Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Proposed new lease accounting standard

Tier 1 & 2 Public Benefit Entities

PBE IPSAS 43 *Leases*

Exposure Draft (ED)

August 2022

Comment period closes 25 November 2022

NZASB EXPOSURE DRAFT 2022-11

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 103.

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*.

PBE IPSAS 43 LEASES

ISBN

PBE IPSAS 43 LEASES

CONTENTS

Public Benefit Entity International Public Sector Accounting Standard 43 *Leases* is set out in paragraphs 1–127 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 PBE FRS 45 *Service Concession Arrangements: Operator*; 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 that convey the right to use an asset for a specified period of time for no consideration 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, except when this Standard or another Standard requires or permits a different accounting treatment.

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 realisation 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, maximising 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. [Not used]

49. [Not used]

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 99.1(b) of PBE IPSAS 1 *Presentation of Financial Reports* 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. [Not used]

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 specialised 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 PBE IFRS 5 *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 revenue.

*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.

Temporary exception arising from interest rate benchmark reform

102A A lessee shall apply paragraphs 102B–102C to all lease modifications that change the basis for determining future lease payments as a result of interest rate benchmark reform (see paragraphs 72.2 and 72.4 of PBE IPSAS 41). These paragraphs apply only to such lease modifications. For this purpose, the term 'interest rate benchmark reform' refers to the market-wide reform of an interest rate benchmark as described in paragraph 155.2 of PBE IPSAS 41.

102B As a practical expedient, a lessee shall apply paragraph 43 to account for a lease modification required by interest rate benchmark reform. This practical expedient applies only to such modifications. For this purpose, a lease modification is required by interest rate benchmark reform if, and only if, both of these conditions are met:

   (a) the modification is necessary as a direct consequence of interest rate benchmark reform; and

   (b) the new basis for determining the lease payments is economically equivalent to the previous basis (i.e. the basis immediately preceding the modification).

102C However, if lease modifications are made in addition to those lease modifications required by interest rate benchmark reform, a lessee shall apply the applicable requirements in this Standard to account for all lease modifications made at the same time, including those required by interest rate benchmark reform.

Effective Date and Transition

Effective Date

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

104. [Not used]

105. [Not used]

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 comprehensive revenue and expense (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 amortise 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 PBE Combinations

123. If a lessee previously recognised an asset or a liability applying PBE IPSAS 40 *PBE Combinations* or PBE IFRS 3 *Business Combinations* relating to favourable or unfavourable terms of an operating lease acquired as part of a PBE 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.

124. [Not used]

125. [Not used]

126. [Not used]

Interest Rate Benchmark Reform—Phase 2

126A An entity shall apply paragraphs 102A–102C retrospectively in accordance with PBE IPSAS 3, except as specified in paragraph 126B.

126B An entity is not required to restate prior periods to reflect the application of paragraphs 102A–102C. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application of paragraphs 102A–102C in the opening accumulated comprehensive revenue and expense (or other component of net assets/equity, as appropriate) of the annual reporting period that includes the date of initial application of these paragraphs.

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 realised 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

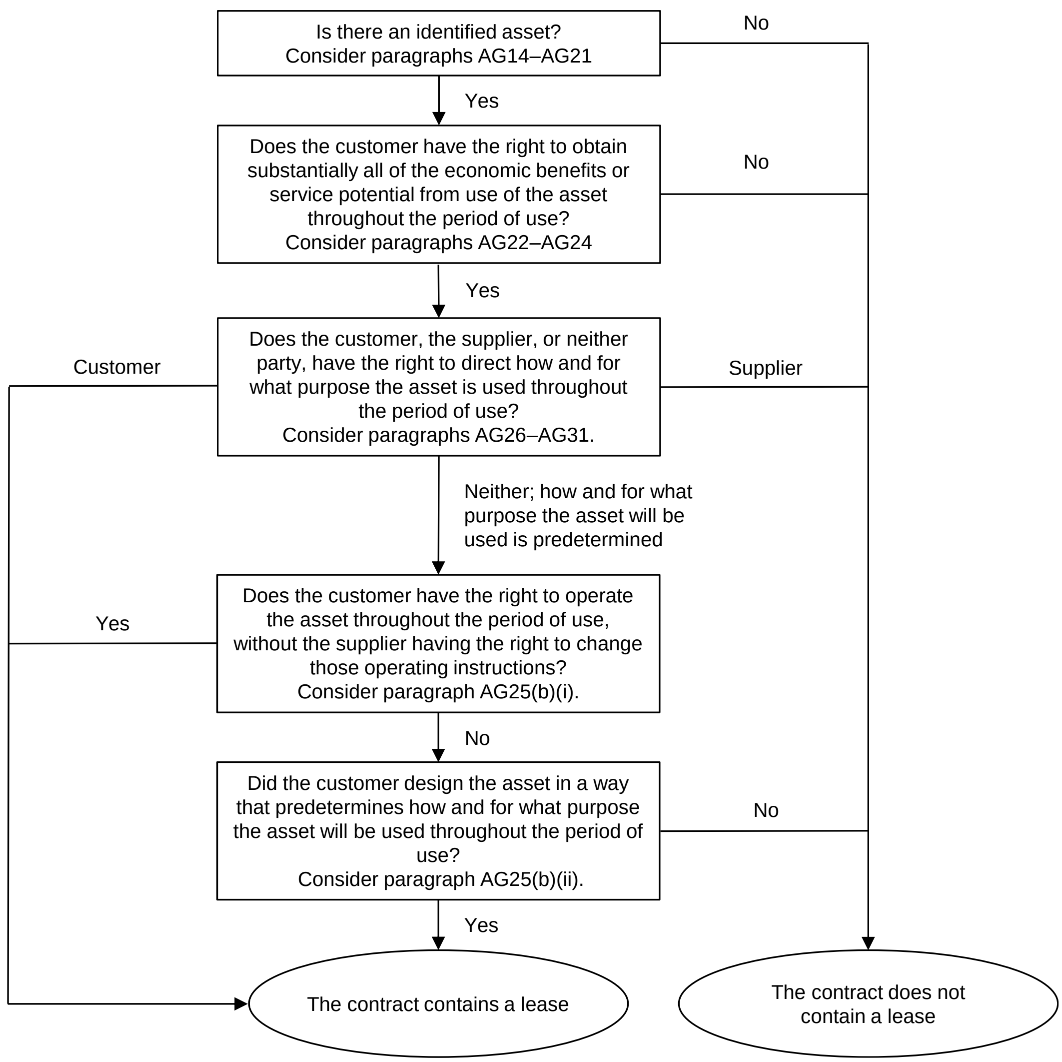
AG29. The relevant decisions about how and for what purpose the asset is used can be predetermined in a number of ways. For example, the relevant decisions can be predetermined by the design of the asset or by contractual restrictions on the use of the asset.

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 specialised 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 customisation 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 realisation 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).

[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 PBE IPSAS 1 discusses the transitional approach to the explanation of reliability.

Appendix B

Amendments to Other Standards

An entity shall apply the amendments in this appendix when it applies PBE IPSAS 43.

The amendments to other standards in this appendix are based on the text of those other standards, including any amendments to those standards approved when PBE IPSAS 43 was issued in [Date].

Amended paragraphs are shown with deleted text struck through and new text is underlined.

PBE IPSAS 2 *Cash Flow Statements*

Paragraphs 26 and 55 are amended. Paragraph 63.5 is added. New text is underlined and deleted text is struck through.

Presentation of a Cash Flow Statement

…

Financing Activities

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

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

    (b) Cash repayments of amounts borrowed; and

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

…

Noncash Transactions

…

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

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

    (b) The conversion of debt to equity.

…

Effective Date

<u>63.5.</u> <u>**PBE IPSAS 43 *Leases*, issued in [Date], amended paragraphs 26 and 55. An entity shall apply these amendments when it applies PBE IPSAS 43.**</u>

PBE IPSAS 4 *The Effects of Changes in Foreign Exchange Rates*

Paragraph 17 is amended. Paragraph 72.7 is added. New text is underlined and deleted text is struck through.

Definitions

…

Monetary Items

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

…

Effective Date

…

72.7. <u>**PBE IPSAS 43 *Leases*, issued in [Date], amended paragraph 17. An entity shall apply this amendment when it applies PBE IPSAS 43.**</u>

PBE IPSAS 5 *Borrowing Costs*

Paragraph 6 is amended. Paragraph 43.6 is added. New text is underlined and deleted text is struck through.

Definitions

Borrowing Costs

…

6. Borrowing costs may include:

   (a) Interest expense calculated using the effective interest method as described in PBE IPSAS 41 *Financial Instruments*;

   (b)–(c) [Deleted by IPSASB]

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

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

…

Effective Date

…

43.6. **PBE IPSAS 43 *Leases*, issued in [Date], amended paragraph 6. An entity shall apply this amendment when it applies PBE IPSAS 43.**

PBE IPSAS 12 *Inventories*

Paragraph 20 is amended. Paragraph 52.7 is added. New text is underlined and deleted text is struck through.

Measurement of Inventories

…

Cost of Inventories

…

Costs of Conversion

20. The costs of converting work-in-progress inventories into finished goods inventories are incurred primarily in a manufacturing environment. The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of (a) the volume of production, such as depreciation and maintenance of factory buildings, ~~and~~ equipment and right-of-use assets used in the production process, and (b) the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

…

Effective date

52.7. **PBE IPSAS 43 *Leases*, issued in [Date], amended paragraph 20. An entity shall apply this amendment when it applies PBE IPSAS 43.**

PBE IPSAS 16 *Investment Property*

Paragraphs 7, 10, 12, 13, 20, 26, 27, 39, 49, 50, 59, 62, 62A, 63, 65, 71, 72, 73, 78, 80, 85, 86, 88, and 89 are amended. Paragraphs 25A, 38A, 49A, 100D and its related heading and paragraph 102.10 are added. Paragraphs 5, 8, 34, 35 and 43 are deleted. New text is underlined and deleted text is struck through.

Scope

…

5. [Deleted by IPSASB] ~~This Standard applies to accounting for investment property, including (a) the measurement in a lessee's financial statements of investment property interests held under a lease accounted for as a finance lease, and (b) the measurement in a lessor's financial statements of investment property~~

~~provided to a lessee under an operating lease. This Standard does not deal with matters covered in PBE IPSAS 13 *Leases* including:~~

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

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

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

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

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

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

…

Definitions

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

…

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

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

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

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

…

Classification of Property as Investment Property or Owner-Occupied Property

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

…

10. Investment property is held to earn rentals or for capital appreciation, or both. Therefore, investment property generates cash flows largely independently of the other assets held by an entity. This distinguishes investment property from other land or buildings controlled by an entity, including owner-occupied property. The production or supply of goods or services (or the use of property for administrative purposes) can also generate cash flows. For example, entities may use a building to provide goods and services to recipients in return for full or partial cost recovery. However, the building is held to facilitate the production of goods and services, and the cash flows are attributable not only to the building, but also to other assets used in the production or

supply process. PBE IPSAS 17 *Property, Plant and Equipment* applies to owned owner-occupied property and PBE IPSAS 43 *Leases* applies to owner-occupied property held by a lessee as a right-of-use asset.

…

12. The following are examples of investment property:

…

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

…

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

…

(c) Owner-occupied property (see PBE IPSAS 17 and PBE IPSAS 43), including (among other things) property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees such as housing for military personnel or religious ministers or priests (whether or not the employees pay rent at market rates) and owner-occupied property awaiting disposal.

…

…

Recognition

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

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

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

…

25A. An investment property held by a lessee as a right-of-use asset shall be recognised in accordance with PBE IPSAS 43.

Measurement at Recognition

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

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

…

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

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

…

38A. An investment property held by a lessee as a right-of-use asset shall be measured initially in accordance with PBE IPSAS 43.

