733

At the effective date of the modification (at the beginning of Year 6), Lessee recognises the effect of the remeasurement of the remaining lease liability reflecting the revised discount rate of 7 per cent per annum, which is CU4,870 (CU267,301 – CU262,431), as an adjustment to the right-of-use asset.

Lease liability	CU4,870	
Right-of-use asset		CU4,870

Increase in the leased space

At the commencement date of the lease for the additional 1,500 square meters of space (at the beginning of Year 6), Lessee recognises the increase in the lease liability related to the increase in scope of CU131,216 (i.e. present value of three annual lease payments of CU50,000, discounted at the revised interest rate of 7 per cent per annum) as an adjustment to the right-of-use asset.

Right-of-use asset	CU131,216	
Lease liability		CU131,216

The modified right-of-use asset and the modified lease liability in relation to the modified lease are as follows.

	Lease liability				**Right-of-use asset**		
	Beginning balance	**7% interest expense**	**Lease payment**	**Ending balance**	**Beginning balance**	**Depreciation charge**	**Ending balance**
Year	**CU**	**CU**	**CU**	**CU**	**CU**	**CU**	**CU**
6	**393,647**	27,556	(150,000)	**271,203**	**347,148**	(115,716)	**231,432**
7	**271,203**	18,984	(150,000)	**140,187**	**231,432**	(115,716)	**115,716**
8	**140,187**	9,813	(150,000)	-	**115,716**	(115,716)	-

Example 19—Modification that is a Change in Consideration Only

Lessee enters into a 10-year lease for 5,000 square 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 recognises the difference between the carrying amount of the modified liability (CU389,519) and the lease liability immediately before the modification (CU421,236) of CU31,717 as an adjustment to the right-of-use asset.

Subleases (see paragraph 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) Derecognises the right-of-use asset relating to the head lease that it transfers to the sublessee and recognises the net investment in the sublease;

(b) Recognises 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 recognises 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) Recognises a depreciation charge for the right-of-use asset and interest on the lease liability; and

(b) Recognises 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 recognised 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 recognised 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, recognised lease liabilities do not include potential future rental payments after the exercise date of termination options because Lessee is not reasonably certain to extend the lease beyond that date. This is the case for most leases for which a longer lease period can be enforced only by Lessee and not by the landlord, and for which there is no penalty associated with the option.

Potential future rental payments relating to periods following the exercise date of termination options are summarized below.

Segment	Lease liabilities recognised (discounted)	Potential future lease payments not included in lease liabilities (undiscounted)		
		Payable during 20X1–20X5	Payable during 20X6–20Y0	Total
	CU	CU	CU	CU
Operation A	569	71	94	165
Operation B	2,455	968	594	1,562
Operation C	269	99	55	154
Operation D	1,002	230	180	410
Operation E	914	181	321	502
	5,209	**1,549**	**1,244**	**2,793**

The table below summarizes the rate of exercise of termination options during 20X0.

Segment	Termination option exercisable during 20X0	Termination option not exercised	Termination option exercised
	No. of leases	No. of leases	No. of leases
Operation A	33	30	3
Operation B	86	69	17
Operation C	19	18	1
Operation D	30	5	25
Operation E	66	40	26
	234	**162**	**72**

Example 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 recognised (discounted)**	**Potential future lease payments not included in lease liabilities (discounted)**	**Historical rate of exercise of extension options**
	CU	**CU**	**%**
Operation A	569	799	52%
Operation B	2,455	269	69%
Operation C	269	99	75%
Operation D	1,002	111	41%
Operation E	914	312	76%
	5,209	**1,590**	**67%**

Sale and Leaseback Transactions (see paragraphs 97–102)

IE11. Example 24 illustrates the application of the requirements in paragraphs 97–102 of IPSAS 43 for a seller-lessee and a buyer-lessor.

Example 24–Sale and Leaseback Transaction

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 for determining when a performance obligation is satisfied in NZ IFRS 15 Revenue from Contracts with Customers. Accordingly, Seller-lessee and Buyer-lessor account for the transaction as a sale and leaseback. This example ignores any initial direct costs.

