# accounting guideline
# PSG-2
# leased tangible capital assets

This Guideline is to be read in conjunction with the Introduction to Accounting Guidelines contained in the CPA Canada Public Sector Accounting Handbook.

April 2000 *

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## PURPOSE AND SCOPE

1 The purpose of this Guideline is to: 1

(a) define leased tangible capital assets;

(b) describe how to account for a leased tangible capital asset and the related lease liability;

(c) describe the information that should be disclosed about transactions involving leased tangible capital assets; and

(d) provide guidance on initial application of the Guideline.

It applies to government financial statements. 2 [Former footnote 2 of paragraph PSG-2.1, amended by the amendments to TANGIBLE CAPITAL ASSETS, Section PS 3150, retained in Archived Pronouncements.]

2 For purposes of this Guideline, the Public Sector Accounting Board has adopted a "benefits and risks" approach to assessing whether a government should classify a lease as a leased tangible capital asset. The Board intends to periodically reassess the continuing need for this Guideline, in light of international standard-setting activities to address the issue of leases.

2A Leased infrastructure satisfying the criteria for recognition per PUBLIC PRIVATE PARTNERSHIPS, Section PS 3160, are accounted for in accordance with Section PS 3160.

## DEFINING A LEASED TANGIBLE CAPITAL ASSET

### Definition

3 A **leased tangible capital asset** is 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 of 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**

4 It is necessary to look at the overall substance of the transaction in determining when substantially all the benefits and risks of ownership have been transferred to the government.

4A An operating lease of a tangible capital asset is a lease in which the lessor does not transfer substantially all the benefits and risks incident to ownership of the tangible capital asset to the lessee.

4B Because most operating leases are short term, charging lease rentals to expense on a straight-line basis over the lease term, even if not payable in such a manner, would normally result in recognition of the expense in a manner that is representative of the time pattern in which the user derives benefit from the leased tangible capital asset. However, circumstances may indicate that another basis is required to achieve this result.

4C *Lease rentals under an operating lease should be included in the determination of surplus or deficit over the lease term on a straight-line basis unless another systematic and rational basis is more representative of the time pattern of the user's benefit.*

5 From the point of view of the government, the benefits and risks of ownership would be transferred to the government when, at inception of the lease, one or more of the following conditions are present:

(a) There is reasonable assurance that the government will obtain ownership of the leased property by the end of the **lease term**. Reasonable assurance that the government will obtain ownership of the leased property would be present when the terms of the lease would result in ownership being transferred to the government by the end of the lease term or when the lease provides for a **bargain purchase option**.

(b) The lease term is of such a duration that the government will receive substantially all of the economic benefits expected to be derived from the use of the leased property over its life span. Although the lease term may not be equal to the **economic life of the leased property** in terms of years, the government would normally be expected to receive substantially all of the economic benefits related to the leased property if the lease term is equal to a major portion (usually 75 percent or more) of the economic life of the leased property. This is due to the fact that new equipment, reflecting later technology and in prime condition, may be assumed to be more efficient than old equipment which has been subject to obsolescence and wear.

(c) The lessor would be 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 condition would exist if the present value, at the beginning of the lease term, of the **minimum lease payments**, excluding any portion thereof relating to executory costs, is equal to substantially all (usually 90 percent or more) of the fair value of the leased property, at the **inception of the lease**.

6 Care must be taken in assessing the conditions in paragraph 5. In particular:

(a) For purposes of applying the test in paragraph 5(a), reasonable assurance that the government will obtain ownership of the leased property could be present in the absence of a bargain purchase option. For example, the lease may contain an option allowing the government to acquire the leased property for its fair value at the end of the lease term. Other terms of the lease relating to the government's obligations may make it probable that the government will acquire the leased property for its fair value at the end of the lease term.

(b) Ancillary contractual arrangements that pertain to services related to the leased property (e.g., maintenance or management of a facility) rather than to the asset itself, should be excluded from the calculation in paragraph 5(c). However, if the terms and conditions of such ancillary agreements result in the government paying an amount that is greater than the fair value of such services, it may indicate that a portion of the cost related to the lease has been included in the cost of the ancillary agreement. In such cases, an appropriate adjustment would be made to the calculation in paragraph 5(c) for the purposes of assessing whether substantially all the benefits and risks of ownership have been transferred to the government.