Measurement after Recognition

Accounting Policy

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

…

Fair Value Model

…

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

…

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

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

50. ~~Paragraph 34~~ PBE IPSAS 43 specifies the basis for initial recognition of the cost of ~~an interest in a leased property~~ an investment property held by a lessee as a right-of-use asset. Paragraph 42 requires ~~the interest in the leased property~~ investment property held by a lessee as a right-of-use asset to be remeasured, if necessary, to fair value if the entity chooses the fair value model. ~~In a lease negotiated~~ When lease payments are at market rates, the fair value of ~~an interest in a leased property~~ an investment property held by a lessee as a right-of-use asset at acquisition, net of all expected lease payments (including those relating to recognised lease liabilities), should be zero. ~~This fair value does not change regardless of whether, for accounting purposes, a leased asset and liability are recognised at fair value or at the present value of minimum lease payments, in accordance with paragraph 28 of PBE IPSAS 13.~~ Thus, remeasuring a ~~leased~~ right-of-use asset from cost in accordance with ~~paragraph 34~~ PBE IPSAS 43 to fair value in accordance with paragraph 42 (taking into account the

requirements in paragraph 59) should not give rise to any initial gain or loss, unless fair value is measured at different times. This could occur when an election to apply the fair value model is made after initial recognition.

…

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

…

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

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

…

Inability to Determine Fair Value Reliably

62. **There is a rebuttable presumption that an entity can reliably determine the fair value of an investment property on a continuing basis. However, in exceptional cases, there is clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property after a change in use) that the fair value of the investment property is not reliably determinable on a continuing basis. This arises when, and only when, comparable market transactions are infrequent and alternative reliable estimates of fair value (for example, based on discounted cash flow projections) are not available. If an entity determines that the fair value of an investment property under construction is not reliably determinable but expects the fair value of the property to be reliably determinable when construction is complete, it shall measure that investment property under construction at cost until either its fair value becomes reliably determinable or construction is completed (whichever is earlier). If an entity determines that the fair value of an investment property (other than an investment property under construction) is not reliably determinable on a continuing basis, the entity shall measure that investment property using the cost model in PBE IPSAS 17 for owned investment property or in accordance with PBE IPSAS 43 for investment property held by a lessee as a right-of-use asset. The residual value of the investment property shall be assumed to be zero. The entity shall continue to apply PBE IPSAS 17 or PBE IPSAS 43 until disposal of the investment property.**

62A. Once an entity becomes able to measure reliably the fair value of an investment property under construction that has previously been measured at cost, it shall measure that property at its fair value. Once construction of that property is complete, it is presumed that fair value can be measured reliably. If this is not the case, in accordance with paragraph 62, the property shall be accounted for using the cost model in accordance with PBE IPSAS 17 for owned assets or PBE IPSAS 43 for investment property held by a lessee as a right-of-use asset.

…

63. In the exceptional cases when an entity is compelled, for the reason given in paragraph 62, to measure an investment property using the cost model in accordance with PBE IPSAS 17 or PBE IPSAS 43, it measures at fair value all its other investment property, including investment property under construction. In these cases, although an entity may use the cost model for one investment property, the entity shall continue to account for each of the remaining properties using the fair value model.

Cost Model

65. ~~**After initial recognition, an entity that chooses the cost model shall measure all of its investment property in accordance with PBE IPSAS 17's requirements for that model, other than those that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) in accordance with PBE IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Investment properties that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) shall be measured in accordance with PBE IFRS 5.**~~

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

(a) **In accordance with PBE IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* if it meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale)**

(b) **In accordance with PBE IPSAS 43 if it is held by a lessee as a right-of-use asset and is not held for sale in accordance with PBE IFRS 5; and**

(c) **In accordance with the requirements in PBE IPSAS 17 for the cost model in all other cases.**

…

Transfers

…

71. **For a transfer from investment property carried at fair value to owner-occupied property or inventories, the property's cost for subsequent accounting in accordance with PBE IPSAS 17, PBE IPSAS 43 or PBE IPSAS 12, shall be its fair value at the date of change in use.**

72. **If an owner-occupied property becomes an investment property that will be carried at fair value, an entity shall apply PBE IPSAS 17 for owned property and PBE IPSAS 43 for property held by a lessee as a right-of-use asset up to the date of change in use. The entity shall treat any difference at that date between the carrying amount of the property in accordance with PBE IPSAS 17 or PBE IPSAS 43, and its fair value in the same way as a revaluation in accordance with PBE IPSAS 17**.

73. Up to the date when an owner-occupied property (including a right-of-use asset held by a lessee that meets the definition of an owner-occupied property) becomes an investment property carried at fair value, an entity depreciates the property (or right-of-use asset) and recognises any impairment losses that have occurred. The entity treats any difference at that date between the carrying amount of the property in accordance with PBE IPSAS 17 or PBE IPSAS 43, and its fair value in the same way as a revaluation in accordance with PBE IPSAS 17. In other words:

(a) Any resulting decrease in the carrying amount of the property is recognised in surplus or deficit. However, to the extent that an amount is included in revaluation surplus for that property, the decrease is recognised in other comprehensive revenue and expense and reduces the revaluation surplus within net assets/equity.

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

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

(ii) Any remaining part of the increase is recognised in other comprehensive revenue and expense and increases the revaluation surplus within net assets/equity. On subsequent disposal of the investment property, the revaluation surplus included in net assets/equity may be transferred to accumulated comprehensive revenue and expense. The transfer from revaluation surplus to accumulated comprehensive revenue and expense is not made through surplus or deficit.

…

Disposals

…

78. The disposal of an investment property may be achieved by sale or by entering into a finance lease. In determining the date of disposal for investment property that is sold, an entity applies the criteria in PBE IPSAS 9 for recognising revenue from the sale of goods and considers the related guidance in the Implementation Guidance to PBE IPSAS 9. ~~PBE IPSAS 13~~ PBE IPSAS 43 applies to a disposal effected by entering into a finance lease and to a sale and leaseback.

…

80. **Gains or losses arising from the retirement or disposal of investment property shall be determined as the difference between the net disposal proceeds and the carrying amount of the asset, and shall be recognised in surplus or deficit (unless ~~PBE IPSAS 13~~ PBE IPSAS 43 requires otherwise on a sale and leaseback) in the period of the retirement or disposal.**

…

Disclosure

Fair Value Model and Cost Model

85. The disclosures below apply in addition to those in ~~PBE IPSAS 13~~ PBE IPSAS 43. In accordance with ~~PBE IPSAS 13~~ PBE IPSAS 43, the owner of an investment property provides lessors' disclosures about leases into which it has entered. ~~An entity~~ A lessee that holds an investment property ~~under a finance lease or operating lease~~ as a right-of-use asset provides lessees' disclosures ~~for finance leases~~ as required by PBE IPSAS 43 and lessors' disclosures as required by PBE IPSAS 43 for any operating leases into which it has entered.

86. **An entity shall disclose:**

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

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

…

Fair Value Model

…

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

89. **In the exceptional cases referred to in paragraph 62, when an entity measures investment property using the cost model in PBE IPSAS 17 or in accordance with PBE IPSAS 43, the reconciliation required by**

paragraph 87 shall disclose amounts relating to that investment property separately from amounts relating to other investment property. In addition, an entity shall disclose:

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

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

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

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

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

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

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

Transitional Provisions

…

Fair Value Model

…

PBE IPSAS 43 *Leases*

100D. **An entity applying PBE IPSAS 43, and its related amendments to this Standard, for the first time shall apply the transition requirements in PBE IPSAS 43 to its investment property held as a right-of-use asset.**

