



Republic of Kenya



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# IPSAS 43

# LEASES GUIDELINE

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## October 2023

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**Promoting Sound Financial Reporting and Internal Audit Standards in the Public Sector**

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## IPSAS 43 Leases Guideline

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### 1.0 Introduction

IPSASB issued International Public Sector Accounting Standard (IPSAS) 43, "Leases," in January 2022 for the application period beginning on or after January 1, 2025. IPSAS 43 replaces IPSAS 13 'Leases' and is aligned with IFRS 16 "Leases."

The objective of this IPSAS is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. The data gives the users of financial statements a basis for assessing the effect that leases have on the financial position, financial performance, and cash flows of an entity.

### 2.0 Scope

#### 2.1 Scope of IPSAS 43

An entity shall apply this standard to all leases, including leases of right-of-use assets in a sublease.

IPSAS 43 does not apply to the leases below:

- a) Leases on exploration or use of use minerals, oil, natural gas, and similar non-regenerative resources.
- b) IPSAS 27-Leases on biological assets held by a lessee.
- c) IPSAS 32-Service Concession Arrangements for the grantor.
- d) IPSAS 31-Intangible assets for rights held by a lessee under licensing agreements.

**Note:** For other leases on Intangible assets (other than those under licensing agreements), an entity **may** but is NOT required to apply IPSAS 43.

#### 2.2 Examples of leases in the public sector

Some of the common leasing arrangements in the public sector may include leasing of:

1. *Medical equipment.*
2. *Property, plant, and equipment that include high-value scanners, printers, and machinery among others*
3. *Motor vehicles and other transport equipment*
4. *Buildings, including office premises, warehouses, and industrial space, among others*

#### 2.3 Application of IPSAS 43 by public sector entities

IPSAS 43 applies to public sector entities that apply the IPSAS Accrual basis of accounting and have leasing arrangements as defined under IPSAS 43 - Leases.

#### 2.4 Definition of Terms

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



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**Right-of-use asset:** an asset that represents a lessee's right to use an underlying asset for the lease term.

**Lease:** a contract, or part of a contract, that conveys the right to use an underlying asset for a period of time in exchange for consideration.

**Sublease:** a transaction for which an underlying asset is leased by a lessee to a third party, and the lease between the head lessor and lessee remains in effect.

**Short-term lease:** 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.

**Lessee:** an entity that obtains the right to use an underlying asset for a period of time in exchange for consideration.

**Lessor:** an entity that provides the right to use an underlying asset for a period of time in exchange for consideration.

**Lease payments** are payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, including fixed payments less any lease incentives, variable lease payments, and any payments of penalties for terminating the lease.

**Commencement date:** is the date on which a lessor makes an underlying asset available for use by a lessee.

**Finance lease:** a lease that transfers substantially all the risks and rewards incidental to ownership of an underlying asset.

**Operating lease:** a lease that does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

**Residual value guarantee:** 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.

**Unguaranteed residual value** is that portion of the residual value of the underlying asset, the realization of which by a lessor is not assured or is guaranteed solely by a party related to the lessor.

**The 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 the lease payments and the unguaranteed residual value to equal the sum of the fair value of the underlying asset and any initial direct costs of the lessor.

**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.



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**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

**Gross investment in the lease** is the sum of the lease payments receivable by a lessor under a finance lease and any unguaranteed residual value accruing to the lessor.

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



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### 3.0 Recognition and measurement

#### 3.1 Recognition by the lessee

At the commencement date, a lessee shall recognize a right-of-use asset and a lease liability.

#### 3.2 Initial measurement

##### 3.2.1 Initial Measurement of the Right of Use Asset

At the commencement date, a lessee shall measure the right of use asset at **cost**.

**Cost of the right of use asset** = the amount of the initial measurement of lease liability + any lease payments made at or before the commencement date less any lease incentives received + any direct costs incurred by lessee + an estimate of the costs to be incurred by the lessee in dismantling and removing the underlying asset and restoring the site in which the underlying asset is located.

#### Example 1

An entity leases a vehicle to entity ABC for a 10-year period with the following terms on January 1, 2023. The lease commencement date is February 1, 2023. Entity ABC must pay the lessor entity the first monthly rental payment of Ksh. 10,000 upon execution of the lease which is 1<sup>st</sup> January 2023. The lessor entity will also pay ABC Ksh. 50,000 cash incentive to enter into the lease payable upon lease execution.

ABC incurred Ksh. 1,000 of initial direct costs, which are payable on February 1, 2023. Entity ABC calculated the initial lease liability as the present value of the remaining unpaid lease payments discounted using its incremental borrowing rate because the rate implicit in the lease could not be readily determined; the initial lease liability is Ksh. 900,000.

How would ABC measure the right-of-use asset and record this lease?

