

Leases and licences, part 1 and part 2

Summary conclusions

Questions

1. Altogether 18 questions were set out for the AEG's consideration in paper SNA/M1.06/09.1, covering a number of different aspects of the recording of transactions relating to leases and licences.
2. Two questions concerned clarification of the distinction between operating and financial leases.
 - (a) Does the AEG agree on the distinction between operating and financial leases as depending primarily on whether the lessor or lessee has responsibility for the maintenance of the leased asset and a production activity in which it was used?
 - (b) Does the AEG agree that operating and financial leases are not assets in their own right?

Outcomes

3. The outcome of the discussion on these points was:
 - (a) There was broad agreement on this point but further elaboration is needed including a reference to criteria for economic ownership.
 - (b) There was agreement that leases are seldom assets in their own right; some specific instances to the contrary are discussed below.

Questions

4. There were two questions clarifying the recording of financial leases.
 - (c) Does the AEG agree that the breakdown between repayment of principal and interest is estimated in a manner similar to determining depreciation and net operating surplus/return to capital in the case of a fixed asset?
 - (d) Does the AEG agree that a financial service may be provided by the lessor if the lessor is a financial institution; and if this is so, that the service is reflected in FISIM?

Outcomes

5. The outcome of the discussion on these points was
 - (c) The proposals set out in the paper are correct but some further explanation is required, with care being taken to ensure the principles set out in the paper are not changed.
 - (d) The AEG agreed.

Questions

6. There were five questions relating to the treatment of operating leases, especially those where the lessee might have the right to transfer the lease.
- (e) Does the AEG agree that the payment due under a lease agreement represents the market price even if a newly leased identical asset would command a different price?
 - (f) Does the AEG agree that if a lessee is able legally and practically to sub-contract a lease at a higher rental, this represents an asset for the lessee and a reduction in net worth of the lessor? In this case the value of the object of the lease appears in the lessor's balance sheet at the unencumbered value with the reduction shown separately?
 - (g) Does the AEG agree that if the lessee is not able either legally or practically to sub-contract a lease, the value of the object of the lease appears in the lessor's balance sheet at the encumbered value? In this case there is no separately identified asset belonging to the lessee?
 - (h) Does the AEG agree that these assets (or reductions in net worth) are only relevant in the case of operational leases?
 - (i) If the benefit which comes from a transferable/enforceable lease is regarded as a non-financial asset (under contracts, leases and licences), how should the negative counterpart be shown?

Outcomes

- (e) The majority of the AEG agreed that the contractual price represented the market price.
- (f),(g) The AEG agreed that the two propositions could be combined. In principle there may be an asset attributable to the lessee but it should be only be recognised if the asset can actually or potentially be transferred.
- (h) General agreement – no discussion.
- (i) A sub-group of the AEG met to reformulate this question in the light of the discussion. The sub-group provided three alternatives for recording. The AEG agreed that the leased asset should always be recorded by the lessor at the encumbered value. If the encumbered value is less than the unencumbered value and only if it can be actually or potentially transferred, the lessee would have an asset, valued at the difference between the unencumbered and encumbered values, to be included in the heading “contracts, leases and licences”

Questions

7. Two questions concerned prepayments in relation to leases. The AEG members were asked whether they agreed with the following proposals:

- (j) Do you agree the treatment of prepayments may be a payment for a service or the acquisition of an asset depending on the nature of the agreement?
- (k) If a party to a collective project contributes an asset in lieu of a financial payment, the SNA treatment should be to impute a financial transaction and acquisition of an asset in a similar way to the treatment of wages in kind.

Outcomes

- 8. The AEG agreed with both these propositions.

Questions

- 9. Four questions were raised concerning the use of natural resources authorised by permits.

10. The first of these questions concerned the lease of a natural resource with an infinite life made available by the legal owner to a lessee in return for a regular income (rent). Such a lease does not quite fit either the operating or financial lease conditions. The AEG was therefore asked:

- (l) Is the concept of a resource lease in addition to operating and financial leases helpful?

11. Two other questions related to the use of environmental assets. One concerned resources with sustainability constraints such as fish and the other emissions permits.

- (m) Does the AEG agree that fishing quotas represent assets to the holders? Can this be generalised to quotas, licences, etc for all protected plant and animal species?
- (n) Does the AEG think emission permits should be recorded as taxes in the first instance and assets when they are traded in secondary markets or as assets from inception? Does this generalise to all assets used as “sinks”?

12. The fourth question concerned permits not issued by government.

- (o) Does the AEG agree that when there is an underlying asset, payments should be property income; when there is no underlying asset, payments should be recorded as a payment for a service.

Outcomes

- (l) The AEG agreed that the introduction of a resource lease as a third kind of lease would be helpful.
- (m), (n) The AEG deferred these questions until the paper on government permits was discussed.
- (o) The AEG agreed to the proposal on permits not issued by government.

Questions

13. The last section of the first paper on leases and licences dealt with the provision of goods in the future, for example options to purchase aircraft or the provision of services in the future by nominated persons, for example, footballers' contracts.

- (p) Is the provision of a good in future, e.g. an aircraft option, an asset, specifically some sort of financial derivative.?
- (q) Does the AEG agree that, e.g. footballers contracts, may be a non-financial asset in the group "contracts, leases and licences"?

Outcomes

- (p) The AEG agreed there is an asset if there is a demonstrated value but **the type of asset needs to be further clarified.**
- (q) The AEG agreed that such contracts should be treated as non-produced, non-financial assets.

Question

14. Given the amount of time the Canberra II Group had spent investigating the questions surrounding contracts, leases and licences, the AEG was asked

- (r) Should there be generic advice about the treatment of contracts, leases and licences?

Outcomes

- (r) The AEG agreed.

Questions

15. Paper SNA/M1.06/09.2 reported the results of an e-discussion carried out among members of the Canberra II Group in an attempt to complete some matters unresolved at the end of the last meeting. These were concerned with the partitioning of the benefits of an asset between different units either over time or within the same period of time. Six questions were put to the AEG.

- (s) Should any lease of a produced asset for less than the entire life of the asset be automatically treated as an operating lease? If no, is this a change or a clarification of the SNA?
- (t) Assuming a financial lease may be for less than the whole life of a produced asset, how would you prefer to record the partition of ownership between the legal owner and economic owner of the asset?
- (u) How would you prefer to record the partition of a mineral deposit between the extractor and the owner?

- (v) Do you agree that the concept of a resource rent is a useful means of describing the regular payments for the use of a resource which does not decline in value over the term of the lease but where the user of the resource and the legal owner differ?
- (w) How would you prefer to record the ownership of land under a long lease paid for up front?
- (x) How would you prefer to record the partition of ownership of a radio spectrum between the user and owner?

16. The AEG noted that the result of the e-discussion among the Canberra II Group members suggested that the overwhelming response to (s) was that a financial lease could be for less than the entire life of an asset and that the concept of a resource lease (v) was thought to be helpful. On the four other questions, alternative recordings had been proposed to members of the Canberra II Group and they were in favour of a solution positing two loans, one for the value of the asset to be paid by the lessee and one for the residual value of the asset to be exchanged for the asset at the end of the lease.

Outcomes

17. The AEG was prepared to consider the recommendation from the Canberra II Group sympathetically but agreed that a worked example showing all the recording implications would be useful in reaching a final position. It was agreed that such examples would be prepared and circulated to the AEG in time to reach a position by the end of March 2006. Charles Aspden will lead this work.