The fair value of the building at the date of sale is CU1,800,000. Because the consideration for the sale of the building is not at fair value, Seller-lessee and Buyer-lessor make adjustments to measure the sale proceeds at fair value. The amount of the excess sale price of CU200,000 (CU2,000,000 – CU1,800,000) is recognised as additional financing provided by Buyer-lessor to Seller-lessee.

The interest rate implicit in the lease is 4.5 per cent per annum, which is readily determinable by Seller-lessee. The present value of the annual payments (18 payments of CU120,000, discounted at 4.5 per cent per annum) amounts to CU1,459,200, of which CU200,000 relates to the additional financing and CU1,259,200 relates to the lease—corresponding to 18 annual payments of CU16,447 and CU103,553, respectively.

<u>Seller-lessee</u>

At the commencement date, Seller-lessee measures the right-of-use asset arising from the leaseback of the building at the proportion of the previous carrying amount of the building that relates to the right of use retained by Seller-lessee, which is CU699,555. This is calculated as: CU1,000,000 (the carrying amount of the building) ÷ CU1,800,000 (the fair value of the building) × CU1,259,200 (the discounted lease payments for the 18-year right-of-use asset).

Seller-lessee recognises only the amount of the gain that relates to the rights transferred to Buyer-lessor of CU240,355 calculated as follows. The gain on sale of building amounts to CU800,000 (CU1,800,000 – CU1,000,000), of which:

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

(b) CU240,355 (CU800,000 ÷ CU1,800,000 × (CU1,800,000 – CU1,259,200)) relates to the rights transferred to Buyer-lessor.

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

Cash	CU2,000,000	
Right-of-use asset	CU699,555	
Building		CU1,000,000
Financial liability		CU1,459,200
Gain on rights transferred		CU240,355

<u>Buyer-lessor</u>

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

Building	CU1,800,000	
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.

Comparison with IPSAS 43 (to be completed)

Agenda Item 8.1

Memorandum

Date:	17 June 2022
To:	NZASB Members
From:	Carly Berry
Subject:	**Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12 – project update**

Purpose and introduction

1. The purpose of this paper is to provide the Board with an update on the post-implementation review (PIR) of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*. The Feedback Statement for this project is expected to be issued towards the end of June 2022[1].

Recommendation

2. We recommend that the Board NOTES this project update and provides FEEDBACK on any actions we should take to promote consistent application in New Zealand.

Background

3. IFRS 10, IFRS 11 and IFRS 12 (the Standards) were issued in 2011 and became effective for annual periods beginning on or after 1 January 2013. In September 2019, the IASB commenced the first of two phases of the PIR.

   (a) Phase 1 – meetings with a broad range of stakeholders, for the purpose of understanding and gathering evidence on the experience of implementing and applying the Standards. Overall, these stakeholders said that the Standards were working well.

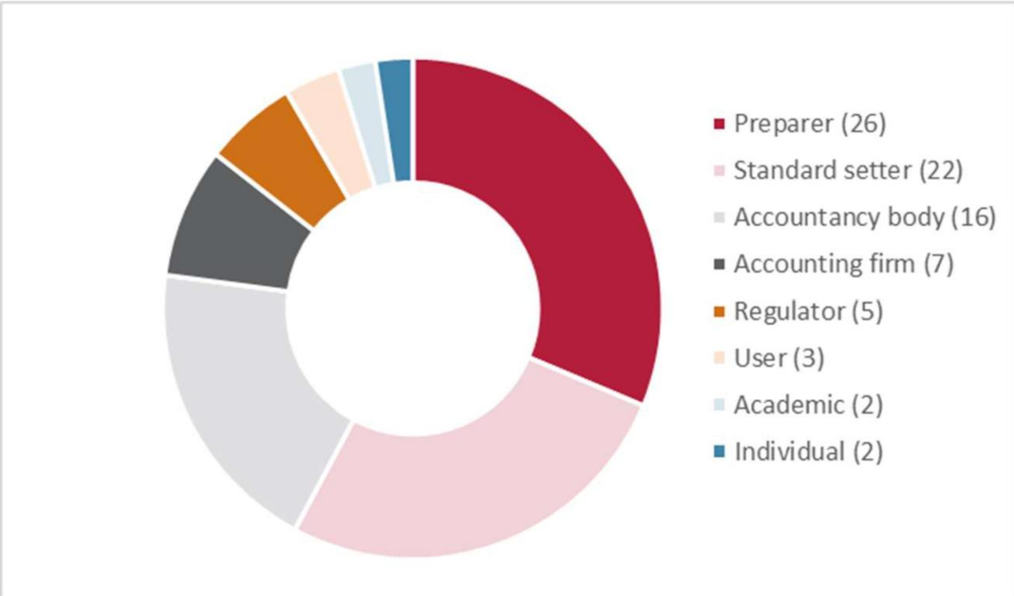
   (b) Phase 2 – a Request for Information (RFI) was published in December 2020, with a focus on particular matters of the Standards (based on the results of the first phase).