…

Effective Date

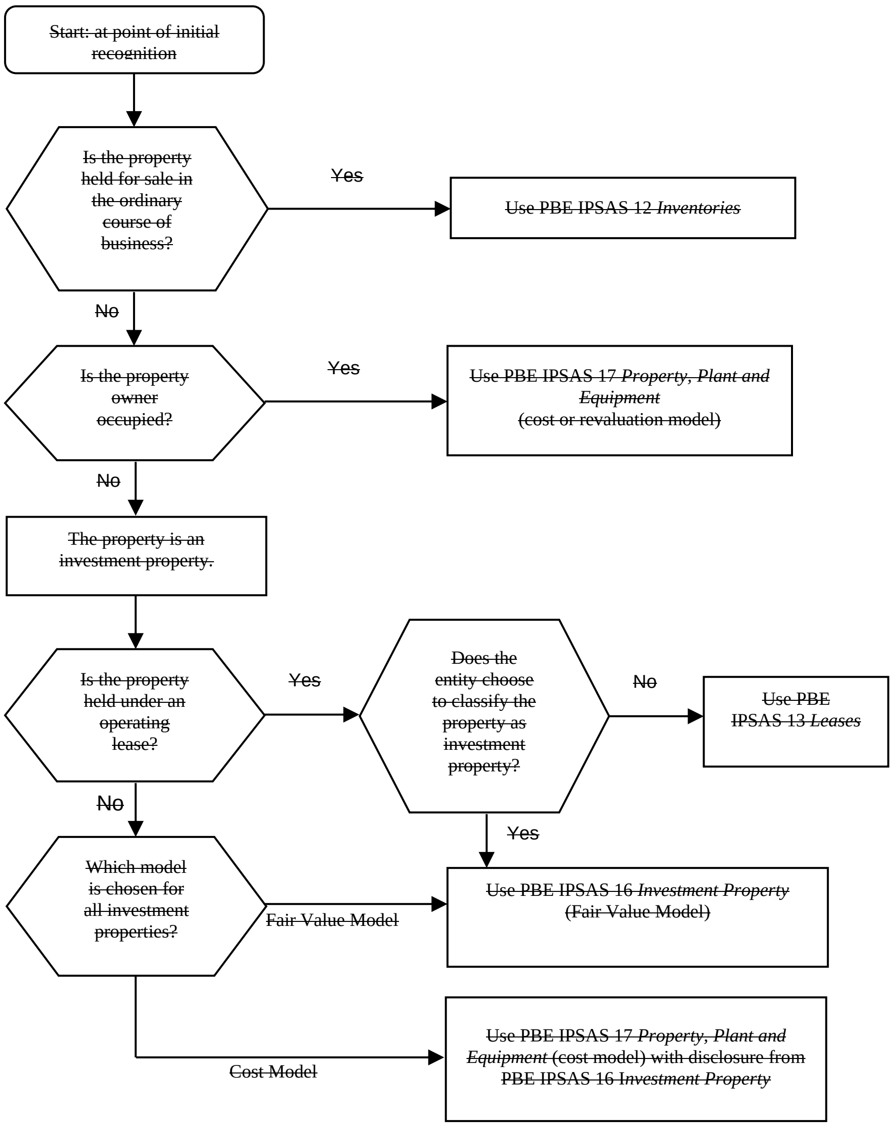
…

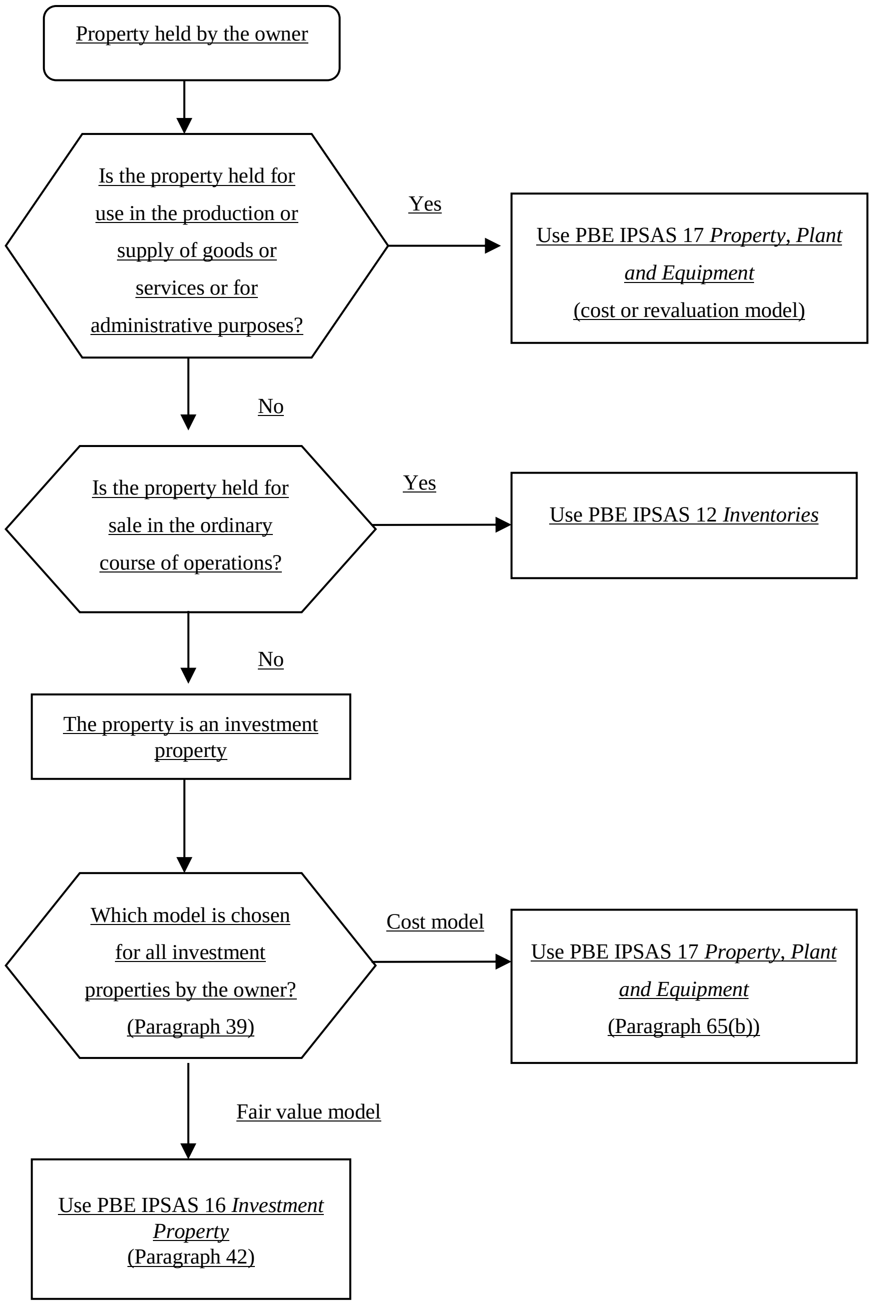
102.10. **PBE IPSAS 43, issued in [Date], amended the scope of PBE IPSAS 16 by defining investment property to include both owned investment property and property held by a lessee as a right-of-use asset. Paragraphs 7, 10, 12, 13, 14, 20, 26, 27, 39, 49, 50, 59, 62, 62A, 63, 65, 71, 72, 73, 78, 80, 85, 86, 88, and 89 were amended, paragraphs 25A, 38A, 49A and 100D and its related heading were added, and paragraphs 5, 8, 34, 35 and 43 were deleted by PBE IPSAS 43. An entity shall apply these amendments when it applies PBE IPSAS 43.**

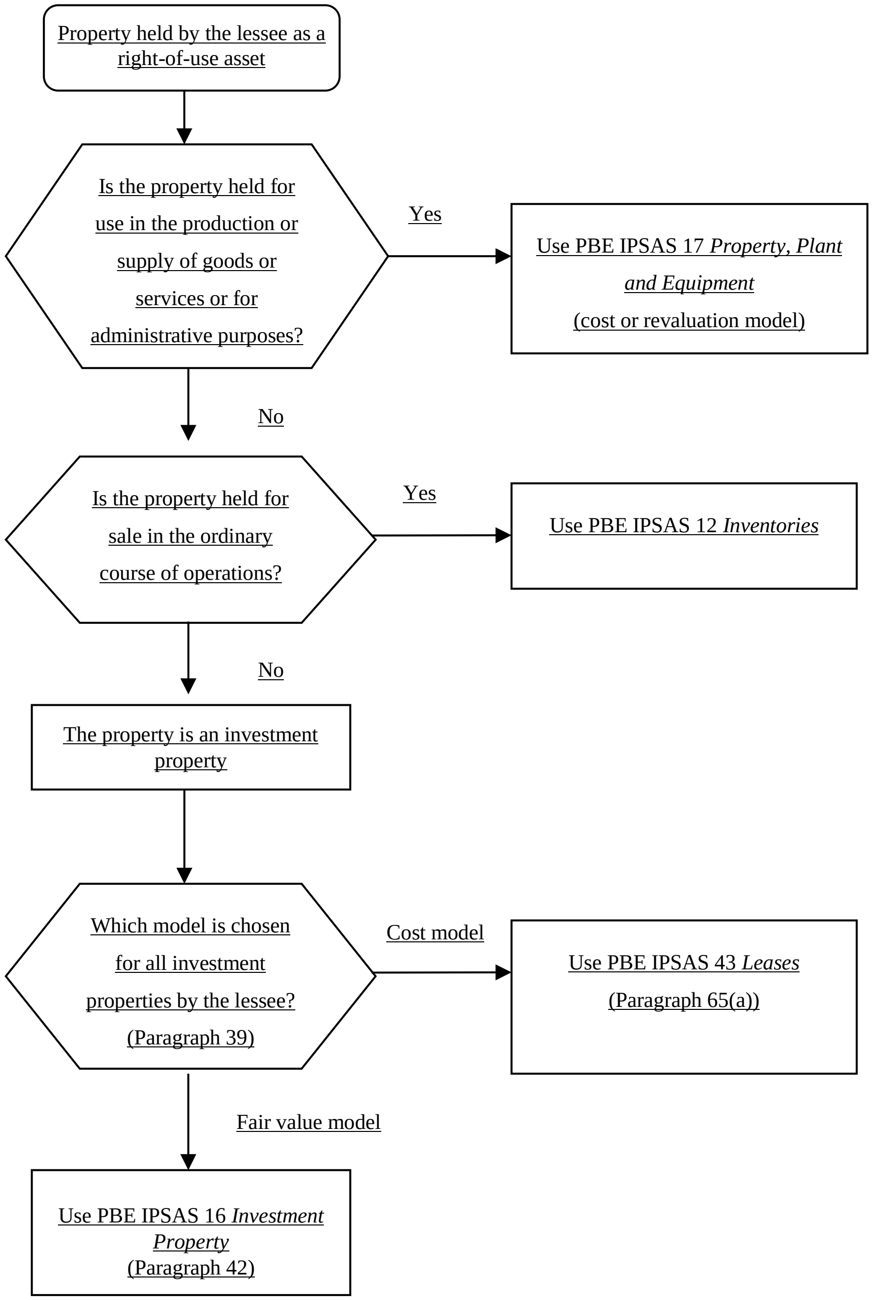
The illustrative decision tree accompanying PBE IPSAS 16 is deleted and two illustrative decision trees are added. New text is underlined and deleted text is struck through.

Illustrative Decision Trees

~~This~~ These decision trees ~~accompanies~~ accompany, but ~~is~~ are not part of, PBE IPSAS 16.




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


Property held by the lessee as a right-of-use asset
Is the property held for use in the production or supply of goods or services or for administrative purposes?
Yes
Use PBE IPSAS 17 *Property, Plant and Equipment* (cost or revaluation model)
No
Is the property held for sale in the ordinary course of operations?
Yes
Use PBE IPSAS 12 *Inventories*
No
The property is an investment property
Which model is chosen for all investment properties by the lessee? (Paragraph 39)
Cost model
Use PBE IPSAS 43 *Leases* (Paragraph 65(a))
Fair value model
Use PBE IPSAS 16 *Investment Property* (Paragraph 42)

PBE IPSAS 17 *Property, Plant, and Equipment*

Paragraphs 8, 19, 60, 83, 84 are amended. Paragraph 108.14 is added. Paragraphs 7 and 41 are deleted. New text is underlined and deleted text is struck through.

Scope

…

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

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

Recognition

…

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

Measurement at Recognition

…

Measurement of Cost

…

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

Measurement after Recognition

…

Depreciation

…

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

…

Derecognition

…

83. **The gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in surplus or deficit when the item is derecognised (unless ~~PBE~~ ~~IPSAS 13~~ PBE IPSAS 43 *Leases* requires otherwise on a sale and leaseback).**

…

84. The disposal of an item of property, plant and equipment may occur in a variety of ways (e.g., by sale, by entering into a finance lease or by donation). In determining the date of disposal of an item, an entity applies the criteria in PBE IPSAS 9 for recognising revenue from the sale of goods. ~~PBE~~ ~~IPSAS 13~~ PBE IPSAS 43 applies to disposal by a sale and leaseback

…

Effective Date

…

108.14. **PBE IPSAS 43, issued in [Date], amended paragraphs 8, 19, 60, 83, 84 and deleted paragraphs 7 and 41. An entity shall apply these amendments when it applies PBE IPSAS 43.**

PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*

Paragraph 13 and paragraph A2 are amended. Paragraph 112.12 is added. New text is underlined and deleted text is struck through.

Scope

…

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

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

    (b) Leases (see ~~PBE~~ ~~IPSAS 13~~ PBE IPSAS 43 *Leases*). However, ~~as PBE IPSAS 13 contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases~~ this Standard applies to any lease that becomes onerous before the commencement date of the lease as defined in PBE IPSAS 43. This Standard also applies to short-term leases and leases for which the underlying asset is of low value accounted for in accordance with paragraph 7 of PBE IPSAS 43 and that have become onerous.

…

Appendix A

Application Guidance Changes in Existing Decommissioning, Restoration and Similar Liabilities

This Appendix is an integral part of PBE IPSAS 19.

A2. This Appendix applies to changes in the measurement of any existing decommissioning, restoration or similar liability that is both:

(a) Recognised as part of the cost of an item of property, plant and equipment in accordance with PBE IPSAS 17 *Property, Plant and Equipment* or as part of the cost of a right-of-use asset in accordance with PBE IPSAS 43 *Leases*; and

(b) Recognised as a liability in accordance with this Standard.

Effective Date

…

112.12. **PBE IPSAS 43, issued in [Date], amended paragraph 13 and paragraph A2. An entity shall apply these amendments when it applies PBE IPSAS 43.**

Implementation Guidance paragraph IG13 is deleted. Deleted text is struck through.

Implementation Guidance

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

…

An Onerous Contract

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

~~**Analysis**~~

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

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

~~**Conclusion**~~

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

PBE IPSAS 23 *Revenue from Non-exchange Transactions*

Paragraphs 2.1 and 125.7 are added. New text is underlined. Paragraph 2 is not amended but is included for context.

Scope

2. 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.

2.1 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 convey the right to use an asset for a specified period of time for no consideration are also excluded from the scope of this Standard.

…

Effective Date

…

125.7. **PBE IPSAS 43, issued in [Date], added paragraph 2.1. An entity shall apply this amendment when it applies PBE IPSAS 43.**

…

In the Basis for Conclusions of PBE IPSAS 23, paragraphs BC25–BC27 and the preceding heading are added. New text is underlined.

Basis for Conclusion

…

Scope clarification: concessionary leases and arrangements that convey a right to use an asset 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 43 on [Date], the NZASB clarified that leases within the scope of PBE IPSAS 43 (including concessionary leases) and arrangements that convey the right to use an asset for a specified period of time for no consideration are 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.