#### Solution

ABC would measure the right-of-use asset as follows:

Initial measurement of lease liability      Ksh. 900,000

Lease payments made to Lessor Entity before the commencement date (i.e., before the first lease payment) Ksh.10,000

Lease incentive received from the Lessor at lease execution date      Ksh 50,000

Initial direct costs Ksh. 1,000

Initial measurement of right-of-use asset:

**=900,000+10,000-50,000+1,000=861,000.**



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To record initial lease payment on 1<sup>st</sup> January 2023:

Dr. Prepaid rent	10,000	
Cr. Cash		10,000

To record receipt of the lease incentive from the lessor on 1<sup>st</sup> January 2023:

Dr. Cash	50,000	
Cr. Lease Incentive		50,000

To record right of use asset and lease liability on 1<sup>st</sup> February 2023:

Dr. Right of use of asset	900,000	
Cr. Lease liability		900,000

To record lease incentive as an offset to the right-of-use asset on 1<sup>st</sup> February 2023:

Dr. Lease Incentive	50,000	
Cr. Right of use asset		50,000

To record lease payments made to the lessor before the commencement date on 1<sup>st</sup> February 2023:

Dr. Right of use asset	10,000	
Cr. Prepaid rent		10,000

To record initial direct cost on 1<sup>st</sup> February 2023

Dr. Right of use asset	1,000	
Cr. Accrued expenses		1,000

#### 3.2.2 Initial measurement of lease liability

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.

Lease payments to be included in the measurement of lease liability:

**Note:** *Exclude any payments made before the commencement date.*

- a) Fixed payments less any lease incentives receivable





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- b) Variable lease payables that depend on an index or a rate initially measured using the index or rate at the commencement date.
- 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.
- e) Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

**Example 2**

**(a) Lease Payment in Arrears**

An entity enters into a 3-year lease of machinery on 1<sup>st</sup> January 2021. The annual rentals are Ksh. 5,000, with the first installment being paid on 31<sup>st</sup> December 2021. The present value of the minimum lease payments is Ksh. 12,000, and the implicit interest rate in the lease is 12.04% per annum.

Calculate the lease liability to be recognized in the statement of financial position as at 31<sup>st</sup> December 2021, 2022, and 2023.

**Solution.**

Date	Opening	Int @ 12.04%	Cash Paid	Closing
31 <sup>st</sup> Dec 21	12,000	1,444.8	(5,000)	8,444.8
31 <sup>st</sup> Dec 22	8,444.8	1,016.75	(5,000)	4,461.55
31 <sup>st</sup> Dec 23	4,461.55	537.17	(5,000)	-

**(b) Lease Payment in advance**

An entity enters into a 5-year lease of PPE on 1st January 2019. The annual rentals are Ksh. 5,000, with the first installment being paid on 1st January 2019. The present value of the minimum lease payments is Ksh. 22,730, and the implicit interest rate in the lease is 5% per annum.

Calculate the lease liability to be recognized in the statement of financial position as at 31<sup>st</sup> December 2021, 2022, 2023, 2024, and 2025.

**Solution.**

Date	Opening	Cash Paid	Subtotal	Int @ 5%	Closing
31 <sup>st</sup> Dec 19	22,730	(5,000)	17,730	887	18,617
31 <sup>st</sup> Dec 20	18,617	(5,000)	13,617	681	14,298
31 <sup>st</sup> Dec 21	14,298	(5,000)	9,298	465	9,763
31 <sup>st</sup> Dec 22	9,763	(5,000)	4,763	237	5,000
31 <sup>st</sup> Dec 23	5,000	(5,000)	-	-	-





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### 3.2.3 Subsequent measurement- Right of Use

After the commencement date, a lessee shall measure the right-of-use asset by applying a cost model unless the lessee applies any of the measurement methods below:

- If a lessee applies fair value in IPSAS 16 - Investment property, the lessee shall also apply the fair value model to right-of-use assets that meet the definition of Investment Property.
- If the right-of-use assets relate to a class of property, plant, and equipment to which the lessee applies the revaluation model in IPSAS 17, the lease 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.

#### 3.2.3.1 Measurement using the cost model

Right of use at cost- any accumulated depreciation- any accumulated impairment losses(-+) adjustments for any remeasurement of lease liability to reflect lease modifications at each reporting date, if any.

##### a) Depreciation

Depreciation shall be applied in line with the requirements of IPSAS 17- Property, Plant, and Equipment. If the lease transfers the ownership of the underlying asset to the lessee by the end of the lease term or if the cost of the right of use reflects that the lessee will exercise a purchase option, the lessee shall depreciate the right of use asset from the commencement date of the lease 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 useful life of the right-of-use asset or the end of the lease term.

##### b) Impairment

Impairment shall be assessed in line with IPSAS 21 – Impairment of non-cash-generating assets or IPSAS 26- Impairment of cash-generating assets as appropriate.

### 3.2.4 Subsequent measurement- Lease Liability

After the commencement date, a lessee shall measure the lease liability by:

- ✓ Increasing the carrying amount to reflect interest on the lease liability.
- ✓ Reducing the carrying amount to reflect the lease payments made.



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- ✓ Remeasuring the carrying amount to reflect any reassessment or lease modifications.

Interest on the lease liability and any 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 are recognized in surplus or deficit.

### **Reassessment of the Lease Liability**

After the commencement date, a lessee shall remeasure the lease liability to reflect changes to the lease payments. A lessee shall recognize 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 recognize any remaining amount of the remeasurement in surplus or deficit.

A lease liability shall be remeasured by discounting the revised lease payments using a revised discount rate if either:

- a) There is a change in the lease term.
- b) There is a change in the assessment of an option to purchase the underlying asset, which is assessed considering the events and circumstances in the context of a purchase option.