4. At its December 2020 meeting the NZASB agreed to comment on the RFI, subject to TRG feedback on any New Zealand-specific issues. At its March 2021 meeting the TRG raised some issues but it was decided that, since the IASB was already aware of these issues, the NZASB would not formally comment on the RFI. Comments were, however, sent through to the AOSSG for the purposes of the March 2021 ASAF meeting. Refer to Appendix A for a summary of the issues raised by the TRG.

1 The detail on the IASB's final decisions on this project was taken from the May 2022 Due Process and Oversight Committee (DPOC) meeting (agenda item 2A). At this meeting, IASB staff were seeking agreement from the DPOC that the IASB has completed the Post-Implementation Review satisfactorily and that the Feedback Statement can be finalised and published.

Findings from the PIR

5. The comment period on the RFI closed on 10 May 2021. In total, there were 84 respondents to the RFI. The diagram below shows the analysis by stakeholder type.



6. The IASB discussed the feedback from respondents between July 2021 and February 2022. Based on this feedback the IASB has concluded that the Standards are achieving their objectives, and that the implementation and application of the Standards have not given rise to substantial unexpected costs.

7. Matters raised through the PIR were put through the IASB's new approach to prioritisation, as discussed in Appendix B. The IASB concluded that there are no high priority matters (i.e. those requiring immediate action) or medium priority matters (i.e. matters that should be added to the research pipeline). Five matters were identified as low priority.

   (a) Subsidiaries that are investment entities

   (b) Transactions that change the relationship between an investor and an investee

   (c) Transactions that involve 'corporate wrappers'

   (d) Collaborative arrangements outside the scope of IFRS 11

   (e) Additional disclosures about interests in other entities

8. As a result of their low priority status, these topics will not be added to the IASB's work plan of active projects or its research pipeline for 2022 to 2026. If stakeholders require application support on these or other matters relating to the Standards, questions must be submitted to the IFRS Interpretations Committee. Refer to Appendix C for more detail on these low priority matters.

APPENDIX A: Summary of issues raised by the TRG at its March 2021 meeting

Applicable Standard	TRG issue
IFRS 10	Close call control judgements – more examples would be useful.
	Judgements about relevant activities can be difficult.
	Judgements about veto rights can be difficult.
	Judgements about start-up entities and the control assessment can be difficult.
IFRS 11	Lack of awareness of requirements from mid-tier clients (probably not a concern for the IASB).
	Lack of guidance on accounting for a change from a joint venture to a joint operation.
IFRS 12	Some preparers are unhappy about the level of disclosure required.
	Is disclosure of non-controlling interests in subsidiaries useful when those subsidiaries are required to report separately? (This was raised in the context of PBEs and New Zealand legislative requirements.)

APPENDIX B: Approach to prioritisation of matters identified in PIRs

At its January 2022 meeting, the IASB decided to develop further its strategy for deciding whether and when to take action based on feedback from PIRs. The need for further clarification on the IASB's strategy was also important for considering priorities from PIRs compared to priorities arising from the Third Agenda Consultation.