(c) Some types of additional rentals should be included in the calculation of minimum lease payments for the purpose of assessing whether the government has a leased tangible capital asset. When the amount of additional rental is likely and can be reasonably estimated at inception of the lease (e.g., a payment that relates to a minimum amount of usage, such as expected school enrolment), that amount should be included in minimum lease payments.

(d) There is greater measurement uncertainty implicit in the numerical tests in paragraphs 5(b) and 5(c), the longer the time between the inception of the lease and construction / operation of the asset, and/or the longer the term of the lease. Further, the numerical tests involve factors (e.g., economic life and fair value) that are subject to judgment.

(e) When the government provides financial assistance (e.g., transfers 3 of financial assets or real property, loans 4 or loan guarantees 5) to the lessor to assist in financing the cost of the asset the government will lease, that assistance reduces the cost that the lessor must recover through minimum lease payments and guarantees of residual value. The impact of such financial assistance on the conditions in paragraph 5 should be considered.

7 Where the conditions in paragraph 5 are not present, the lease may still need to be classified as a leased tangible capital asset. In determining whether substantially all the benefits and risks of ownership have been transferred to the government, the results of the assessment of the conditions in paragraph 5 should be considered in conjunction with the guidance set out in paragraph 6 and paragraphs 8-10.

8 In assessing the factors in paragraph 10, it will be necessary to look at their overall effect; it is not appropriate to focus on one factor in isolation. In addition, an assessment should be made as to whether the factors are internally consistent. If one factor calls into question other evidence, it may be necessary to carefully examine other terms of the transaction to determine whether the government should classify the lease as a leased tangible capital asset. Further, each factor should be considered in terms of its relative significance to a particular lease.

9 It is necessary to consider any restrictions or implied terms or arrangements related to the use of the asset when determining whether substantially all the benefits and risks of ownership are transferred to the government. Further, it will often be useful in weighing all the evidence, including the business case, to consider the position of the parties to the transaction, including their apparent expectations and motives for agreeing to a form that may not reflect the substance of the transaction.

10 Where the conditions in paragraph 5 are not present, the following factors would be considered in conjunction with paragraphs 5-9 in assessing whether the benefits and risks of ownership have been transferred:

(a) Ownership of the asset

If the leased property is used to provide an essential service (e.g., schools, prisons, roads and highways, utilities systems) and the asset is specialized such that there is no alternative asset readily available to the government, it is likely that the government will have the use of the property throughout its economic life, even though the lease term may be for only a minor portion of the asset's economic life.

Examples of assets that are specialized or are used in providing an essential service include:

(i) Assets for which there is no alternative use other than that for which the government is using it (e.g., roads and highways).

(ii) Assets for which the conversion to another use would require a significant cost.

In such cases, it is likely that ownership of the asset will be transferred to the government, or the government will need to renew the lease at the end of the lease term.

(b) Financing

If the government contributes significant financial assistance towards the cost of acquiring or constructing the property that it will lease, the government would bear certain costs and risks associated with the leased property that would normally be associated with ownership of property. Such assistance may be in the form of government transfers, loans or loan guarantees. Examples include cases where the government provides the land on which the leased property will be situated, where the government provides financing for the leased property, or where the government guarantees that the financing for the leased property will be fully paid out by the government under all events of default, including default by the lessor.

(c) Control of the asset

If the government has a significant degree of control over the idle capacity of the leased property (e.g., there is a potential for significant third-party use of the asset and the government is able to restrict such use, whether or not it pays for that capacity), it may indicate that the government has a benefit of asset ownership.

(d) Residual risk or benefit

The following terms and conditions may indicate that the government bears residual risk or benefit of asset ownership:

(i) The government owns or retains control of the land on which the leased property is located, and the asset cannot be easily moved. This would be the case, for example, when the lessor builds a road on a government-owned road bed.

(ii) Under the conditions of the lease agreement, the government is obliged to either find a sublessee or pay significant costs to the lessor in order to exit the agreement before its termination.