PBE IPSAS 27 *Agriculture*

> Paragraph 3 is amended. Paragraph 57.7 is added. New text is underlined and deleted text is struck through.

Scope

…

3. This Standard does not apply to:

   …

   (c) Intangible assets related to agricultural activity (see PBE IPSAS 31 *Intangible Assets*); ~~and~~

   (d) Biological assets held for the provision or supply of services~~.~~; and

   (e) Right-of-use assets arising from a lease of land related to agricultural activity (see PBE IPSAS 43 *Leases*).

Effective Date

…

57.7. **PBE IPSAS 43, issued in [Date], amended paragraph 3. An entity shall apply this amendment when it applies PBE IPSAS 43.**

PBE IPSAS 28 *Financial Instruments: Presentation*

> Paragraphs AG16 and AG17 are amended. Paragraph 62.8 is added. New text is underlined and deleted text is struck through.

Effective Date

…

62.8. **PBE IPSAS 43 *Leases*, issued in [Date], amended paragraphs AG16 and AG17. An entity shall apply these amendments when it applies PBE IPSAS 43.**

Definitions (paragraphs 9 and 10)

Financial Assets and Financial Liabilities

…

AG16. ~~Under PBE IPSAS 13 *Leases*, a finance lease is regarded as primarily~~ A lease typically creates an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. The lessor accounts for its investment in the amount receivable under ~~the~~ a finance lease ~~contract~~ rather than the ~~leased~~ underlying asset itself that is subject to the finance lease. Accordingly, a lessor regards a finance lease as a financial instrument. Under PBE IPSAS 43 *Leases* a lessor does not recognise its entitlement to receive lease payments under an operating lease. ~~An operating lease, on the other hand, is regarded as primarily an uncompleted contract committing the lessor to provide the use of an asset in future periods in exchange for consideration similar to a fee for a service.~~ The lessor continues to account for the ~~leased~~ underlying asset itself rather than any amount receivable in the future under the contract. Accordingly, a lessor ~~finance lease is regarded as a financial~~

~~instrument and~~ does not regard an operating lease ~~is not regarded~~ as a financial instrument, ~~(~~except as regards individual payments currently due and payable by the lessee).

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

PBE IPSAS 30 *Financial Instruments: Disclosures*

Paragraphs 35 and AG16 are amended. Paragraph 53.14 is added. New text is underlined and deleted text is struck through.

Significance of Financial Instruments for Financial Position and Financial Performance

…

Other Disclosures

…

Fair Value

…

35. Disclosures of fair value are not required:

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

…

(d) For lease liabilities.

…

Effective Date and Transition

…

53.14. **PBE IPSAS 43 *Leases*, issued in [Date], amended paragraphs 35 and AG16. An entity shall apply these amendments when it applies PBE IPSAS 43.**

Application Guidance

This Appendix is an integral part of PBE IPSAS 30

…

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

…

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

…

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

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

…

PBE IPSAS 31 *Intangible Assets*

Paragraphs 6, 9, 112, 113 and AG6 are amended. Paragraph 133.10 is added. New text is underlined and deleted text is struck through.

Scope

…

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

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

   (b) Leases ~~that are within the scope of PBE IPSAS 13 *Leases*~~ of intangible assets accounted for in accordance with PBE IPSAS 43 *Leases*;

   …

9. ~~In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee accounts for an intangible asset held under a finance lease in accordance with this Standard.~~ Rights held by a lessee under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents, and copyrights ~~are excluded from the scope of PBE IPSAS 13 and~~ are within the scope of this Standard and are excluded from the scope of PBE IPSAS 43.

…

Retirements and Disposals

…

112. **The gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be recognised in surplus or deficit when the asset is derecognised (unless ~~PBE IPSAS 13~~ PBE IPSAS 43 requires otherwise on a sale and leaseback).**

113. The disposal of an intangible asset may occur in a variety of ways (e.g., by sale, by entering into a finance lease or through a non-exchange transaction). In determining the date of disposal of such an asset, an entity applies the criteria in PBE IPSAS 9 *Revenue from Exchange Transactions* for recognising revenue from the sale of goods. ~~PBE IPSAS 13~~ PBE IPSAS 43 applies to disposal by a sale and leaseback

…

Effective Date

…

133.10. **PBE IPSAS 43, issued in [Date], amended paragraphs 6, 9, 112, 113 and AG6. An entity shall apply these amendments when it applies PBE IPSAS 43.**

Application Guidance

This Appendix is an integral part of PBE IPSAS 31

…

Website costs

…

AG6. PBE IPSAS 31 does not apply to intangible assets held by an entity for sale in the ordinary course of operations (see PBE IPSAS 11 and PBE IPSAS 12) or leases ~~that fall within the scope of PBE IPSAS 13~~ <u>of intangible assets accounted for in accordance with PBE IPSAS 43</u>. Accordingly, this Application Guidance does not apply to expenditure on the development or operation of a website (or website software) for sale to another entity <u>or that is accounted for in accordance with PBE IPSAS 43</u>. ~~When a website is leased under an operating lease, the lessor applies this Application Guidance. When a website is leased under a finance lease, the lessee applies this Application Guidance after initial recognition of the leased asset.~~

PBE IPSAS 32 *Service Concession Arrangements: Grantor*

Paragraphs AG13 and AG17 are amended. Paragraph 37.7 is added. New text is underlined and deleted text is struck through.

Effective Date

…

37.7. <u>**PBE IPSAS 43 *Leases*, issued in [Date], amended paragraphs AG13 and AG17. An entity shall apply these amendments when it applies PBE IPSAS 43.**</u>

Application Guidance

This Appendix is an integral part of PBE IPSAS 32

…

AG13. The operator may have a right to use the separable asset described in paragraph AG12(a), or the facilities used to provide ancillary unregulated services described in paragraph AG12(b). In either case, there may in substance be a lease from the grantor to the operator; if so, it is accounted for in accordance with ~~PBE IPSAS 13~~ <u>PBE IPSAS 43</u>.

…

AG17. If the asset no longer meets the conditions for recognition in paragraph 9 (or paragraph 10 for a whole-of-life asset), the grantor follows the derecognition principles in PBE IPSAS 17 or PBE IPSAS 31, as appropriate. For example, if the asset is transferred to the operator on a permanent basis, it is derecognised. If the asset is transferred on a temporary basis, the grantor considers the substance of this term of the service concession arrangement in determining whether the asset should be derecognised. In such cases, the grantor also considers whether the arrangement is a lease transaction or a sale and leaseback transaction that should be accounted for in accordance with ~~PBE IPSAS 13~~ <u>PBE IPSAS 43</u>.

Implementation Guidance paragraphs IG2 and IG4 are amended. New text is underlined and deleted text is struck through.

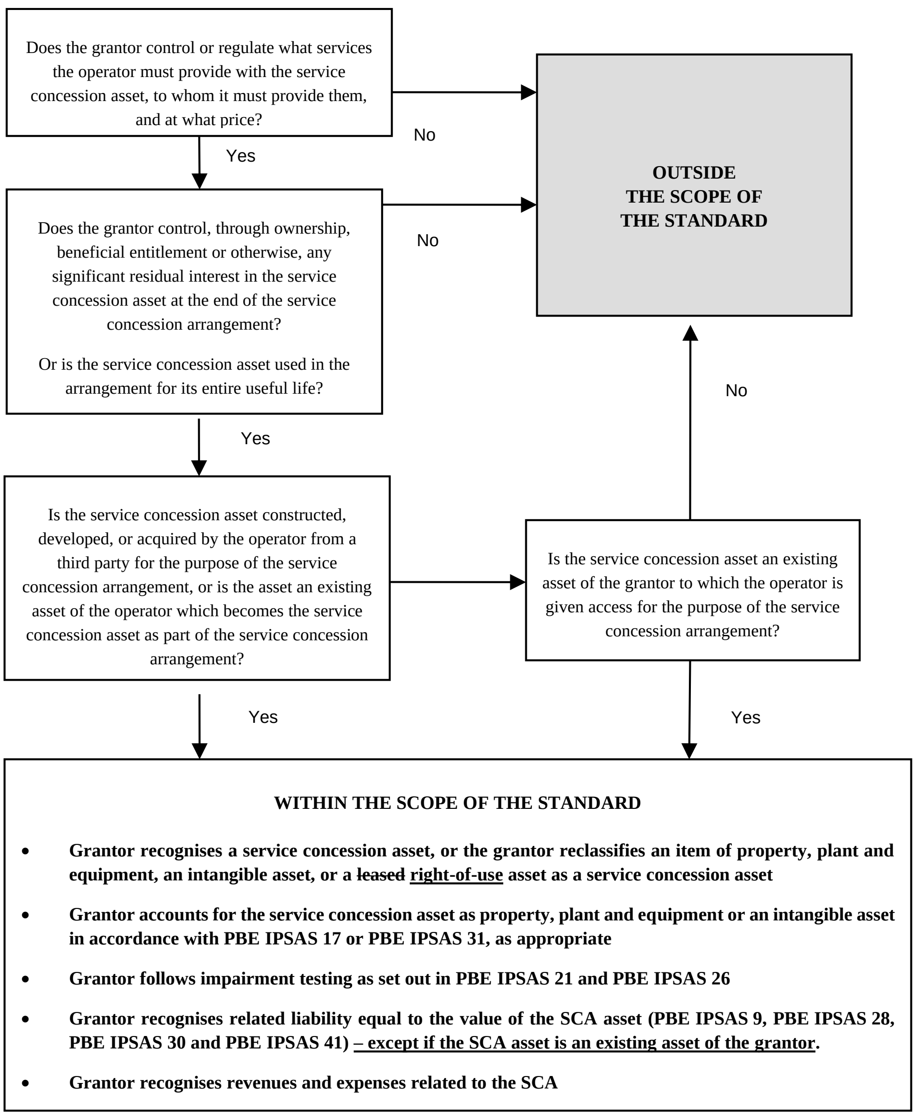
Implementation Guidance

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

…

Accounting Framework for Service Concession Arrangements

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



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

(…)

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

<table>
<tr><th>Category</th><th>Lessee</th><th colspan="3">Service provider</th><th colspan="2">Owner</th></tr>
<tr><td>Typical arrangement types</td><td>Lease (e.g., operator leases asset from grantor)</td><td>Service and/or maintenance contract (specific tasks e.g., debt collection, facility management)</td><td>Rehabilitate-operate-transfer</td><td>Build-operate-transfer</td><td>Build-own-operate</td><td>100% Divestment/ Privatisation/ Corporation</td></tr>
<tr><td>Asset ownership</td><td colspan="4">Grantor</td><td colspan="2">Operator</td></tr>
<tr><td>Capital investment</td><td colspan="2">Grantor</td><td colspan="4">Operator</td></tr>
<tr><td>Demand risk</td><td>Shared</td><td>Grantor</td><td colspan="2">Grantor and/or Operator</td><td colspan="2">Operator</td></tr>
<tr><td>Typical duration</td><td>8–20 years</td><td>1–5 years</td><td colspan="3">25–30 years</td><td>Indefinite (or may be limited by binding arrangement or licence)</td></tr>
<tr><td>Residual interest</td><td colspan="4">Grantor</td><td colspan="2">Operator</td></tr>
<tr><td>Relevant PBE Standards</td><td>~~PBE IPSAS 13~~
PBE IPSAS 43</td><td>PBE IPSAS 1</td><td colspan="2">This Standard/PBE IPSAS 17/ PBE IPSAS 31/ PBE FRS 45</td><td colspan="2">PBE IPSAS 17/PBE IPSAS 31 (derecognition)
PBE IPSAS 9 (revenue recognition)</td></tr>
</table>

PBE IPSAS 40 *PBE Combinations*

Paragraphs 68, 71, 120, AG76, and AG89 are amended. Paragraphs AG72–AG74 and their related heading are deleted. Paragraphs 82A, 82B, and 126.3 are added. The heading before paragraph 82A is added. New text is underlined and deleted text is struck through.