<u>Step one</u>

A matter identified in a PIR would warrant **further action** if there is evidence of one of the following:

- The objective of the standard is not being met
- Significant deficiency in how information from application of the standard is meeting user needs
- Costs or challenges of applying the standard (or auditing, enforcing or using information arising from the application of the standard) is significantly greater than expected

<u>Step two</u>

Timing of further action is based on the following characteristics of the matter:

- Consequences are significant
- Pervasive
- Can be addressed by the IASB or IFRS Interpretations Committee
- Benefits of action > costs

<u>Step three</u>

Categorisation of matters in terms of priority:

High priority
- Addressed as soon as possible

Medium priority
- Added to the IASB's research pipeline or the IFRS Interpretations Committee's pipeline

Low priority
- Addressed only if the matters are identified as a priority in the next Agenda Consultation

'No action' matters
- Neither the IASB nor the Intepretations Committee will take further action

APPENDIX C: Low priority matters arising from the PIR

Topic	Issue	IASB analysis
Subsidiaries that are investment entities	When a subsidiary that is an investment entity itself is measured at fair value, the information on the assets and liabilities held by the subsidiary is aggregated to an extent that the users are not able to understand the investment entity group's operations.	Information is only lost for multi-layered group structures and the loss of information can be compensated for by voluntary disclosure.
Transactions that change the relationship between an investor and an investee	Certain transactions of this nature are not currently addressed by IFRS Accounting Standards. For example: - A subsidiary becoming a joint operation - A joint venture becoming a joint operation - Changes from a joint operator to a party to a joint operation without having joint control	IFRS Accounting Standards do not provide guidance for all transactions that alter the relationship between an investor and an investee. The transactions identified by respondents occur infrequently and, therefore, did not assess the matter to be pervasive.
Transactions that involve 'corporate wrappers'	Different IFRS Accounting Standards may be applicable depending on whether assets and liabilities are exchanged separately or through a corporate entity. Consequently, the same transaction with the same economic phenomena may have difference outcomes depending on the standard applied and may not be a faithful representation of the transaction.	The concerns of stakeholders regarding transactions that involve 'corporate wrappers' extend beyond the scope of the PIR and include other IFRS Accounting Standards. The IASB was also concerned about whether it could satisfactorily address this matter.
Collaborative arrangements outside the scope of IFRS 11	Challenging to apply the requirements in IFRS Accounting Standards to collaborative arrangements outside the scope of IFRS 11. Guidance would be helpful as these types of arrangements are common in several industries.	Collaborative arrangements outside the scope of IFRS 11 were only observed in some industries.
Additional disclosures about interests in other entities	Users think that additional information would be helpful for them to understand an entity's interests in other entities, particularly around the following topics: - Significant judgements and assumptions - Subsidiaries with material NCI - Unconsolidated structured entities - Information on JVs and associates by operating segment, and joint operations	Although users had called for improved disclosure of interests in other entities the overall feedback was that the disclosure requirements in IFRS 12 enable entities to meet this Standard's disclosure objective.

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Memorandum

Date:	17 June 2022
To:	NZASB Members
From:	Carly Berry
Subject:	**Cover memo: Application of the PBE Policy Approach to IPSAS 44 *Non-current Assets Held for Sale and Discontinued Operations***

Introduction[1]

1. The International Public Sector Accounting Standards Board (IPSASB) approved IPSAS 44 *Non-current Assets Held for Sale and Discontinued Operations* at its March 2022 meeting. IPSAS 44 was published on 4 May 2022, with an effective date of 1 January 2025. Earlier application is permitted.

2. IPSAS 44 introduces new requirements into IPSAS for the accounting for assets held for sale, and the presentation and disclosure of discontinued operations. IPSAS 44 is aligned with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

3. In accordance with the *Policy Approach to Developing the Suite of PBE Standards* (PBE Policy Approach), the Board is required to consider if and when to incorporate IPSAS 44 into the suite of PBE Standards as issued by the XRB.

4. The content of this memo includes the application of the PBE Policy Approach to IPSAS 44.

Recommendation

5. We recommend that the Board:

   (a) NOTES that the IPSASB recently issued IPSAS 44 *Non-current Assets Held for Sale and Discontinued Operations* (see agenda item 9.2);

   (b) APPLIES the *Policy Approach to the Development of PBE Standards* (PBE Policy Approach) and AGREES to develop a PBE Standard based on IPSAS 44; and

   (c) AGREES to expose the PBE Standard for public comment at the same time as the PBE Standards based on the IPSASB's *Measurement* project.

[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

Structure of this memo

6. This memo has the following sections.

   (a) Background

   (b) Application of the PBE Policy Approach

   (c) Timing of a PBE ED based on IPSAS 44

   (d) Next steps

Background

7. ED 79 *Non-current Assets Held for Sale and Discontinued Operations* was issued for comment by the IPSASB in April 2021. ED 79 was aligned with the requirements of IFRS 5 but proposed an additional public sector disclosure, in the notes, of the fair value of assets held for sale that are measured at their carrying amounts, when the carrying amount is materially lower than fair value (paragraph 52 of the ED). This proposed disclosure was the subject of the only specific matter for comment (SMC) within the ED.