### **Lease Modifications**

A lease modification is accounted for in one of two ways:

1. It is treated as a separate lease or
2. It is not treated as a separate lease.

The conditions below should be fulfilled for a lease modification to be accounted for as a separate lease.

- ✓ The modification increases the scope of the lease by adding the right to use one or more underlying assets.
- ✓ The consideration for the lease increases proportionately with the standalone price for the increased scope, along with any necessary adjustments to reflect the specifics of the contract.

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:

- ✓ 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



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lease. The lessee shall recognize in surplus or deficit any gain or loss relating to the partial or full termination of the lease.

- ✓ Making a corresponding adjustment to the right-of-use asset for all other lease modifications.

### **Examples of lease modifications**

- ✓ Changing the consideration
- ✓ Extending the lease term.
- ✓ Shortening the lease term.
- ✓ Adding assets.
- ✓ Removing assets.

### **Effective date of modification.**

In situations where this is not clear, it is worth bearing in mind that 'the date when both parties agree to a lease modification' is essentially the date when both parties have a shared understanding of and are committed to the modified principal terms and conditions of the lease. It could be viewed as equivalent to the inception date of a lease but on modified terms.

### **Recognition Exemptions**

A lessee may elect not to apply the recognition criteria outlined above to:

- a) Short term leases
- b) Leases for which the underlying asset is of low value (examples may include tablets and personal computers, small items of office furniture, and telephones.

An underlying asset can be of low value only if:

- The lessee can benefit from the use of the underlying asset on its own or together with other resources that are readily available to the lessee and
- The underlying asset is not highly dependent on, or highly interrelated with, other assets.

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 vehicle would typically not be of low value.

If this election is made as per the criteria above, the lessee shall recognize the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis.



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The election for short-term leases shall be made by class of the underlying asset to which the right of use relates. The election for leases for which the underlying asset is of low value can be made on a lease-by-lease basis.

### **3.2.5 Presentation in the books of the lessee**

#### **Statement of financial position**

A lessee shall either present in the statement of financial position or disclose in the notes:

- ✓ 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:
  - 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
  - Disclose which line items in the statement of financial position include those right-of-use assets.
- ✓ 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.
- ✓ Right-of-use assets that meet the definition of investment property shall be presented in the statement of financial position as an investment property.

#### **Statement of Financial Performance**

A lessee shall present interest expense on the lease liability as a finance cost separately from the depreciation charge for the right-of-use asset.

#### **Statement of Cashflows**

A lessee shall classify:

- ✓ Cash payments for the principal portion of the lease liability within financing activities
- ✓ Cash payments for the interest portion of the lease liability as interest paid
- ✓ Short-term lease payments, payments for leases of low-value assets, and variable lease payments are not included in the measurement of the lease liability within operating activities.



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### 3.2 Classification of Leases by the lessor

A lessor classifies leases as either finance or operating.

- Finance leases transfer substantially all the risks and rewards incidental to ownership of an underlying asset.
- Operating leases do not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

Whether a lease is a finance lease or an operating lease depends on the transaction's substance rather than the contract's form, thus requiring the application of considerable professional judgment.

Situations that would typically lead to a lease being classified as a finance lease:

- The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
- 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.
- The lease term is for a significant part of the underlying asset's economic life, even if the title is not transferred.
- 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.
- The underlying asset is of such a specialized nature that only the lessee can use it without significant modifications.

Indicators of situations that could lead to a lease being classified as a finance lease are:

- If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee.
- Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee.
- The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

Lease classification is made at the inception date of a lease and is reassessed only if there is a lease modification. The below scenarios do not give rise to a new classification of a lease:

- Changes in estimates, e.g., changes in estimates of the economic life or the residual value of the underlying asset
- Changes in circumstances, e.g., default by the lessee.



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### **Recognition and Measurement of Finance Leases**

At the commencement date, lessors account for finance leases by initially derecognizing the asset and recognizing a receivable for the net investment in the lease. The interest income on this receivable is recognized, with the lease payments made by the lessee reducing the outstanding balance of the receivable.

### **Initial Measurement**

The lessor shall use the interest rate implicit in the lease to measure the net investment in the lease.

For 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.

Initial direct costs are included in the initial measurement of the net investment in the lease and reduce the amount of revenue recognized over the lease term.

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:

- Fixed payments, less any lease incentives payable.
- Variable lease payments that depend on an index or a rate initially measured using the index/rate at the commencement date.
- Any residual value guarantees provided to the lessor by the lessee, a related party of the lessee, or other parties unrelated to the lessor that are financially capable of discharging the obligations under the guarantee.
- The exercise price of a purchase option if the lessee is reasonably certain to exercise that option.
- Payments of penalties for terminating the lease if the lease term reflects the lessee exercising an option to terminate the lease.

### **Subsequent Measurement**

A lessor shall recognize finance income over the lease term based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease.

A lessor shall apply the derecognition and impairment requirements in IPSAS 41 to the lease's net investment, i.e., lease receivable.

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) shall account for that asset under IPSAS 44.

### **Recognition of lease modifications to a finance lease by the Lessor**

A lessor shall account for a modification to a finance lease as a separate lease if both:

- The modification increases the scope of the lease by adding the right to use one or more underlying assets.





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- The consideration for the lease increases proportionately with the standalone price for the increased scope, along with any necessary adjustments to reflect the specifics of the contract.