The Acquisition Method of Accounting

…

Recognising and Measuring the Identifiable Assets Acquired, the Liabilities Assumed and any Non-Controlling Interest in the Acquired Operation

Recognition Principle

…

Recognition Conditions

…

68. Paragraphs ~~AG72–AG84~~ <u>AG75–AG84</u> provide guidance on recognising ~~operating leases and~~ intangible assets. Paragraphs 76–82<u>D</u> specify the types of identifiable assets and liabilities that include items for which this Standard provides limited exceptions to the recognition principle and conditions.

…

Classifying or Designating Identifiable Assets Acquired and Liabilities Assumed in an Acquisition

…

71. This Standard provides an exception to the principle in paragraph 69:

    (a) Classification of a lease ~~arrangement~~ <u>contract in which the acquiree is the lessor</u> as either an operating lease or a finance lease in accordance with ~~PBE IPSAS 13 *Leases*~~ <u>PBE IPSAS 43, *Leases*</u>; and (…)

    …

Exceptions to the Recognition or Measurement Principles

…

Exceptions to both the Recognition and Measurement Principles

…

<u>Leases in Which the Acquiree is the Lessee</u>

<u>82A. The acquirer shall recognise right-of-use assets and lease liabilities for leases identified in accordance with PBE IPSAS 43 in which the acquiree is the lessee. The acquirer is not required to recognise right-of-use assets and lease liabilities for:</u>

<u>(a) Leases for which the lease term (as defined in PBE IPSAS 43) ends within 12 months of the acquisition date; or</u>

<u>(b) Leases for which the underlying asset is of low value (as described in paragraphs AG4–AG9 of PBE IPSAS 43).</u>

<u>82B. The acquirer shall measure the lease liability at the present value of the remaining lease payments (as defined in PBE IPSAS 43) as if the acquired lease were a new lease at the acquisition date. The acquirer shall measure</u>

the right-of-use asset at the same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market terms.

…

Disclosures

…

120. To meet the objective in paragraph 119, the acquirer shall disclose the following information for each acquisition that occurs during the reporting period:

…

*(h) For acquired receivables:

(i) The fair value of the receivables;

(ii) The gross amounts receivable in accordance with a binding arrangement; and

(iii) The best estimate at the acquisition date of the cash flows in accordance with a binding arrangement not expected to be collected.

The disclosures shall be provided by major class of receivable, such as loans, ~~direct finance~~ leases and any other class of receivables.

…

Effective Date and Transition

Effective Date

…

126.3. **PBE IPSAS 43, issued in [Date], amended paragraphs 68, 71, 120, AG76 and AG89, deleted paragraphs AG72–AG74 and their related heading, and added paragraphs 82A and 82B and the related heading. An entity shall apply these amendments when it applies PBE IPSAS 43.**

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 40.

…

Recognising Particular Assets Acquired and Liabilities Assumed in an Acquisition (see paragraphs 64–68)

~~Operating leases~~

AG72. [Deleted by IPSASB] ~~The acquirer shall recognise no assets or liabilities related to an operating lease in which the acquired operation is the lessee except as required by paragraphs AG73–AG74.~~

AG73. [Deleted by IPSASB] ~~The acquirer shall determine whether the terms of each operating lease in which the acquired operation is the lessee are favourable or unfavourable. The acquirer shall recognise an intangible asset if the terms of an operating lease are favourable relative to market terms and a liability if the terms are unfavourable relative to market terms. Paragraph AG89 provides guidance on measuring the acquisition-date fair value of assets subject to operating leases in which the acquired operation is the lessor.~~

AG74. [Deleted by IPSASB] ~~An identifiable intangible asset may be associated with an operating lease, which may be evidenced by market participants' willingness to pay a price for the lease even if it is at market terms. For~~

~~example, a lease of gates at an airport or of retail space in a prime shopping area might provide entry into a market or other future economic benefits or service potential that qualify as identifiable intangible assets, for example, as a relationship with users of a service. In that situation, the acquirer shall recognise the associated identifiable intangible asset(s) in accordance with paragraph AG75.~~

…

Intangible Assets

…

AG76. An intangible asset that meets the binding arrangement criterion is identifiable even if the asset is not transferable or separable from the acquired operation or from other rights and obligations. For example:

(a) [Deleted by IPSASB] ~~An acquired operation leases a facility under an operating lease that has terms that are favourable relative to market terms. The lease terms explicitly prohibit transfer of the lease (through either sale or sublease). The amount by which the lease terms are favourable compared with the terms of current market transactions for the same or similar items is an intangible asset that meets the binding arrangement criterion for recognition separately from goodwill, even though the acquirer cannot sell or otherwise transfer the lease arrangement~~.

(b) An acquired operation owns and operates a nuclear power plant. The licence to operate that power plant is an intangible asset that meets the binding arrangement criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. An acquirer may recognise the fair value of the operating licence and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.

(c) An acquired operation owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future foreign revenue in exchange. Both the technology patent and the related licence agreement meet the binding arrangement criterion for recognition separately from goodwill even if selling or exchanging the patent and the related licence agreement separately from one another would not be practical.

…

Assets Subject to Operating Leases in Which the Acquired Operation is the Lessor

AG89. In measuring the acquisition-date fair value of an asset such as a building that is subject to an operating lease in which the acquired operation is the lessor, the acquirer shall take into account the terms of the lease. ~~In other words, the~~ <u>The</u> acquirer does not recognise a separate asset or liability if the terms of an operating lease are either favourable or unfavourable when compared with market terms ~~as paragraph AG73 requires for leases in which the acquired operation is the lessee~~.

…

In the Illustrative Examples, paragraph IE224 is amended. New text is underlined and deleted text is struck through.

Illustrative Examples

These examples accompany, but are not part of, PBE IPSAS 40

…

Identifiable Intangible Assets in an Acquisition

…

Binding Arrangement-Based Intangible Assets

IE224. Binding arrangement-based intangible assets represent the value of rights that arise from binding arrangements. Binding arrangements with customers are one type of binding arrangement-based intangible asset. If the terms of a binding arrangement give rise to a liability (for example, if the terms of ~~an operating lease or~~ a binding arrangement with a customer are unfavourable relative to market terms), the acquirer recognises it as a liability assumed in the acquisition. Examples of binding arrangement-based intangible assets are:

Class	**Basis**
Licensing, royalty and standstill agreements	Binding arrangement
Advertising, construction, management, service or supply binding arrangements	Binding arrangement
~~Lease agreements (whether the acquired operation is the lessee or the lessor)~~	~~Binding arrangement~~
Construction permits	Binding arrangement
(…)	

PBE IPSAS 41 *Financial Instruments*

Paragraphs 2, 87, AG198, and AG210 are amended. Paragraph 156.7 is added. New text is underlined and deleted text is struck through.

Scope

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

…

(b) **Rights and obligations under leases to which ~~PBE IPSAS 13 *Leases*~~ PBE IPSAS 43 *Leases* applies. However:**

(i) **Finance lease receivables (i.e., net investments in finance leases) and operating lease receivables recognised by a lessor are subject to the derecognition and impairment requirements of this Standard;**

(ii) **Lease liabilities recognised by a lessee are subject to the derecognition requirements in paragraph 35 of this Standard; and**

(iii) **Derivatives that are embedded in leases are subject to the embedded derivatives requirements of this Standard.**

…

Simplified Approach for Receivables

87. **Despite paragraphs 75 and 77, an entity shall always measure the loss allowance at an amount equal to lifetime expected credit losses for:**

(a) **Receivables that result from exchange transactions that are within the scope of PBE IPSAS 9 and non-exchange transactions within the scope of PBE IPSAS 23.**

(b) **Lease receivables that result from transactions that are within the scope of ~~PBE IPSAS 13~~ PBE IPSAS 43, if the entity chooses as its accounting policy to measure the loss allowance at an amount equal to lifetime expected credit losses. That accounting policy shall be applied to all lease receivables but may be applied separately to finance and operating lease receivables.**

…

Effective Date and Transition

Effective Date

…

156.7. **PBE IPSAS 43, issued in [Date], amended paragraphs 2, 87, AG198 and AG210. An entity shall apply these amendments when it applies PBE IPSAS 43.**

…

Appendix A

Application Guidance

This Appendix is an integral part of PBE IPSAS 41.

…

Measurement of Expected Credit Losses

Expected Credit Losses

…

AG198. When measuring a loss allowance for a lease receivable, the cash flows used for determining the expected credit losses should be consistent with the cash flows used in measuring the lease receivable in accordance with ~~PBE IPSAS 13 *Leases*~~ PBE IPSAS 43 *Leases*.

…

Time Value of Money

…

AG210. Expected credit losses on lease receivables shall be discounted using the same discount rate used in the measurement of the lease receivable in accordance with ~~PBE IPSAS 13~~ PBE IPSAS 43 *Leases*.

PBE IFRS 4 *Insurance Contracts* (superseded on adoption of PBE IFRS 17 for not-for-profit PBEs)

The amendments to PBE IFRS 4 do not apply to an entity that applies PBE IFRS 17 *Insurance Contracts*. PBE IFRS 17 applies to Tier 1 and Tier 2 not-for-profit public benefit entities for reporting periods beginning on or after 1 January 2023. Early application is permitted. PBE IFRS 4 continues to apply to public sector public benefit entities after 1 January 2023.

Paragraphs 4 and D2.2 are amended and paragraph 45.10 is added. New text is underlined and deleted text is struck through.

Scope

…

4. An entity shall not apply this Standard to:

…

(c) Contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item (for example, some licence fees, royalties, ~~contingent~~ <u>variable</u> lease payments and similar items), as well as a lessee's residual value guarantee embedded in a ~~finance~~ lease (see ~~PBE IPSAS 13~~ <u>PBE IPSAS 43</u> *Leases*, PBE IPSAS 9 and PBE IPSAS 31 *Intangible Assets*).

…

Effective Date and Transition

…

<u>**45.10. PBE IPSAS 43, issued in [Date], amended paragraphs 2 and D2.2. An entity shall apply these amendments when it applies PBE IPSAS 43.**</u>

…

Appendix D

Financial Reporting of Insurance Activities

This Appendix is an integral part of the Standard.

…

Application

Transactions Outside the Scope of this Appendix

D2.2 **This Appendix does not apply to:**

…

(e) **Contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item (for example, some licence fees, royalties, ~~contingent~~ <u>variable</u> lease payments and similar items), as well as a lessee's residual value guarantee embedded in a finance lease (see ~~PBE IPSAS 13~~ <u>PBE IPSAS 43</u> *Leases*, PBE IPSAS 9 and PBE IPSAS 31 *Intangible Assets*);**

…

PBE IFRS 17 *Insurance Contracts* (not-for-profit entities)

The amendments to PBE IFRS 17 do not apply to an entity that applies PBE IFRS 4 *Insurance Contracts*. PBE IFRS 17 applies to Tier 1 and Tier 2 not-for-profit public benefit entities for reporting periods beginning on or after 1 January 2023. Early application is permitted. PBE IFRS 4 continues to apply to public sector public benefit entities after 1 January 2023.

Paragraph 7 is amended and paragraph 132.2B is added. New text is underlined and deleted text is struck through.

Scope

…

7. An entity shall not apply PBE IFRS 17 to:

…

(c) Contractual rights or contractual obligations contingent on the future use of, or the right to use, a non-financial item (for example, some licence fees, royalties, variable and other contingent lease payments and similar items: see PBE IPSAS 9, ~~PBE IPSAS 13~~ PBE IPSAS 43 *Leases* and PBE IPSAS 31 *Intangible Assets*).