8. The IPSASB received strong support for the proposals in ED 79, including support for the additional public sector disclosure - 79% of respondents either agreed fully or partially with the proposed disclosure. The IPSASB has therefore retained this disclosure in IPSAS 44. The NZASB did not support this disclosure, as noted in its comment letter dated 28 October 2020. This was the most significant issue raised in the comment letter. Refer to Appendix A for other issues raised by both the NZASB and The Treasury (and the IPSASB's response).

9. Now that the IPSASB has issued IPSAS 44 (which is based on ED 79) we need to apply the PBE Policy Approach. Assuming the Board decides to incorporate IPSAS 44 into PBE Standards, we need to decide how and when to give effect to that decision. This decision is affected by the fact that the suite of PBE Standards already includes a Standard based on IFRS 5 – PBE IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations.*

Application of the PBE Policy Approach

10. The Board regularly considers whether a new or amending IPSAS should be incorporated into PBE Standards. These decisions are guided by the PBE Policy Approach.

11. The PBE Policy Approach identifies triggers for changes to PBE Standards. One of these triggers is the IPSASB issuing a new IPSAS. Section 4.1 (paragraphs 22–24) of the PBE Policy Approach establishes a rebuttable presumption that the NZASB will adopt a new or amended IPSAS. The PBE Policy Approach states that it is expected that the adoption of a new or amended IPSAS will lead to higher quality financial reporting by public benefit entities (PBEs) in New Zealand and the factors in the development principle are presumed to be met.

12. Table 1 considers the factors in the development principle as they apply to IPSAS 44.

Table 1: Factors in the Development Principle

Factors in the Development Principle	Comment
Whether the potential development will lead to higher quality financial reporting by public sector PBEs and not-for-profit entities, including public sector PBE groups and not-for-profit groups, than would be the case if the development was not made.	Although IPSAS 44 is aligned with IFRS 5, the PBE suite of standards already includes PBE IFRS 5. There is one significant difference between PBE IFRS 5 and IPSAS 44 – the additional fair value disclosure – but this may not be retained by the NZASB in a PBE Standard based on IPSAS 44, as the NZASB was not in favour of this disclosure. It can therefore be argued that there would be no significant increase in the quality of PBEs' financial reporting as a result of incorporating IPSAS 44 into the PBE suite of standards. Refer to Appendix B for a summary of the key differences between PBE IFRS 5 and IPSAS 44. There is, however, the rebuttable presumption mentioned in paragraph 11 of this paper. It is expected that this presumption will only be rebutted in exceptional circumstances. As discussed above, both the new IPSAS and the current PBE Standard are based on IFRS 5, which means that a decision to incorporate IPSAS 44 into the PBE suite of standards is not clear-cut – the costs and benefits will have to be considered (see below).
Whether the benefits of a potential development will outweigh the costs, considering as a minimum: **(i) *relevance to the PBE sector as a whole:* for example, where the potential development arises from the issue of a new or amended IFRS, whether the type and incidence of the affected transactions in the PBE sector are similar to the type and incidence of the transactions addressed in the change to the NZ IFRS;** **(ii) *relevance to the not-for-profit or public sector sub-sectors:* whether there are specific user needs in either of the sub-sectors, noting that IPSAS are developed to meet the needs of users of the financial reports of public sector entities;** **(iii) *coherence:* the impact on the entire suite of PBE Standards (e.g. can the change be adopted without destroying the coherence of the suite);** **(iv) *the impact on mixed groups*.**	Considering the four factors in the column to the left is not enough to determine whether incorporating IPSAS 44 into the PBE suite of standards is the right approach to take. This is because, based on those four factors, it would be beneficial to develop a PBE Standard based on IPSAS 44, but this situation is unique as there is already a PBE Standard which is materially the same in substance as IPSAS 44. Therefore, to determine whether the presumption mentioned above can be rebutted, the following analysis sets out additional costs and benefits to consider. *Benefits* • It is likely that new PBE Standards will be developed to incorporate the outcome of the IPSASB's *Measurement* project (currently ongoing). Incorporating IPSAS 44, which was developed as part of the *Measurement* project, will ensure consistency of approach to all the new IPSASs arising from this project. • IPSAS 44 already includes updated guidance and references to the IFRS 13 *Fair Value Measurement* definition of fair value. PBE IFRS 5 would need to be updated at some stage, as it still refers to the pre-IFRS 13 definition of fair value. • Not incorporating IPSAS 44 could raise questions, since on the face of it there is no reason not to use the IPSAS – it may seem "odd" not to incorporate an IPSAS which is clearly relevant in New Zealand, even though it may be that the costs to develop a new PBE Standard would lead to minimal benefit.