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:

- If the lease would have been classified as an operating lease had the modification been in effect at the inception date, the lessor shall:
  - ✓ Account for the lease modification as a new lease from the effective date of the modification and
  - ✓ Measure the carrying amount of the underlying asset as the net investment in the lease immediately before the effective date of the lease modification.
- Otherwise, the lessor shall apply the requirements of IPSAS 41.

### Recognition and Measurement of Operating Leases

For operating leases, lessors retain the leased asset on their books and account for the leases by recognizing income received (net of lease incentives provided to the lessee) on a straight-line basis over the term of the lease (unless another systematic basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished, in which case lease income received is recognized on that basis).

The lessor must also:

- Recognize costs incurred in earning the lease income as an expense.
- Depreciate the asset in a manner consistent with the lessor's normal depreciation policy for similar assets.
- Assess the leased asset for impairment under IPSAS 21 or 26.
- Add initial direct costs incurred in obtaining the lease to the carrying amount of the leased asset and recognize those costs as an expense over the lease term on the same basis as the lease income.

### Recognition of lease modifications to an operating lease by the Lessor

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 of Operating Leases.

In the statement of financial position, a lessor shall present underlying assets according to their nature.

## 3.3 Sale and Leaseback Transactions

If an entity (seller-lessee) transfers an asset to another entity (the buyer-lessor) and leases that asset back from the buyer-lessor, both parties shall account for the transfer





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contract by assessing whether the transfer is a sale or not by applying the requirements for determining a performance obligation in IFRS 15- Revenue.

### **3.3.1 Transfer of asset is a sale**

- 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. The seller-lessee shall recognize only the amount of any gain or loss that relates to the rights transferred to the buyer-lessee.
- b) The buyer-lessee shall account for the asset's purchase applying applicable standards and for the lease applying the lessor accounting requirements of IPSAS 43.

### **3.3.2 Transfer of the asset is not a sale**

If the transfer of an asset by the seller-lessee does not satisfy the requirements to be accounted for as a sale of the asset, the seller-lessee shall continue to recognize the transferred asset and shall recognize a financial liability equal to the transfer proceeds. It shall account for the financial liability applying IPSAS 41.

The buyer-lessee shall not recognize the transferred asset and shall recognize a financial asset equal to the transfer proceeds. It shall account for the financial asset applying IPSAS 41.



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### 4.0 Disclosures

#### ***Disclosure by the Lessee***

Disclosure of lease transactions enhances the readers' assessment of the effect leases have on the Statements of Financial Position, Financial Performance, and Cashflows.

Leases shall be disclosed as a single note or single section in the Financial statements. The single note can be used as a cross-reference for multiple lease disclosures.

The following (among other disclosures) shall be disclosed.

- i) Depreciation charge for right-of-use assets
- ii) Interest expense on lease liabilities
- iii) Total cash outflow for leases
- iv) Any additions to right-of-use assets
- v) Gains/losses arising from sale and lease back transactions and
- vi) The carrying amount of right-of-use assets at the end of the reporting period.

***Note: A tabular format of disclosures is preferred.***

#### ***Disclosure by the Lessor***

Disclosure by the lessor for **finance leases** or **operating leases** shall comprise of :

- i) Finance Leases**
  - a) Selling Surplus or deficit
  - b) Finance revenue on the net investment in the lease
  - c) Any revenue arising from a variable lease not included in the measurement of the net investment in the lease
  - d) A maturity analysis of lease payments receivable shows the undiscounted lease payments to be received annually for a minimum of the remaining first five years and a total of the amounts for the remaining years.
  - e) Under (d), the lessor shall **reconcile** the undiscounted lease payments to the net investment in the lease.
  - f) Other qualitative and quantitative explanations of significant changes in the carrying amount of the net investment in the finance leases.
- ii) Operating Leases**
  - a) The lessor shall apply IPSAS 17(PPE) disclosure requirements for items subject to an operating lease. These shall be disaggregated from items not subject to operating leases.
  - b) The lessor shall also apply IPSAS 16(investment property), IPSAS 21, IPSAS26, IPSAS 31, or items subject to an operating lease
  - c) A maturity analysis of lease payments receivable shows the undiscounted lease payments to be received annually for a minimum of the remaining first five years and a total of the amounts for the remaining years.





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### Financial Position extract as at 1<sup>st</sup> Jan 2023

	Kshs
<b>Non Current assets</b>	
ROU Assets	9,822,867
<b>Current liabilities</b>	
Lease liability	1,636,364
Payable	220,000
<b>Non Current Liabilities</b>	
Lease liability	7,966,504
<b>Total liability</b>	<b>9,822,867</b>

### Subsequent measurement: As at 31<sup>st</sup> Dec 2023.

#### 1. Interest schedule

Monthly interest; 10%/12 months=0.008.