(d) Residual value guarantees provided by a manufacturer, dealer or retailer and a lessee's residual value guarantees when they are embedded in a lease (see ~~PBE IPSAS 13~~ PBE IPSAS 43).

…

Effective Date and Transition

Effective Date

…

132.2B **PBE IPSAS 43, issued in [Date], amended paragraph 7. An entity shall apply this amendment when it applies PBE IPSAS 43.**

PBE IAS 12 *Income Taxes*

Paragraphs 20, 22A and 98.13 are amended and paragraph 98.14 is added. New text is underlined and deleted text is struck through.

Recognition of Deferred Tax Liabilities and Deferred Tax Assets

Taxable Temporary Differences

…

Assets Carried at Fair Value

20. PBE Standards permit or require certain assets to be carried at fair value or to be revalued (see, for example, PBE IPSAS 17 *Property, Plant and Equipment*, PBE IPSAS 31 *Intangible Assets,* PBE IPSAS 16 *Investment Property* ~~and~~ PBE IPSAS 41 *Financial Instruments* and PBE IPSAS 43 *Leases*). The revaluation or other restatement of an asset used in a taxable activity to fair value affects taxable profit (tax loss) for the current

period. As a result, the tax base of the asset is adjusted and no temporary difference arises. In other jurisdictions, the revaluation or restatement of an asset does not affect taxable profit in the period of the revaluation or restatement and, consequently, the tax base of the asset is not adjusted. Nevertheless, the future recovery of the carrying amount will result in a taxable flow of economic benefits to the entity and the amount that will be deductible for tax purposes will differ from the amount of those economic benefits. The difference between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset. This is true even if:

…

22A A transaction that is not a PBE combination may lead to the initial recognition of an asset and a liability and, at the time of the transaction, affect neither accounting profit nor taxable profit. For example, at the commencement date of a lease ~~classified as a finance lease~~, a lessee typically recognises ~~assets acquired under finance leases as assets and the associated lease obligations as liabilities in their statements of financial position~~ a lease liability and the corresponding amount as part of the cost of a right-of-use asset. Depending on the applicable tax law, equal taxable and deductible temporary differences may arise on initial recognition of the asset and liability in such a transaction. The exemption provided by paragraphs 15 and 24 does not apply to such temporary differences and an entity recognises any resulting deferred tax liability and asset.

…

Effective Date

…

98.13 An entity applying *2022 Omnibus Amendments to PBE Standards* shall also, at the beginning of the earliest comparative period presented:

(a) Recognise a deferred tax asset—to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised—and a deferred tax liability for all deductible and taxable temporary differences associated with:

(i) ~~Assets acquired under finance leases and liability for the associated lease obligations~~ Right-of-use assets and lease liabilities; and

(ii) Decommissioning, restoration and similar liabilities and the corresponding amounts recognised as part of the cost of the related asset; and

(b) Recognise the cumulative effect of initially applying the amendments as an adjustment to the opening balance of accumulated comprehensive revenue and expense (or other component of net assets/equity, as appropriate) at that date.

98.14 **PBE IPSAS 43, issued in [Date], amended paragraphs 20 and 22A. An entity shall apply these amendments when it applies PBE IPSAS 43. PBE IPSAS 43 also amended paragraph 98.13, which relate to the first-time application of *2022 Omnibus Amendments to PBE Standards*. An entity shall apply the amendment to paragraph 98.13 when it applies PBE IPSAS 43 if the entity applies *2022 Omnibus Amendments to PBE Standards* at the same time.**

PBE FRS 45 *Service Concession Arrangements: Operator*

Paragraphs 26 and AG8 are amended and paragraph 30.3 is added. New text is underlined and deleted text is struck through.

Disclosure

26. Certain aspects and disclosures relating to some service concession arrangements are already addressed by other PBE Standards (e.g., PBE IPSAS 32 *Service Concession Arrangements: Grantor* prescribes the accounting by the grantor, PBE IPSAS 17 applies to acquisitions of items of property, plant and equipment, ~~PBE IPSAS 13~~

PBE IPSAS 43 *Leases* applies to leases of assets, and PBE IPSAS 31 applies to acquisitions of intangible assets). However, a service concession arrangement may involve executory contracts that are not addressed in PBE Standards, unless the contracts are onerous, in which case PBE IPSAS 19 applies. Therefore, this Standard addresses additional disclosures of service concession arrangements by operators.

…

Effective Date

…

30.3 **PBE IPSAS 43, issued in [Date], amended paragraphs 26 and AG8. An entity shall apply these amendments when it applies PBE IPSAS 43.**

Application Guidance

This Appendix is an integral part of PBE FRS 45.

Scope (paragraph 4)

AG8. The operator may have a right to use the separable infrastructure described in paragraph AG7(a), or the facilities used to provide ancillary unregulated services described in paragraph AG7(b). In either case, there may in substance be a lease from the grantor to the operator; if so, it shall be accounted for in accordance with ~~PBE IPSAS 13~~ PBE IPSAS 43.

PBE FRS 47 *First-time Adoption of PBE Standards*

Paragraphs 37, A1, A11, B4, B8, C1, C4 and C6 are amended. Paragraph 42.16 and paragraphs C7A–C7D are added. Paragraph C7 is deleted. Paragraphs C2 and C3 are not amended but are included for context. New text is underlined and deleted text is struck through.

Presentation and Disclosure

Use of Fair Value as Deemed Cost

*37. **If an entity uses fair value in its opening statement of financial position under PBE Standards as deemed cost for an item of property, plant and equipment, an investment property, ~~or~~ an intangible asset or a right-of-use asset (see paragraphs C2 and C4), the entity's first set of financial statements shall disclose, for each line item in the opening statement of financial position under PBE Standards:**

(a) **The aggregate of those fair values; and**

(b) **The aggregate adjustment to the carrying amounts reported under previous GAAP.**

…

Effective Date

42.16 **PBE IPSAS 43, issued in [Date], amended paragraphs 37, A1, A11, B4, B8, C1, C4 and C6, added paragraphs C7A–C7D and deleted paragraph C7. An entity shall apply these amendments when it applies PBE IPSAS 43.**

…

Appendix A

Exceptions to the Retrospective Application of other PBE Standards

This Appendix is an integral part of PBE FRS 47.

A1. An entity shall apply the following exceptions:

…

(h) Deferred tax related to ~~finance~~ leases and decommissioning, restoration and similar liabilities (paragraph A11).

…

Deferred tax related to leases and decommissioning, restoration and similar liabilities

A11. Paragraphs 15 and 24 of PBE IAS 12 *Income Taxes* exempt an entity from recognising a deferred tax asset or liability in particular circumstances. Despite this exemption, at the date of transition to PBE Standards, a first-time adopter shall recognise a deferred tax asset—to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised—and a deferred tax liability for all deductible and taxable temporary differences associated with:

(a) ~~Assets acquired under finance leases and liability for the associated lease obligations~~ Right-of-use assets and lease liabilities; and

(b) Decommissioning, restoration and similar liabilities and the corresponding amounts recognised as part of the cost of the related asset.

…

Appendix B

Exemptions for PBE Combinations

This Appendix is an integral part of PBE FRS 47. An entity shall apply the following requirements to PBE combinations that the entity recognised before the date of transition to PBE Standards.

…

B4. If a first-time adopter does not apply PBE IPSAS 40 retrospectively to a past PBE combination, this has the following consequences for that PBE combination:

…

(f) If an asset acquired, or liability assumed, in a past PBE combination was not recognised in accordance with previous GAAP, it does not have a deemed cost of zero in the opening statement of financial position under PBE Standards. Instead, the acquirer shall recognise and measure it in its consolidated statement of financial position on the basis that PBE Standards would require in the statement of financial position of the acquired operation. To illustrate: if the acquirer had not, in accordance with its previous GAAP, recognised ~~capitalised~~ ~~finance~~ leases acquired in a past PBE combination in which the acquiree was a lessee, it shall recognise ~~capitalise~~ those leases in its consolidated financial statements, as ~~PBE IPSAS 13~~ PBE IPSAS 43 *Leases* would require the acquiree to do in its statement of financial position under PBE Standards. (…)

…

B8. If a first-time adopter does not apply PBE IPSAS 40 retrospectively to a past amalgamation, this has the following consequences for that PBE combination:

…

(f) If an asset received, or liability assumed, in a past amalgamation was not recognised in accordance with previous GAAP, it does not have a deemed cost of zero in the opening statement of financial position under PBE Standards. Instead, the resulting entity shall recognise and measure it in its statement of financial position on the basis that PBE Standards would require in the statement of financial position of the combining operation. To illustrate: if the resulting entity had not, in accordance with its previous GAAP, recognised ~~capitalised finance~~ leases assumed in a past amalgamation in which the acquiree was a lessee, it shall recognise ~~capitalise~~ those leases in its first set of financial statements under PBE Standards, as ~~PBE IPSAS 13~~ PBE IPSAS 43 would require the combining operation to do in its statement of financial position under PBE Standards. (…)

…

Appendix C

Exemptions from other PBE Standards

This Appendix is an integral part of PBE FRS 47.

C1. An entity may elect to use one or more of the following exemptions:

(a) Deemed cost (paragraphs C2–C5);

(b) Leases (paragraphs C6 and C7A-C7D);

…

…

Deemed Cost

C2. An entity may elect to measure an item of property, plant and equipment at the date of transition to PBE Standards at its fair value and use that fair value as its deemed cost at that date.

C3. A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to PBE Standards as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:

(a) Fair value; or

(b) Cost or depreciated cost in accordance with PBE Standards, adjusted to reflect, for example, changes in a general or specific price index.

C4. The elections in paragraphs C2 and C3 are also available for:

(a) Investment property, if an entity elects to use the cost model in PBE IPSAS 16 *Investment Property*; ~~and~~

(aa) Right-of-use assets; and

(b) Intangible assets that meet: (…)

…

Leases

C6. ~~In applying the provisions in Appendix C Application Guidance *Determining whether an Arrangement contains a Lease* in PBE IPSAS 13 *Leases*, a first-time adopter may determine whether an arrangement existing at the date of transition to PBE Standards contains a lease on the basis of facts and circumstances existing at that date.~~ A first-time adopter may assess whether a contract existing at the date of transition to PBE Standards contains a lease by applying paragraphs 10–12 of PBE IPSAS 43 to those contracts on the basis of facts and circumstances existing at that date.

C7. [Deleted by NZASB] ~~If a first-time adopter made the same determination of whether an arrangement contained a lease in accordance with previous GAAP as that required by Appendix C of PBE IPSAS 13 but at a date other than the date of transition to PBE Standards, the first-time adopter need not reassess that determination when it adopts PBE Standards. For an entity to have made the same determination of whether the arrangement contained~~

~~a lease in accordance with previous GAAP, that determination would have to have given the same outcome as that resulting from applying PBE IPSAS 13, including Appendix C.~~

C7A. When a fist-time adopter that is a lessee recognises lease liabilities and right-of-use assets, it may apply the following approach to all of its leases (subject to the practical expedients described in paragraph C7C):

(a) Measure a lease liability at the date of transition to PBE Standards. A lessee following this approach shall measure that lease liability at the present value of the remaining lease payments (see paragraph C7D), discounted using the lessee's incremental borrowing rate (see paragraph C7D) at the date of transition to PBE Standards.

(b) Measure a right-of-use asset at the date of transition to PBE Standards. 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 PBE IPSAS 43 had been applied since the commencement date of the lease (see paragraph C7D), but discounted using the lessee's incremental borrowing rate at the date of transition to PBE Standards; 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 transition to PBE Standards;

(c) Apply PBE IPSAS 21 or PBE IPSAS 26 to right-of-use assets at the date of transition to PBE Standards.