Factors in the Development Principle	Comment
	Costs • If it was decided to incorporate IPSAS 44 into the PBE suite of standards, the new PBE Standard would have to be exposed for public comment. Since there are very few material differences between this IPSAS and PBE IFRS 5 this may confuse constituents, who will have already been asked for feedback on ED 79. • It would take time to turn IPSAS 44 into a PBE Standard – time that may not need to be spent, since IPSAS 44 and PBE IFRS 5 are so similar. • Issuing a new PBE Standard would mean having to revoke PBE IFRS 5. This would require time to deal with the admin for this, as well as considering effective dates and transition requirements.
In the case of a potential development arising from the issue of a new or amended IFRS, the IPSASB's likely response to the change (e.g. whether the IPSASB is expected to develop an IPSAS on the topic in an acceptable time frame).	Not applicable.

13. The conclusion, based on the analysis above, is not heavily weighted in favour of or against developing a PBE Standard based on IPSAS 44. Therefore, there is not a strong enough argument to rebut the presumption discussed earlier and so we recommend developing a PBE Standard based on IPSAS 44.

Question for the Board

Q1. Does the Board AGREE to develop a PBE Standard based on IPSAS 44?

Timing of a PBE ED based on IPSAS 44

14. If the Board agrees to develop a new PBE Standard based on IPSAS 44, the next step is to develop a domestic PBE ED for public consultation.

15. We recommend that, since the current PBE Standard and IPSAS 44 are so similar in substance, we do not issue a domestic ED in the immediate future. Instead, we recommend including the ED in the same 'package' as the other domestic PBE EDs which will likely be issued once the IPSASB's *Measurement* project is finalised.

16. The IPSASB is planning to issue pronouncements relating to the *Measurement* project in December 2022. Therefore, PBE IPSAS 44 would likely be exposed for public comment in the second half of 2023.

Question for the Board
Q2. Does the Board AGREE to expose the PBE Standard for public comment at the same time as the PBE Standards based on the IPSASB's *Measurement* project?

Next steps

17. Depending on the Board's decisions, an ED and accompanying Consultation Document will be drafted for consideration at a future meeting. This will include Board consideration of whether the additional disclosure requirement is included in the ED.

Attachments

Agenda item 9.2: IPSAS 44 *Non-current Assets Held for Sale and Discontinued Operations*

APPENDIX A: XRB and Treasury comments on ED 79 and the IPSASB's response

This analysis will be considered during the development of a New Zealand PBE ED.

Issue	Entity	IPSASB response
The NZASB did not support the proposed disclosure in paragraph 52: *An entity shall disclose in the notes, the fair value of the non-current asset (or disposal group) classified as held for sale when that non-current asset (or disposal group) is measured at a materially lower carrying amount than fair value.* The costs of obtaining a fair value and including that information in an audited set of financial statements would outweigh the benefits to users.	XRB	IPSAS 44 retains this disclosure from ED 79. In their analysis for the March 2022 IPSASB meeting, the IPSASB staff noted that the information required by the disclosure should be readily available, since the entity should have already determined the fair value as part of measuring the non-current asset held for sale (i.e. at the lower of carrying amount and fair value less costs to sell). In IPSAS 44.BC14, the IPSASB explains that information which allows users to hold the entity accountable for decisions regarding sales of non-current assets is in the public interest.
The illustrative examples should be expanded to show how a discontinued operation could be presented on the face of the statement of financial performance.	XRB	This suggestion was not incorporated into IPSAS 44.
ED 79 could have a significant impact on the measurement of infrastructure assets to be transferred between entities within the public sector (i.e. could go from COV measurement to FVLC then back to COV once transferred). FVLC of infrastructure assets is likely to be less than COV because FV is an exit, market-based measurement that reflects the perspective of market participants.	XRB	Not addressed.
Transfers between commonly controlled public entities with reporting obligations to comply with GAAP – such transfers can take place at full consideration, nominal consideration, below market	Treasury	Not addressed.