(iii) The lessor has the option, at the end of the lease, to transfer the leased property and any related obligation, to the government.

(iv) The government shares in the residual loss or gain on the leased property.

(e) Operating risk

Operating risk relates to the performance / availability and maintenance of the leased property. If the government is responsible for performance / availability and/or maintenance, it may indicate that the government bears the operating risk. For example, some lease agreements provide for penalties if the asset is not maintained to a specified standard, is unavailable or does not perform to the standard specified in the lease agreement because of lessor fault. The penalties may take the form of either cash payments or reductions in revenue. The government may bear operating risk if:

(i) the penalty rests with the government, and it is significant and has a reasonable possibility of occurring; or

(ii) the penalty rests with the lessor, but it is insignificant and/or does not have a reasonable possibility of occurring.

Examples include cases where the lessor has no obligation to provide a replacement asset if the leased property is unavailable for use or does not perform to the agreed standard, or the lessor has no obligation to compensate the government for unavailability or non-performance of the leased property.

(f) Business risk

If the lease agreement contains provisions for significant future cost increases to be passed on to the government (e.g., lease payments that fluctuate with specific indices such as interest rates or the CPI), the government would bear business risk associated with the leased property. This factor is linked to (h) in that guaranteed payments by the government transfer a significant component of business risk to the government.

(g) Construction risk

If the government bears the financial or other implications of cost and time overruns caused by events outside of its control (e.g., pays for cost overruns or does not have use of the asset by the agreed date) during the construction period, or subsequent warranty repairs, it may indicate that construction risk has been transferred to the government.

(h) Demand risk

Demand risk is the risk that demand for the asset will be greater or less than expected or predicted. If the government is obliged to pay for the output or capacity, whether or not it is needed (e.g., guaranteed payment for a minimum number of patients in a hospital, students in a school, or prisoners in a correctional facility), the government would bear demand risk associated with the leased property.

(i) Other potential risks

Other potential risks of asset ownership include obsolescence, environmental liability, and uninsured damage or condemnation of the asset. If these or any other risks are significant and are borne by the government, it may provide additional evidence that the government has a leased tangible capital asset.

## ACCOUNTING

### Recognition

11 A government should account for leased property that meets the definition of a leased tangible capital asset as a tangible capital asset and a financial liability. [Former paragraph PSG-2.11, amended by FINANCIAL STATEMENT PRESENTATION, Section PS 1202, retained in Archived Pronouncements.]

12 Such accounting ensures that a government is accountable for the total tangible capital assets available for its use. It also ensures that all types of long-term financing arrangements of the government are reported.

### Accounting for the asset

13 A government should account for 6 its leased tangible capital assets in accordance with TANGIBLE CAPITAL ASSETS, Section PS 3150.

### Valuation at inception of the lease

14 The value of the leased tangible capital asset and the amount of the lease liability, recorded at the beginning of the lease term, would be the present value of the minimum lease payments, excluding the portion thereof relating to **executory costs**.

15 At inception of the lease, the estimate of the discount rate used should be reviewed together with:

(a) the present value of the minimum lease payments;

(b) the assumed fair value of the property; and

(c) the assumed residual value, to ensure that all figures are reasonable and internally consistent.

16 The amount relating to executory costs included in the minimum lease payments would be estimated if not known to the government.

17 The **interest rate implicit in the lease** is affected by the residual value of the leased property in which the government would usually have no interest. As a result, to use the interest rate implicit in the lease as the discount rate when it is higher than the **government's rate for incremental borrowing**, would produce an amount that is less representative of the value of the asset to the government than would be obtained by using the government's rate for incremental borrowing as the discount rate. Therefore, the discount rate used by the government in determining the present value of minimum lease payments would be the lower of the government's rate for incremental borrowing and the interest rate implicit in the lease, if practicable to determine. Notwithstanding the foregoing, the maximum value recorded for the asset may not exceed the leased property's fair value.