C7B. Notwithstanding the requirements in paragraph C7A, a first-time adopter that is a lessee shall measure the right-of-use asset at fair value at the date of transition to PBE Standards for leases that meet the definition of investment property in PBE IPSAS 16 if they are measured using the fair value model in PBE IPSAS 16 from the date of transition to PBE Standards.

C7C. A first-time adopter that is a lessee may do one or more of the following at the date of transition to PBE Standards, applied on a lease-by-lease basis:

(a) Apply a single discount rate to a portfolio of leases with reasonably similar characteristics (for example, a similar remaining lease term for a similar class of underlying asset in a similar economic environment).

(b) Elect not to apply the requirements in paragraph C7A to leases for which the lease term (see paragraph C7A) ends within 12 months of the date of transition to PBE Standards. Instead, the entity shall account for (including disclosure of information about) these leases as if they were short-term leases accounted for in accordance with paragraph 7 of PBE IPSAS 43.

(c) Elect not to apply the requirements in paragraph C7A to leases for which the underlying asset is of low value (as described in paragraphs AG4–AG9 of PBE IPSAS 43). Instead, the entity shall account for (including disclosure of information about) these leases in accordance with paragraph 7 of PBE IPSAS 43.

(d) Exclude initial direct costs (see paragraph C7D) from the measurement of the right-of-use asset at the date of transition to PBE Standards.

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

C7D. Lease payments, lessor, lessee, lessee's incremental borrowing rate, commencement date of the lease, initial direct costs and lease term are defined terms in PBE IPSAS 43 and are used in this Standard with the same meaning.

XRB A1 *Application of the Accounting Standards Framework*

The accounting standards table in Appendix C is amended. New text is underlined.

APPENDIX C

Tier 1 PBE Accounting Requirements and Tier 2 PBE Accounting Requirements to be applied by public benefit entities

This appendix forms an integral part of XRB A1 Application of the Accounting Standards Framework.

This appendix lists the accounting standards and authoritative notices that contain the Tier 1 PBE Accounting Requirements for Tier 1 PBEs and the Tier 2 PBE Accounting Requirements for Tier 2 PBEs.

Accounting standards

(…)	
PBE IPSAS 41	*Financial Instruments*
PBE IPSAS 43	*Leases*
PBE IFRS 4	*Insurance Contracts* (superseded on adoption of PBE IFRS 17 for not-for-profit entities)
(…)	

Basis for Conclusions

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

Background: IPSAS 43 *Leases*

BC1. In January 2022, the IPSASB issued IPSAS 43 *Leases*. IPSAS 43 is based on IFRS 16 *Leases*, issued by the International Accounting Standards Board (IASB) in January 2016. IPSAS 43 supersedes IPSAS 13 *Leases*. IPSAS 13 was based on the IASB standard IAS 17 *Leases*, which was superseded by IFRS 16.

BC2. IPSAS 43 sets out the accounting requirements for leases. Consistently with IFRS 16, IPSAS 43 introduces a new lease accounting model for lessees – the 'right-of-use' model. The right-of-use model is based on the foundational principle that leases are financings of the right to use an underlying asset. Under the right-of-use model, a lessee recognises a 'right-of-use asset' and a lease liability related to the future lease payments. Lessees are required to apply the right-of-use model to all leases, with limited exemptions. By contrast, under IPSAS 13, lessees classified leases as operating leases or finance leases. Operating leases were recognised as an expense over the lease term, whereas finance leases were recognised as assets and liabilities in the statement of financial position.

BC3. When developing IPSAS 43 *Leases*, the IPSASB considered that there were no public sector issues that warranted a departure from the right-of-use model for lessee accounting in IFRS 16, for the following reasons.

(a) The right-of-use asset satisfies the definition of, and recognition criteria for, an asset in the IPSASB's *Conceptual Framework*. The right-of-use asset is recognised when the lessee controls the asset, which is consistent with the IPSASB's *Conceptual Framework*.

(b) The information reported under the single right-of-use lessee accounting model specified in IFRS 16 would provide the most useful information to the broadest range of users of financial statements.

(c) The right-of-use model prevents accounting arbitrage and information asymmetry. It improves comparability between public sector entities that lease assets and public sector entities that purchase assets.

(d) The IPSASB acknowledged that there would be costs for lessees associated with implementing the right-of-use model in the public sector. However, the IPSASB considered that the benefits outweigh the costs, particularly if the IPSASB also adopted the exemptions in IFRS 16.

BC4. IPSAS 43 does not introduce significant changes to lessor accounting as compared to IPSAS 13. This is consistent with IFRS 16.

BC5. IPSAS 43 does not contain specific accounting requirements for leases at below-market terms, often referred to as concessionary leases. However, such leases are not excluded from the scope of IPSAS 43. IPSAS 43 also does not contain accounting requirements for arrangements that convey a right to use an asset for a specified period of time for no consideration. Accounting requirements for concessionary leases and the abovementioned arrangements for no consideration are being considered by the IPSASB separately, as part of the project *Other Lease-type Arrangements*.

NZASB decision to develop PBE IPSAS 43 *Leases*

BC6. Following the issue of IPSAS 43, the NZASB decided to develop a PBE Standard based on IPSAS 43, which would supersede PBE IPSAS 13 *Leases*. The NZASB noted that developing a PBE Standard based on IPSAS 43 would be in accordance with New Zealand's Accounting Standards Framework. The NZASB also noted the following.

(a) The IPSASB's reasons for developing IPSAS 43 based on IFRS 16, as described in paragraph BC3 above, also justify the introduction of these requirements into PBE Standards.

(b) New Zealand constituents who commented on the proposals in IPSASB ED 75 *Leases* – on which IPSAS 43 is based –broadly supported the proposals in that ED.

(c) Developing a PBE Standard based on IPSAS 43 would substantially align the requirements in PBE Standards with the most recent IPSAS (and IFRS Accounting Standards), allowing New Zealand public benefit entities to benefit from the latest international thinking on lease accounting.

(b) Developing a PBE Standard based on IPSAS 43 substantially aligns the requirements in PBE Standards with the equivalent requirements in NZ IFRS and minimises mixed group issues.

BC7. The NZASB considered whether to wait for the IPSASB to finalise its project on *Other Lease-type Arrangements* – which covers concessionary leases and arrangements that convey a right to use an asset for a specified period of time for no consideration – before developing a PBE Standard based on IPSAS 43. The NZASB decided to develop a PBE Standard based on IPSAS 43 without waiting for the IPSASB to finalise the abovementioned project – but to allow a long implementation period before the Standard becomes effective, with early application permitted. The rationale for this decision was as follows.

(a) Issuing a PBE Standard based on IPSAS 43, without waiting for the IPSASB to finalise its project on *Other Lease-type Arrangements*, would make the benefits noted in paragraph BC6 available to public benefit entities in New Zealand.

(b) At the same time, the long effective date would allow public benefit entities sufficient time to prepare for the implementation of the Standard before it becomes mandatory.

(c) Furthermore, it is expected that the IPSASB will finalise its project on *Other Lease-type Arrangements* before the effective date of PBE IPSAS 43 – therefore, the NZASB will be able to consider the development of requirements for concessionary leases and arrangements that convey a right to use an asset for a specified period of time for no consideration before PBE IPSAS 43 becomes effective.

BC8. The NZASB decided not to add specific requirements for concessionary leases and arrangements that convey a right to use an asset for a specified period of time for no consideration into PBE IPSAS 43, but rather to consider the development of such requirements when the IPSASB finalises its project on *Other Lease-type Arrangements*. However, the NZASB decided to clarify that concessionary leases (that meet the definition of a lease) are in the scope of PBE IPSAS 43, and that the concessionary component of concessionary leases or of an arrangement that conveys a right to use an asset for a specified period of time for no consideration is not to be recognised at fair value (see below). These scope clarifications will be reconsidered after the IPSASB finalises its project on *Other Lease-type Arrangements*.

BC9. The NZASB considered that the requirements of IPSAS 43 were generally appropriate for application by public benefit entities and followed its usual processes in modifying IPSAS 43 for application by Tier 1 and Tier 2 public benefit entities. Most of the changes made to IPSAS 43 were to ensure coherence within the suite of PBE Standards (in terms of aligning terminology and requirements with other PBE Standards). In the case of disclosure requirements, the NZASB identified disclosure concessions for Tier 2 entities and aligned these with the disclosure concessions in NZ IFRS 16 *Leases*. The NZASB issued ED 2022-11 PBE IPSAS 43 *Leases* in August 2022 with comments due by 25 November 2022.

BC10. The specific modifications made by the NZASB in developing PBE IPSAS 43, as well as modifications that were considered but ultimately not included in PBE IPSAS 43, are outlined below.

Scope clarification: concessionary leases and arrangements that convey a right to use an asset for a specified period of time for no consideration

BC11. 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).

BC12. 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. The NZASB notes that concessionary leases are often granted with conditions or obligations attached over their use. For example, the lessee may be required to use the leased asset in a way that is complementary to the lessor's objectives. The NZASB will consider the development of requirements for concessionary leases and arrangements that convey a right to use an asset for no consideration (and any related obligations arising from such arrangements) after the IPSASB finalises its project on concessionary leases and other public sector-specific lease-like arrangements. Until such requirements are considered by the NZASB, 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 (except where this Standard or another Standard explicitly requires or permits a different accounting treatment – see paragraph BC12A).

BC12A. Despite the abovementioned requirement to take into account the lease payments as per the lease agreement, and not what the lease payments would have been had the lease been at market terms, there are certain situations where this Standard or another Standard requires or permits a right-of-use asset to be measured at fair value or to be adjusted for off-market lease terms. For example:

(a) An entity measures a right-of-use asset at fair value after initial recognition if it is required to do so under paragraph 35 of this Standard or if it chooses to do so under paragraph 36 of this Standard.

(b) In accordance with PBE FRS 47 *First-time Adoption of PBE Standards*, a lessee that is a first-time adopter of PBE Standards may elect to measure a right-of-use asset at fair value, or using a previous GAAP revaluation that is equivalent to fair value, cost or depreciated cost, on the date of transition to PBE Standards (see PBE FRS 47).

(c) In accordance with PBE IPSAS 40 *PBE Combinations*, when the acquirer recognises a right-of-use asset as part of an acquisition, the acquirer measures the right-of-use asset at the same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market terms.

BC13. 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.

BC14. The abovementioned scope clarifications will be reconsidered after the IPSASB completes its project on concessionary leases and other public sector-specific lease-type arrangements.

Leases of low-value underlying assets

BC15. IPSAS 43 provides a recognition exemption for ‘leases for which the underlying asset is of low value’. This means that an entity need not recognise a right-of-use asset and a lease liability for leases of low-value assets. Instead, the lease payments relating to such leases may be accounted for as expenses on either a straight-line basis or another systematic basis. IPSAS 43 requires an entity to determine whether a leased asset is of ‘low value’ on an absolute basis – not based on whether the asset is material to the entity. Paragraph AG9 lists examples of low value underlying assets.

BC16. The NZASB considered whether to retain the IPSASB’s approach of performing the ‘low value underlying asset’ assessment based on the asset’s absolute value on an individual asset basis – or whether to require the assessment to be performed on the basis of materiality and/or in aggregate for similar leased assets. The NZASB noted the following.

(a) Performing the assessment on an absolute basis for each individual asset is more likely to ensure that the cost of applying PBE IPSAS 43 do not outweigh the benefits. The Basis for Conclusions of IFRS 16 *Leases* notes the following with respect to exemption for leases of low-value underlying assets: “[…] in the light of feedback received from preparers of financial statements, the IASB concluded that the exemption would provide substantial cost relief to many lessees (and, in particular, smaller entities) by removing the burden of justifying that such leases would not be material in the aggregate”. The NZASB considered that similar cost-benefit considerations would apply to public benefit entities in New Zealand.

