PSAB
At a Glance

Leased Tangible Capital Assets
& Sale-leaseback Transactions

BDO

Leased Tangible Capital Assets & Sale-leaseback Transactions[1]

Lease	Leased Tangible Capital Asset (LTCA)
The conveyance, by a lessor to a lessee, of the right to use a tangible capital asset usually for a specified period of time in return for rent.	A non-financial asset that has physical substance and a useful life extending beyond an accounting period, and is held under lease by a government for use, on a continuing basis, in the production or supply of goods and services. Under the terms and conditions of the lease, substantially all the benefits and risks incident to ownership are, in substance, transferred to the government without necessarily transferring legal ownership.

Identifying When Substantially All the Benefits and Risks Have Been Transferred

- Substantially all the benefits and risks of ownership have been transferred to the government when one or more of the following conditions are present:
  - There is reasonable assurance the government will obtain ownership of the leased property by the end of the lease term (ownership transfer provisions or bargain purchase option are included in the lease).
  - The duration of the lease term is equal to a major portion (usually 75% or more) of the economic life of the leased property.
  - The lessor is assured of recovering the investment in the leased property and of earning a return on the investment as a result of the lease agreement. This occurs when the present value of the minimum lease payments, excluding any executory costs, is equal to substantially all (usually 90% or more) of the fair value of the leased property.
- Even if the factors listed above are not present, the lease may still need to be classified as a LTCA. To determine whether substantially all the benefits and risks of ownership have been transferred, the assessment of the factors above should be considered in conjunction with the guidance provided in paragraphs PSG-2.6-.10.

Accounting for a LTCA

- **Recognition**
  - Leased property that meets the definition of a LTCA should be accounted for as a tangible capital asset and a liability.
- **Accounting for the asset**
  - The asset should be accounted for in accordance with Section PS 3150, *Tangible Capital Assets*.[2]
- **Value at inception of the lease**
  - The value of the LTCA and the amount of the lease liability, recorded at the beginning of the lease term, is the present value of the minimum lease payments, excluding executory costs.
  - The discount rate used by the government to determine the present value of the minimum lease payments should be the lower of:
    - The government's rate for incremental borrowing; and
    - The interest rate implicit in the lease, if practicable to determine.
  - The maximum value recorded for the asset cannot exceed the leased property's fair value.
- **Amortizing the asset**
  - The LTCA is amortized over the period of expected use of the asset on a basis consistent with the government's amortization policy for other similar tangible capital assets.
    - The asset is amortized over the economic life of the property if, the lease contains terms that allow ownership to pass to the government or a bargain purchase option.
    - Otherwise, the property is amortized over the lease term.
- **Accounting for the liability**
  - Lease payments are allocated between repayments of the liability, interest expense and any executory costs.
- **Contingent rentals**
  - Are expensed as incurred.

Presentation

- The government reports its LTCAs in accordance with Section PS 1201, *Financial Statement Presentation.*[3]
- Liabilities related to LTCAs should be presented separate from other liabilities on the Statement of Financial Position.

[1] Includes Public Sector Guideline 2, *Leased Tangible Capital Assets*, and Public Sector Guideline 5, *Sale-leaseback Transactions*.
[2] See also our publication PSAB At a Glance: Section PS 3150 – *Tangible Capital Assets*.
[3] See also our publication PSAB At a Glance: Section PS 1201 – *Financial Statement Presentation*.

Sale-Leaseback Transaction

The sale of property by a government and the leasing of the same property, or a portion thereof, back to the government. The transaction may be effected through a series of concurrent sale transactions involving more than one external party or organization within the government reporting entity, with the end result being that the government retains the use of the property, or a portion thereof.

Sale-Leaseback Involving a Leased Tangible Capital Asset (LTCA)

- In substance a sale-leaseback transaction that results in an LTCA is a financing arrangement as the government still retains substantially all the benefits and risks incidental to ownership of the property.