18 The contract for the leased property may be "bundled" into a larger contractual arrangement that also includes the provision of services (e.g., maintenance or management of the asset). In such cases, the discount rate should relate only to the asset to be leased and not to any other features of the contract. A rate based in some way on the return from the entire contract may not be a suitable rate to use since it would include an allowance for the risk relating to the service element of the contract. Where the service element is considered to be riskier relative to the property, it will result in a rate that is too high. It is usually possible to derive a property-specific rate from the contractual arrangement. If sufficient information is not available to do so, the discount rate should be estimated by reference to the rate that would be expected on a similar lease (i.e., a lease of a similar property in a similar location and for a similar term).

**Amortizing the asset**

19 A leased tangible capital asset would be amortized over the period of expected use of the asset, on a basis that is consistent with the government's amortization policy for other similar tangible capital assets. If the lease contains terms that allow ownership to pass to the government or a bargain purchase option, the period of amortization would be the **economic life of the property**. Otherwise the property would be amortized over the lease term.

**Accounting for the liability**

20 Lease payments would be allocated between repayments of the liability, interest expense and any related executory costs.

21 The total minimum lease payments less the initial liability recorded represents the total interest cost of the lease. The interest expense would be calculated using the same discount rate used in computing the present value of the minimum lease payments applied to the outstanding lease liability at the beginning of the lease payment period.

**Contingent rentals**

22 **Contingent rentals** should be charged to expense as incurred.

**PRESENTATION**

**Reporting the asset**

23 A government should report its leased tangible capital assets in accordance with FINANCIAL STATEMENT PRESENTATION, Section PS 1202. [Former paragraph PSG-2.23, amended by FINANCIAL STATEMENT PRESENTATION, Section PS 1202, retained in Archived Pronouncements.]

**Disclosure**

24 The following information should be disclosed with respect to a government's leased tangible capital assets:

(a) The gross amount of leased tangible capital assets and related accumulated amortization should be disclosed. Disclosure of leased tangible capital assets and accumulated amortization by major category (for example, land, buildings, machinery) may be desirable.

(b) Liabilities related to leased tangible capital assets should be shown separately from other liabilities. Particulars of liabilities related to leased tangible capital assets, including interest rates and expiry dates, should be shown separately from other long-term liabilities. Significant conditions of the lease agreement should be disclosed, including future contractual obligations, purchase options, terms of renewal and contingent liabilities, and circumstances that require or result in the government's continuing involvement in the contractual arrangement. [Former paragraph PSG-2.24(b), amended by 2019-2020 annual improvements, retained in Archived Pronouncements.]

(c) The amount of amortization of leased tangible capital assets included in the determination of operating results should be disclosed separately or as part of amortization expense for tangible capital assets. Disclosure should also be made of methods and rates of amortization.

(d) Interest expense related to lease liabilities should be disclosed separately, or as part of interest on long-term debt.

25 The level of detail disclosed by the government should reflect the highly aggregated nature of financial statements. In deciding the level of detail to disclose, governments should consider the usefulness of the information to the reader in assessing the nature of, and the costs associated with, leased tangible capital assets. The level of disclosure would also consider the sensitivity of the information to the government's financial position.

**Disclosure of contractual obligations and contingent liabilities**

26 Disclosure of contractual obligations and contingent liabilities related to leased tangible capital assets helps readers assess the financial resources that the government may require in the future. [Former paragraph PSG-2.26, amended by 2019-2020 annual improvements, retained in Archived Pronouncements.]

27 Disclosure of contractual obligations and contingent liabilities related to a government's leased tangible capital assets would include the following:

(a) The nature and basis of determination of contingent rentals.

(b) The amount of contingent rentals included in the determination of operating results.

(c) The nature of any renewal options, purchase options or escalation clauses.

(d) The commitment represented by the future minimum lease payments in aggregate and for each of the five succeeding years. A separate deduction should be made from the aggregate figure for amounts included in the minimum lease payments representing executory costs and imputed interest. The resultant net amount would be the balance of the unpaid liability.

(e) Any other contractual obligations and contingent liabilities related to leased tangible capital assets.

[Former paragraph PSG-2.27, amended by 2019-2020 annual improvements, retained in Archived Pronouncements.]

## EFFECTIVE DATE AND TRANSITIONAL PROVISIONS

28 Governments should proceed with the adoption of the guidance set out in this Guideline as soon as practicable after the date of its issue.