(b) The NZASB did not identify a New Zealand-specific reason to depart from the requirements in IPSAS 43, or a public benefit entity-specific reason to depart from the requirements for for-profit entities in NZ IFRS 16.

BC17. Consequently, the NZASB decided to retain the requirement to perform the ‘low-value underlying asset’ assessment based on absolute value on an individual asset basis.

Materiality – concessionary leases

BC18. The NZASB noted that for leases at below-market terms, often referred to as concessionary leases, the lease payments may not be material. However, if the underlying leased asset is not of low value, the recognition exemption for leases of low-value underlying assets in PBE IPSAS 43 would not apply. Nevertheless, if the lease payments are low, the right-of-use asset and lease liability that would arise from applying the right-of-use model to a concessionary lease may not be material to the entity. PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* notes that the accounting policies set out in PBE Standards "need not be applied when the effect of applying them is immaterial".

BC19. The NZASB considered whether to include in PBE IPSAS 43 specific requirements or guidance on the application of materiality, particularly with respect to leases where the lease payments are not material. The NZASB noted that PBE Standards generally do not include materiality guidance about specific transactions or events. As with all PBE Standards, the application of the requirements of PBE IPSAS 43 are subject to materiality considerations. General guidance on the application of materiality is included in PBE IPSAS 1, PBE IPSAS 3 and the *PBE Conceptual Framework*.

References to NZ IFRS 15 *Revenue from Contracts with Customers*

BC20. IFRS 16 *Leases* contains references to IFRS 15 *Revenue from Contracts with Customers*. The IPSASB's project to develop a new IPSAS on Revenue, which includes alignment with IFRS 15, was ongoing when the IPSASB issued IPSAS 43. Therefore, the IPSASB included references to IFRS 15 in IPSAS 43, with a view to updating these references when the new IPSAS on Revenue is issued.

BC21. Consistent with IFRS 16, IPSAS 43 refers preparers to IFRS 15 in the following circumstances:

(a) Allocating consideration to lease and/or non-lease 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 determine whether the transfer is accounted for as a sale by applying the requirements in IFRS 15 for determining when a performance obligation is satisfied.

BC22. In developing PBE IPSAS 43, the NZASB considered whether the relevant requirements in NZ IFRS 15 *Revenue from Contracts with Customers* could be included in PBE IPSAS 43 – instead of requiring public benefit entities to refer to a for-profit standard.

BC23. The NZASB identified the paragraphs of NZ IFRS 15 that relate directly to the circumstances outlined in BC27 above. However, the NZASB noted that these paragraphs are interrelated with several other paragraphs in NZ IFRS 15, as explained below.

(a) With respect to allocating consideration to the separate components of a contract (lessor): Paragraphs 73–90 of NZ IFRS 15 cover the allocation of the transaction price to performance obligations and changes in the transaction price. 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: 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.

BC24. The NZASB considered that it would not be desirable to include a large portion of NZ IFRS 15 in PBE IPSAS 43. Therefore, NZASB considered including the 'most essential' NZ IFRS 15 paragraphs in PBE IPSAS 43, and either:

(a) referring preparers to further guidance in NZ IFRS 15 via a footnote; or

(b) describing within PBE IPSAS 43 the relevant key concepts from NZ IFRS 15 when applying the included NZ IFRS 15 paragraphs.

BC25. The NZASB noted that deciding which paragraphs are most essential would require significant judgement. Furthermore, including only those NZ IFRS 15 paragraphs that are considered 'most essential' and excluding the other interrelated paragraphs (as explained above) would result in preparers having insufficient context for applying those paragraphs that are included. This could limit the usefulness of the included NZ IFRS 15 paragraphs and lead to application challenges. In addition, under the option described in paragraph BC30(a), preparers would still refer to NZ IFRS 15 for additional guidance. The option described in paragraph BC30(b) above would mean that preparers do not need to refer to NZ IFRS 15. However, this option runs the risk of creating a New Zealand interpretation of IFRS 15, which could have unintended consequences.

BC26. Consequently, the NZASB decided not to add paragraphs from NZ IFRS 15 or descriptions of the requirements of NZ IFRS 15 into PBE IPSAS 43. Instead, PBE IPSAS 43 refers preparers to NZ IFRS 15 in the circumstances listed in paragraph BC23 above. The NZASB will update these references to NZ IFRS 15 when the IPSASB finalises its project on Revenue and the NZASB considers updates to the revenue requirements in PBE Standards based on that project. Given the long effective date of PBE IPSAS 43, it is expected that the references to NZ IFRS 15 will be updated before PBE IPSAS 43 becomes effective. Therefore, it is expected that only some early adopters of PBE IPSAS 43 would need to refer to NZ IFRS 15 when applying PBE IPSAS 43.

COVID-19-related rent concessions

BC27. IPSAS 43 includes paragraphs that provide an optional practical expedient for lessees for the accounting for COVID-19-related rent concessions. These paragraphs are based on *COVID-19-Related Rent Concessions*, issued by the IASB, which amended IFRS 16 *Leases*. Consistent with the IASB amendments, the application of the practical expedient in IPSAS 43 is limited to lease payments that would have been due on or before 30 June 2022. This time limitation is also consistent with the requirements for for-profit entities in NZ IFRS 16 *Leases*. The NZASB did not identify a New Zealand-specific reason to extend this time limit for public benefit entities. The NZASB also noted that given this time limit, the COVID-19-related practical expedient in IPSAS 43 will not be applicable when PBE IPSAS 43 becomes effective, and is highly unlikely to be applicable by the time any early adopters apply PBE IPSAS 43. To avoid confusion in relation to the applicability of the paragraphs relating to COVID-19-related rent concessions, the NZASB deleted those paragraphs.

Interest Rate Benchmark Reforms – Part 2

BC28. The IASB issued *Interest Rate Benchmark Reforms – Part 2*, which amended IFRS 16 and other IFRS Accounting Standards to provide relief for entities that are affected by the phasing out of interest-rate benchmarks, such as interbank offered rates (IBOR). These amendments were included in the relevant NZ IFRS, including NZ IFRS 16. In 2021, these amendments were then also included in the relevant PBE Standards – except for the amendments to NZ IFRS 16, as PBE Standards did not yet include a standard with requirements that are aligned with NZ IFRS 16. When the NZASB issued PBE IPSAS 43, the NZASB incorporated the parts of *Interest Rate Benchmark Reforms – Part 2* that relate to NZ IFRS 16 into PBE IPSAS 43.

ILLUSTRATIVE EXAMPLES

CONTENTS

Illustrative Examples

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

IE1. These examples portray hypothetical situations illustrating how an entity might apply some of the requirements in PBE 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 PBE 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 City A to City B. 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 City A to City B. 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 City A to City B. 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 City A and delivery in City B, are specified in the contract.

Customer is responsible for driving the truck from City A to City B.

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 City A to City B 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 City A to City B 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 PBE IPSAS 43 to leases of low-value assets; and (b) determine portfolios of leases to which it would apply the requirements in PBE 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 PBE 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 PBE 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 PBE IPSAS 43 to each master lease agreement would not result in a materially different effect than applying the requirements of PBE IPSAS 43 to each individual lease within the master lease agreement. Consequently, Lessee concludes that it can apply the requirements of PBE 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 PBE IPSAS 43 to the combined portfolio of leases within the two master lease agreements would not differ materially from applying PBE 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 PBE 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 PBE 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 PBE IPSAS 43. Lessee does not elect the practical expedient in paragraph 16 of PBE IPSAS 43. Lessee considers the requirements in paragraph AG33 of PBE 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 PBE 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 specialised 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 PBE 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 minimise 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**	**Depreciati on 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**		
	Beginning balance	**6% interest expense**	**Lease payment**	**Ending balance**	**Beginning balance**	**Depreciation charge**	**Ending balance**
Year	**CU**	**CU**	**CU**	**CU**	**CU**	**CU**	**CU**
1	**736,009**	44,160	(100,000)	**680,169**	**736,009**	(73,601)	**662,408**
2	**680,169**	40,810	(100,000)	**620,979**	**662,408**	(73,601)	**588,807**
3	**620,979**	37,259	(100,000)	**558,238**	**588,807**	(73,601)	**515,206**
4	**558,238**	33,494	(100,000)	**491,732**	**515,206**	(73,601)	**441,605**
5	**491,732**	29,504	(100,000)	**421,236**	**441,605**	(73,601)	**368,004**
6	**421,236**				**368,004**		

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability on the basis of: (a) a three-year remaining lease term, (b) annual payments of CU150,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. The modified liability equals CU393,647, of which (a) CU131,216 relates to the increase of CU50,000 in the annual lease payments from Year 6 to Year 8 and (b) CU262,431 relates to the remaining three annual lease payments of CU100,000 from Year 6 to Year 8.

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

At the effective date of the modification (at the beginning of Year 6), the pre-modification right-of-use asset is CU368,004. Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset based on the remaining right-of-use asset for the original 2,000 square 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 PBE 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 PBE 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 PBE 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 PBE IPSAS 43 about variable lease payments. This example shows only current period information. PBE IPSAS 1 *Presentation of Financial Reports* 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: Crown Entity 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 minimise fixed costs. Fixed and variable rental payments by tourism outlet for the period ended 31 December 20X0 are summarised 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%**

Example 22B: Crown Entity 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 Crown Entity XYZ's property leases 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 summarised 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: Crown Entity 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 PBE IPSAS 43 about extension options and termination options. This example shows only current period information. PBE 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 Council 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. 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 maximise 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 summarised 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 summarises 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 maximise 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 summarises 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 PBE 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

PBE IPSAS 43 *Leases* is drawn from IPSAS 43 *Leases.*

The significant differences between PBE IPSAS 43 and IPSAS 43 are:

(a) PBE IPSAS 43 includes scope clarification paragraphs 4.1 and 4.2. These paragraphs clarify that concessionary leases that meet the definition of a lease are within the scope of the Standard – but an entity applies the measurement requirements of this Standard based on the lease payments as per the lease agreement, and not based on what the lease payments would have been had the lease been at market terms. The scope clarification paragraphs also clarify that an arrangement that conveys the right to use an asset for a specified period of time for no consideration does not meet the definition of a lease. These paragraphs will be reconsidered when the IPSASB finalises its project on *Other Lease-type Arrangements*.

(b) PBE IPSAS 43 includes additional consequential amendments to PBE IPSAS 23 *Revenue from Non-exchange Transactions*. These amendments clarify that leases within the scope of PBE IPSAS 43, as well as arrangements that convey the right to use an asset for a specified period of time for no consideration, are outside the scope of PBE IPSAS 23. This scope exclusion will be reconsidered when the IPSASB finalises its project on *Other Lease-type Arrangements*.

(c) IPSAS 43 provides an optional practical expedient for the accounting for COVID-19-related rent concessions. This practical expedient is limited to lease payments that would have been due on or before 1 July 2022. Given the timing of the issuance of PBE IPSAS 43, the practical expedient is not included in PBE IPSAS 43.

(d) PBE IPSAS 43 includes amendments equivalent to those issued by the International Accounting Standards Board to provide relief to entities affected by the phasing out of interest-rate benchmarks, such as interbank offered rates.

(e) PBE IPSAS 43 includes additional consequential amendments to certain PBE Standards that are based on NZ IFRS – such as PBE FRS 47 (based on NZ IFRS 1), PBE IFRS 4 (based on NZ IFRS 4) and PBE IAS 12 *Income Taxes*. The amendments are based on equivalent amendments to the relevant NZ IFRS.

(f) PBE IPSAS 43 includes RDR concessions for public benefit entities in Tier 2. These concessions are aligned with those provided in NZ IFRS 16 *Leases*.