Sale and 100% Leaseback as an LTCA

- The LTCA is recognized at its carrying amount prior to the transaction.
- Holding gains are not recognized in operating results.
  - **Holding gain** – occurs when the fair value of the property exceeds its carrying amount.
- The lease liability, after considering effects of any arrangements outlined in paragraphs PSG-5.25-.26, is recognized at the present value of the minimum lease payments.
- Any economic gains and losses, after considering effects of any arrangements outlined in paragraphs PSG-5.25-.26, are recognized immediately in operating results.
  - **Economic gain** - results from each of the following circumstances:
    - The proceeds received for the property are greater than its fair value.
    - The present value of the minimum lease payments is less than the fair value of the lease.
  - **Economic loss** - results from each of the following circumstances:
    - The proceeds received for the property are less than its fair value.
    - The present value of the minimum lease payments is greater than the fair value of the lease.

Sale and Less Than 100% Leaseback as an LTCA

- The LTCA is recognized at its carrying amount in proportion to the amount of the property leased back.
- Holding gains associated with the portion of the LTCA leased back are not recognized in operating results.
- Holding gains associated with the portion of the property not leased back as an LTCA are recognized in operating results since there has effectively been a sale of that portion of the property.
- The lease liability, after considering effects of any arrangements outlined in paragraphs PSG-5.25-.26, is recognized at the present value of the minimum lease payments.
- Any economic gains and losses, after considering effects of any arrangements outlined in paragraphs PSG-5.25-.26 on the whole transaction, are recognized immediately in operating results.

Presentation

- When the leased back property is an LTCA, the Statement of Cash Flow should present the transaction as a financing transaction.

Sale-Leaseback Involving an Operating Lease

- This type of transaction is a sale of property as the government no longer retains substantially all the benefits and risks incidental to ownership of the property.
- Professional judgment needs to be exercised since a unique relationship can occur where an economic gain and an economic loss arise in the same transaction. This is referred to as interrelationship.
- Consideration must be given to the effects of any arrangements described in paragraphs PSG-5.25, .26 and .37.
- Holding gains are immediately recognized in the operating results.

Sale-Leaseback Without Interrelationship

- All economic gains and losses associated with proceeds received are recognized immediately in operating results since they have been realized.
- Any economic gains associated with the present value of the minimum lease payments that are less than the fair value of the lease are not immediately recognized in operating results. Instead, they are recognized over the life of the lease as they are realized.
- Any economic losses associated with the present value of the minimum lease payments that are greater than the fair value of the lease are recognized immediately in operating results. In substance, the economic loss constitutes a form of contribution payable to the lessor. As a result, a corresponding liability is recorded and it is settled in proportion to the minimum lease payments.

Sale-Leaseback With Interrelationship

- An interrelationship occurs within a transaction when an operating lease results in the creation of an economic gain and a compensatory economic loss.
- When this occurs, the amount of the interrelationship must be determined in order to enable the substance of the transaction to be reported.
- If the gain and loss are equal, the compensatory amount is the entire amount of the economic gain and economic loss. However, if the amounts of the gain and loss are different, the compensatory amount is embedded within the economic gain and economic loss. The amount of interrelationship is limited to the extent to which the economic gain and economic loss can be offset.
- A compensatory economic gain and economic loss are treated as discussed below. Once the interrelationship has been accounted for, any remaining actual economic gain and economic loss are treated in accordance with paragraphs PSG-5.40-.42. In addition, consideration must be given to the effects of any arrangements described in paragraphs PSG-5.25 and .26 when determining if an interrelationship exists.
  - The amount of interrelationship is in substance a prepayment, when the proceeds received and the present value of the minimum lease payments are both less than their respective fair values. This prepayment is recognized in the financial statements as a prepaid expense (a non-financial asset). The prepayment is then settled in proportion to the minimum lease payments.
  - The amount of interrelationship is in substance a loan payable, when the proceeds received and the present value of the minimum lease payments are both greater than their respective fair values. The amount of the interrelationship is recognized as a loan payable (a liability) in the financial statements. The loan liability is then settled in proportion to the minimum lease payments.

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