#### Interest Schedule.

Mont	Opening LL	Rate	Interest	Subtotal	Repayment	Closing LL
Jan	9,602,867.00	0.008	80,023.89	9,682,890.892	(150,000.00)	9,532,890.89
Feb	9,532,890.89	0.008	79,440.76	9,612,331.649	(150,000.00)	9,462,331.65
March	9,462,331.65	0.008	78,852.76	9,541,184.413	(150,000.00)	9,391,184.41
April	9,391,184.41	0.008	78,259.87	9,469,444.283	(150,000.00)	9,319,444.28
May	9,319,444.28	0.008	77,662.04	9,397,106.319	(150,000.00)	9,247,106.32
June	9,247,106.32	0.008	77,059.22	9,324,165.538	(150,000.00)	9,174,165.54
July	9,174,165.54	0.008	76,451.38	9,250,616.917	(150,000.00)	9,100,616.92
Aug	9,100,616.92	0.008	75,838.47	9,176,455.392	(150,000.00)	9,026,455.39
Sep	9,026,455.39	0.008	75,220.46	9,101,675.853	(150,000.00)	8,951,675.85
Oct	8,951,675.85	0.008	74,597.30	9,026,273.152	(150,000.00)	8,876,273.15
Nov	8,876,273.15	0.008	73,968.94	8,950,242.095	(150,000.00)	8,800,242.10
Dec	8,800,242.10	0.008	73,335.35	8,873,577.446	(150,000.00)	8,723,577.45
<b>Total</b>			<b>920,710.45</b>		<b>1,800,000</b>	



## IPSAS 43 Leases Guideline

### Liability movement

Opening balance	9,602,867
Lease payments	(1,800,000)
Interest accrued	920,710
Closing balance	<b>8,723,577</b>

### Financial statements "Extracts" as at 31<sup>st</sup> Dec 2023

#### 1. Statement of Financial Performance

	<b>Dr</b>
Depreciation on ROU(9,822,867/8)	1,227,858
Finance Cost Interest on lease liability	920,710

#### 2. Statement of Financial Position

<b>Non current Assets</b>		<b>Kshs</b>
ROU ASSET	9,822,867	
Accumulated depreciation (9,822,867/8)	<u>(1,227,858)</u>	
<b>Net book value</b>		<b>8,595,009</b>
<b>Lease liability</b>		<b>8,723,577</b>

#### 3. Statement of cashflows

Cash flows from operating activities	XXXX
Cashflows from Investing activities	XXXX
<b>Cashflows from financing activities</b>	
Payment of principal portion of lease liability	1,800,000

#### Example 2: Treatment of Sub –lease arrangement.

After operating the tractor for 5 years , entity XYZ decided to sublease the tractor to entity A in Uganda following poor crop production in Kenya as a result of prolonged drought. The amount of lease rentals to be received from entity A is kes 100,000 per month.

#### Requirement

Show the extracts of financial statements at the end of year 6.

#### ROU at the beginning of year 6

		<b>Kshs</b>
R.O.U		9,822,867



### IPSAS 43 Leases Guideline

Accumulated dep -5 years (1,227,858*5)	(6,139,292)
<b>Net book value</b>	<b>3,683,575</b>

#### Liability at the beginning of year 6

Year	Opening LL	Rate	Interest	Subtotal	Repayment	Closing LL
1-23	9,602,867.00	0.10	960,286.70	10,563,153.700	1,800,000.00	8,763,153.70
2-24	8,763,153.70	0.10	876,315.37	9,639,469.070	1,800,000.00	7,839,469.07
3-25	7,839,469.07	0.10	783,946.91	8,623,415.977	1,800,000.00	6,823,415.98
4-26	6,823,415.98	0.10	682,341.60	7,505,757.575	1,800,000.00	5,705,757.57
5-27	5,705,757.57	0.10	570,575.76	6,276,333.332	1,800,000.00	<b>4,476,333.33</b>
6-28	4,476,333.33	0.10	<b>447,633.33</b>	4,923,966.665	1,800,000.00	<b>3,123,966.67</b>
7-29	3,123,966.67	0.10	312,396.67	3,436,363.332	1,800,000.00	1,636,363.33
8-30	1,636,363.33	0.10	163,636.33	1,799,999.665	1,800,000.00	(0.33)

	<b>Kshs.</b>
Opening balance in year 1	9,602,867
Payments (1,800,000*5)	(9,000,000)
Interest accrued	3,873,466
<b>Opening balance in year 6</b>	<b>4,476,333</b>

#### Financial statements "Extracts" as at end of year 6

##### Financial Performance

	<b>Ksh</b>
Sub lease income (12*100,000)	1,200,000
Depreciation	(1,227,858)
Finance Cost (Interest on leases)	(447,633)



## IPSAS 43 Leases Guideline

### Financial Position extracts

	<b>Ksh</b>
ROU	3,683,575
depreciation for the year	(1,227,858)
<b>NBV</b>	<b>2,455,717</b>
Lease liability	3,123,967
<b>Total Liability</b>	<b>3,123,967</b>

**NB: Sublease arrangement is treated as a separate transaction from the head lease. Hence the lease accounting where entity XYZ is the primary obligor will continue while the lease income from entity A is recognized as a separate line income.**

### Example 3: Lessor accounting

On 1 January 2021, Entity A agrees to a five-year equipment lease contract with Entity X (a lessee). The relevant details of this lease are as follows:

- ✓ Annual lease payments of Ksh. 20,000 are made at the end of each year.
- ✓ Entity A determines the equipment’s carrying amount at Ksh. 90,000 and assesses its fair value at Ksh. 95,000.
- ✓ Economic useful life of the equipment is seven years, and Entity A estimates its residual value to be Ksh. 25,000, of which Ksh. 15,000 is guaranteed by Entity X.
- ✓ Interest rate implicit in the lease is 8.7%