Issue	Entity	IPSASB response
consideration or no consideration. Where assets are transferred between commonly controlled entities at an entry value (COV/CC) that is above exit value (fair value), the accounting under the proposed standard will not be appropriate, as it would result in: • an immediate loss for the transferor on classification of the asset as held for sale (resulting from measuring the assets at fair value less costs to sell); and • an immediate write up in value of the asset for the transferee (resulting from measuring the assets back to COV/CC).		
The inclusion of asset and liability line items in IPSAS 1 (as a result of the ED proposals) should be included with the other asset and liability line items respectively, to make it easier for constituents.	XRB	The IPSASB has incorporated this suggestion into IPSAS 1.
IPSAS 14 *Events after the Reporting Period* should be amended to align with IAS 10 *Events after the Reporting Period*, with respect to amendments made to IAS 10 as a result of IFRIC 17 *Distributions of Non-cash Assets to Owners.*	XRB	The IPSASB has incorporated this suggestion into IPSAS 14.
Change paragraph 13(a) in IPSAS 16 *Investment Property* to refer to non-current assets held for sale (instead of inventory).	XRB	No change was made.
In New Zealand's case, other public sector specific examples include assets (for example, land and building) that are held for Treaty of Waitangi treaty settlements. These assets are non-current, are being held for disposal in accordance with a plan, and disposal is highly likely. However, such assets could not be said to be actively marketed, and it is common that the negotiations that lead to the final disposal will take more than a year. It is unclear if these are considered to be non-current assets held for sale and therefore within the scope of the proposed standard.	Treasury	The IPSASB has confirmed in IPSAS 44.BC6 that, although public sector asset disposals can take considerable periods of time to finalise, the scope of IFRS 44 remains aligned with the scope of IFRS 5 (i.e. so if the criteria are not met, these disposals fall outside of scope of IPSAS 44). Therefore, for the example that Treasury gave, these assets would not be within scope of IPSAS 44 (i.e. not actively marketed, not expected to complete within one year from the date of classification).

APPENDIX B: Key differences between PBE IFRS 5 and IPSAS 44

Difference	Comment
IPSAS 44 refers IFRS 13 with respect to the definition of "fair value". PBE IFRS 5 uses the pre-IFRS 13 definition.	Once the IPSASB's *Measurement* project is completed, the reference to IFRS 13 will be updated accordingly. If PBE IFRS 5 remains in the PBE suite of standards, the definition of fair value will be updated to be consistent with the new PBE Standards arising from the *Measurement* project.
Paragraph 24 (last sentence) – *"if the asset (or disposal group) is acquired as part of a public sector amalgamation (see IPSAS 40), it shall be measured at the lower of its carrying amount and fair value less costs to sell"*. Amendment in IPSAS 44 not included in PBE IFRS 5	Assets acquired in a public sector amalgamation are measured at carrying amount. Under IFRS 5 requirements, they would be measured at fair value less costs to sell, and hence there may be an increase in value. Therefore, the IPSASB amended the requirements for assets acquired through a public sector amalgamation.
Disclosure requirement relating to IPSAS 18 *Segment Reporting* (no equivalent PBE Standard)	This disclosure requirement would not be replicated in a PBE Standard based on IPSAS 44.
IPSAS 44 includes paragraph 52, which states that: *"An entity shall disclose in the notes, the fair value of the non-current asset (or disposal group) classified as held for sale when that non-current asset (or disposal group) is measured at a materially lower carrying amount than fair value."* No equivalent disclosure in PBE IFRS 5.	The NZASB did not support this proposed disclosure. Refer to Appendix A for more information.
IPSAS 44 includes fair value disclosures based on IFRS 13. No equivalent disclosures in PBE IFRS 5.	If retained, PBE IFRS 5 would have to be updated to refer to the new PBE Standards arising from the *Measurement* project.