### Solution

Using the implicit interest rate, Entity A calculates the present values of lease payments and residual value:

Year	Date	Payment	Discount factor	Present value
1	2021-12-31	20,000	0.9205	18,410
2	2022-12-31	20,000	0.8471	16,942
3	2023-12-31	20,000	0.7796	15,592
4	2024-12-31	20,000	0.7173	14,346
5	2025-12-31	20,000	0.6602	13,204
5	2025-12-31	15,000	0.6602	9,903
5	2025-12-31	10,000	0.6602	6,602
				<b>95,000</b>





### IPSAS 43 Leases Guideline

At the commencement of the lease, Entity A makes the following accounting entries:

	DR	CR
Net investment in the lease (receivable)	95,000	
Equipment held for lease		90,000
Gain on derecognition		5,000

Each year, the net investment in the lease will increase due to the recognition of interest income in statement of financial performance and will decrease due to the lessee's payments, as follows:

Year	Opening bal: 1 Jan	Interest Income	Payment	Closing bal: 31 Dec
2021	95,000	8,203	(20,000)	83,203
2022	83,203	7,205	(20,000)	70,409
2023	70,409	6,097	(20,000)	56,506
2024	56,506	4,907	(20,000)	41,414
2025	41,414	3,586	(20,000)	25,000

The remaining Ksh. 25,000 on 31 December 2025 is the equipment's residual value.

#### Example 4 : Lease modification

Entity JK leases office space from a Lessor with original terms as follows: Lease term: 5 years from 1 January 2021 to 31 December 2025 with no extension or termination options. Lease payments: Ksh. 100,000 payable annually in arrears; IBR: 5% p.a. JK has a December year-end.

On 1<sup>st</sup> Jan 2023, JK and the lessor agree to extend the lease upon expiry from 1 Jan 2026 for two years at an annual lease payment of Ksh. 105,000. The IBR on 1 January 2023 is 6% p.a. All lease payments are paid annually in arrears.

**Requirement:** To remeasure the lease liability to reflect the modification.



## IPSAS 43 Leases Guideline

### Solution.

The pre-modification RoU asset and lease liability on the effective date of the modification, 1 January 2023, are as follows:

#### RoU asset

Balance 1 Jan 2021 (PV;5 payments of Ksh. 100,000 discounted at 5%)	432,948
Accumulated depreciation (432,948/5*2)	(173,179)
<b>Balance 1 Jan 2023</b>	<b>259,769</b>
 Lease liability (PV;3 payments of Ksh. 100,000 discounted at 5%)	 <b>272,325</b>

#### To remeasure the lease liability after the modification;

Year	Payment	D.F at 6%	Closing LL
2023	100,000	0.943	94,340.00
2024	100,000	0.890	89,000.00
2025	100,000	0.839	83,962.00
2026	105,000	0.792	83,170.00
2027	105,000	0.747	78,462.00
<b>Total</b>			<b>428,934.00</b>

This represents the difference between the original lease liability (Ksh.272,325) and the modified lease liability (Ksh. 428,933) on 1 January 2023. The modified lease liability of Ksh. 428,933 is calculated as the present value of three payments of Ksh. 100,000 from 2023 to 2025 and two lease payments of Ksh. 105,000 from 2026 to 2027, all discounted at 6%.

The difference of Ksh. 156,608 between the original lease liability (Ksh. 272,325) and the modified lease liability (Ksh. 428,934) on 1 January 2023 is adjusted against the RoU asset.

Lessee records the following journal entry on 1 January 2023:

Dr. ROU Asset		156,608
Cr. Lease Liability		156,608



**IPSAS 43 Leases Guideline**

**ROU**

Year	Opening Balance	Depreciation	Closing Balance
2023 Pre modification	259,769		
Adjustment	156,608		
2023 Post modification	416,377	83,275	333,102
2024	333,102	83,275	249,826
2025	249,826	83,275	166,551
2026	166,551	83,275	83,275
2027	83,275	83,275	-

**Lease Liability**

Year	Opening LL	Int @6%	Repayment	Closing LL
2023 Pre modification	272,325			
Adjustment	156,608			
2023 Post modification	428,933	25,736	100,000	354,669
2024	354,669	21,280	100,000	275,949
2025	275,949	16,557	100,000	192,506
2026	192,506	11,550	105,000	99,057
2027	99,057	5,943	105,000	-

**Note: Upon lease modifications, the lease liability is remeasured to reflect the new liability with adjusting entries going through the ROU and the liability.**

**Example 5: Impairment assessment.**

IPSAS 43 requires that ROU balances to be subjected to impairment assessment at the end of accounting period in a similar manner with other PPE assets especially when there are indications of impairment as provided for by the standard.

In our entity XYZ case above(reference to example 1) assume that during the year 2025, the tractor is involved in an accident and therefore is grounded for 5 months before repair is completed. Further during the year there was a prolonged drought that was expected



### IPSAS 43 Leases Guideline

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to continue into the year 2026 thus lowering the agricultural productions. These two conditions are indications of impairment.

The ROU balance as at Dec 25 is  $(9,822,867 - 3,683,574) = 6,139,293$

$(1,227,858 * 3)$

#### Required.

Conduct impairment assessment and show the accounting entries given that the Value in use amount as at Dec 25 was Kes.5,400,000 while the fair value less cost of sale was Kes.6,000,000.

#### Answer.

The impairment loss is given as  $(6,139,293 - 5,400,000) = \text{ksh.}739,293$ .

Accounting entries.

DR: Impairment loss (P&L) : 739,293

CR: ROU : 739,293



## IPSAS 43 Leases Guideline

### 5.2 Frequently Asked Questions

**(i) We are occupying a building but do not have an agreed contract for the lease. Do we still need to apply IPSAS 43?**

Paragraph 5 of IPSAS 43 gives guidance on the assessment of whether a contract is, or contains, a lease. But this guidance is intended to ensure that all contracts are adequately considered to assess whether they are, in essence, a lease. The guidance in the standard does not envisage a scenario where an arrangement exists, but there is no actual contract in place.

The expectation is that most arrangements between lessor and lessee will meet the definition of a lease because it is likely that the customer will obtain substantially all of the economic benefit of use, have the right to direct use and have the right to operate the asset throughout its period of use.

Entities will also have to judge whether the arrangement constitutes a short-term arrangement. If each party (tenant and landlord) could terminate the arrangement with only an insignificant penalty, then there is not an enforceable lease. In such a scenario, the lessee entity should estimate the lease terms based on the commercial reality and business plans. This will be an important local judgment, and the entity will need to document its rationale.

Once the length of the lease is established and the lease liability calculated, this is then used in accounting for each subsequent year, with the lease term reducing by one year at each year's end. After this, a lessee reassesses the lease term only when there is 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 extend the lease.

**(ii) We have an existing lease where we need to estimate a lease term. Are there any implications if we initially estimate this as too low and revise it (by increasing the lease term) in the future?**

To comply with the standard, it is important that an accurate estimate of the lease term is made at commencement (or IPSAS 43 transition). Future lease modifications, such as remeasuring the lease liability as a result of an increased lease term, **should** be considered for remeasurement.



## IPSAS 43 Leases Guideline

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**(iii) We have a historic lease-like agreement with a non-governmental body, e.g., a university, but neither we nor the other party can locate the historic agreement. Does this mean we have a lease or not?**

The spirit of the IPSAS 43 is that such arrangements between public sector bodies could be considered a contract for evaluation as a lease. Relying on the fact that a university can be considered non-governmental is not in that spirit. Even if the other party is firmly a private sector commercial entity, it is recommended that the entity now takes this opportunity to put an updated formal agreement in place with the other party and ensure it is properly accounted for the arrangement.

**(iv) We have a contract where we don't pay for the asset in itself but have to buy consumables from the supplier. How do we factor that into IPSAS 43 considerations?**

This does not affect the definition of whether there is a lease. Paragraph 10 of the standard defines a lease as a contract that conveys the right to control the use of an identified asset for a period of time in exchange for consideration. The standard tests of whether there is an identified asset and so forth apply as normal. If the result of this is that it is assessed that the contract meets the definition of a lease with a right-of-use asset, then the lease payments need to be determined. These are amounts paid under the contract per paragraph 28 of the standard

If the customer is obliged to buy a certain minimum level of consumables, then part of these payments are as explained in paragraph 44 of the standard. The customer would need to estimate the fair value of the consumables (based on what the supplier or another supplier would charge for such consumables if no asset was being provided), with any amount paid above this being considered part of the lease payments for the leased asset. The amount determined as relating solely to the consumables would be expensed as the consumables are used.

If there is no minimum purchase of consumables required by the contract and the purchases only depend on the use of the asset then such purchases, even if likely, will not be considered lease payments. Any consumables purchased would be accounted for separately and expensed when they are used if the contract does not require a fixed minimum to be purchased, and the purchase of consumables is solely related to the future level of use of the asset.

**(v) Presentation: How shall we disclose the Right-of-use assets/liabilities in the statement of financial position?**





## IPSAS 43 Leases Guideline

Paragraph 50 of the standard requires Right-of-use assets to be disclosed separately from other assets. If a lessee does not present the assets separately, then the lessee should;

- (i) Include the assets within the same line item as that within which the corresponding underlying asset would be presented if they were owned and
- (ii) Disclose which line item in the statement of financial position includes those right-of-use assets.

Lease liabilities are to be disclosed 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.

**(vi) For a new lease entered into as a lessee, there may be a gap between signing the lease contract and the right-of-use asset(s) being made available for our use. What is the effective date?**

The commencement date of the lease (commencement date) is the date on which a lessor makes an underlying asset available for use by a lessee. The effective date of a modification is the date when both parties agree to a lease modification.

**(vii) What preparatory steps do I need to take before the effective date of IPSAS 43 in January 2025**

1. Identify of all your assets which will be defined as leases under the new standard through the right of use model. Identity all the assets leased by your organization. This means you may have to review all your contracts and involve your legal and contract management teams, finance among others ti identify whether these contracts contain a lease as defined in this standard.
2. Collect all the information on these leases – term, options at end of lease, rentals payable, interest rate of the lease (if available; for operating leases this will not usually be available) you will need to think about your incremental borrowing cost (this could be the rate they internally borrow at).
3. Then account for your leases to recognise assets and liabilities – once all the information is assembled the calculation is relatively easy as shown in the examples.

**(viii) What is the lease term?**

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





## **IPSAS 43 Leases Guideline**

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- (b) Periods covered by an option not to terminate the lease if the lessee is reasonably certain not to exercise that option.

### **(ix) Can you sublease a leased asset?**

Yes, you can sublease a leased asset. 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 by 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.

## IPSAS 43 Leases Guideline

### 6.0 Transitional Provisions

#### Effective date

The effective date of the standard is 1 January 2025. Early application (adoption) before the effective date is permitted for entities applying IPSAS 41. Entities applying the Standard before the effective date shall disclose that fact.

#### First-Time Adoption of IPSAS Accrual Accounting

For entities that adopt IPSAS Accrual Accounting for financial reporting for the first time (IPSAS 33) subsequent to the effective date of 1 January 2025, this Standard applies to the entity's annual financial statements covering periods beginning on or after the time of adoption of IPSASs.

#### Transition

Entities are allowed to apply the Standard to contracts that were previously identified as leases applying IPSAS 13.

#### Transition requirements

##### 1. Lessee

The **lessee will apply** this Standard either

- a) **Retrospectively** to each prior reporting period presented applying IPSAS 3 "Accounting Policies, Changes in Accounting Estimates and Errors" **or**
- b) **Retrospectively**, with the Cumulative effect of initially applying the Standard recognized at the date of application.

The lessee will apply this consistently to all the leases in which it is a lessee.

By applying section (B), the lessee shall recognize the cumulative effect of initially applying the Standard as an adjustment to the opening balance of accumulated surpluses/deficits (R/E) or of net assets/equity at the date of application.

***The lessee shall not be required to restate the comparative information.***

Transition Steps for leases previously classified either as **operating leases** or **finance leases**

#### Operating leases:

##### (i) *Lease liability*

The lessee shall recognize a lease liability (for leases previously classified as operating

leases-IPSAS 13) at the date of initial application. The lease liability shall be measured

## IPSAS 43 Leases Guideline

at the present value of the remaining lease payments, discounted using the lessee's

**incremental borrowing rate** at the date of initial application.

(ii) *Right of Use asset*

The lessee shall recognize a Right of Use(ROU) asset at the date of initial application (for leases previously classified as operating leases-IPSAS 13). The ROU shall be measured at either the carrying amount at the commencement date, discounted at the lessees' borrowing rate, or an amount equal to the lease liability adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognized in the Statement of Financial Position immediately before the date of initial application.

Note:

**Finance leases:**

For leases that were classified as finance leases applying IPSAS 13, and by applying section (b) above,

The **carrying amount** of the Lease liability & the Right of Use asset at the date of

The initial application shall be the carrying amount of the lease asset and lease liability

immediately before that date measured applying IPSAS13. The lessee shall account for

the Right of Use and the lease liability applying this Standard from the date of initial application.

**Disclosures**

**The lessee shall disclose the following information;**

- a) The weighted average of Lesse's incremental borrowing rate applied to lease liabilities recognized in the Statement of Financial Position at the date of initial application.
- b) Explanation of any difference between,
  - i) Operating lease commitments disclosed applying IPSAS13 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), and
  - ii) Lease liabilities recognized in the statement of financial position at the date of initial application.

## 2. Lessor

A **lessor** will not be 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.

## IPSAS 43 Leases Guideline

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Notwithstanding the above, **an intermediate** lessor shall at the date of application;

- i) Reassess subleases classified as operating leases applying IPSAS 13 that are ongoing to determine whether each sublease should be classified as an operating lease or a finance lease while applying this Standard. The assessment shall be performed at the date of initial application on the basis of the remaining contractual terms and conditions of the head lease and sub lease at that date.
- ii) For subleases that were classified as operating leases applying IPSAS13, but finance leases applying this Standard, (the intermediate lessor shall) account for the sublease as a new finance lease entered into at the date of initial application.

### 3. Sale and Leaseback Transactions

- a) If a sale and leaseback transaction was accounted for a sale and finance lease applying IPSAS 13, the seller-lessee shall;
  - i) Account for the sale-leaseback the same way it accounts for any other finance lease that exists at the date of initial application and
  - ii) Continue to amortize any gain on sale over the lease term.
- a) If a sale and leaseback transaction was accounted for a sale and **operating lease** applying IPSAS 13, the seller-lessee shall;
  - i) Account for the sale-leaseback the same way it accounts for any other operating lease that exists at the date of initial application and
  - ii) Adjust the leaseback right-of-use asset for any deferred gains or losses that relate to off-market terms recognized in the statement of Financial Position immediately before the first initial application.

### Replacement of Current Standard

IPSAS 43 replaces/supersedes IPSAS 13 issued in 2006. IPSAS 13 remains applicable until this Standard is applied **or** becomes effective, whichever is earlier.

#### **Disclaimer:**

***This guideline has been prepared as a guidance to public sector entities in Kenya for implementation of IPSAS 43. However, it does not serve as an advisory or complete standard documentation of Leases or a replacement of IPSAS 43. For further engagements on IPSAS 43 reach out to us on [acctstandards@psasb.go.ke](mailto:acctstandards@psasb.go.ke)***