29 This Guideline may be applied either retroactively or prospectively. It should be applied consistently for all of a government's leases.

30 For guidance on applying these transitional provisions, refer to ACCOUNTING CHANGES, Section PS 2120.

31 [Former paragraph PSG-2.31, deleted by FINANCIAL STATEMENT PRESENTATION, Section PS 1202, retained in Archived Pronouncements.]

32 FINANCIAL STATEMENT PRESENTATION, Section PS 1202, issued in October 2023, amended paragraphs PSG-2.11 and PSG-2.23 and removed paragraph PSG-2.31. The amendments are applicable at the same time as Section PS 1202, for fiscal years beginning on or after April 1, 2026. Earlier adoption is permitted if Section PS 1202 is also early adopted. Prior period amounts would need to be restated to conform to the requirements for comparative financial information in Section PS 1202.

33 Narrow-scope amendments issued in February 2025 added paragraphs 4A-4C, deleted an outdated cross-reference in Appendix A (formerly Appendix B) to LEASES, Section 3065 in former Part V of the Handbook, pre-changeover accounting standards, and replaced it with reference to new paragraphs 4A-4C. As the text in these paragraphs is taken from LEASES, Section 3065 in former Part V of the Handbook, pre-changeover accounting standards, these changes do not comprise a change in practice and so are effective immediately.

## GLOSSARY

This Glossary is an integral part of this Guideline and is therefore a primary source of GAAP identified in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, paragraph PS 1150.03(d)(ii).

**Bargain purchase option** is a provision allowing the government, at its option, to purchase the leased property for a price that is sufficiently lower than the expected fair value of the property at the date the option becomes exercisable, that exercise of the option appears, at the inception of the lease, to be reasonably assured.

**Contingent rental** is a rental that is based on a factor other than the passage of time. However, if some portion of the factor (e.g., a minimum capacity or expected usage) is reasonably estimable at inception of the lease, the contingent rental portion includes only that proportion that is greater than a minimum capacity or expected usage that is reasonably estimable at inception of the lease.

**Economic life of the leased property** is the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease and without limitation by the lease term.

**Executory costs** are costs related to the operation of the leased tangible capital asset (e.g., insurance, maintenance cost and property taxes).

**Fair value** is the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

**Government's rate for incremental borrowing** is the interest rate that, at the inception of the lease, the government would have incurred to borrow, over a similar term and with similar security for the borrowing, the funds necessary to purchase the leased property.

**Inception of the lease** is the earlier of the date of the lease agreement and the date of a commitment that is signed by the parties to the lease transaction and includes the principal terms of the lease (this is the effective date used for the classification of the lease).

**Interest rate implicit in the lease** is the discount rate that, at the inception of the lease, causes the aggregate present value of:

(a) the minimum lease payments, from the standpoint of the lessor, excluding that portion of the payments representing executory costs to be paid by the lessor and any profit on such costs; and

(b) the unguaranteed residual value accruing to the benefit of the lessor;

to be equal to the fair value of the leased property to the lessor at the inception of the lease.

**Lease** is 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.

**Lease term** is the fixed non-cancellable period of the lease plus:

(a) all periods covered by bargain renewal options;

(b) all periods for which failure to renew would impose on the lessee a penalty sufficiently large that renewal appears, at the inception of the lease, reasonably assured;

(c) all periods covered by ordinary renewal options during which the lessee has undertaken to guarantee the lessor's debt related to the leased property;

(d) all periods covered by ordinary renewal options preceding the date on which a bargain purchase option is excercisable; and

(e) all periods representing renewals or extensions of the lease at the lessor's option;

provided that the lease term does not extend beyond the date a bargain purchase option becomes exercisable.

The lease term is considered to be non-cancellable if cancellation is possible only:

(a) upon the occurrence of some unlikely contingency; or

(b) with permission of the lessor; or

(c) upon the lessee entering into a new lease for the same or equivalent property with the same lessor; or

(d) upon payment by the lessee of a penalty sufficiently large that continuation of the lease appears at the inception of the lease, reasonably assured.

**Minimum lease payments**

From the point of view of the government, minimum lease payments comprise:

(a) the minimum rental payments called for by the lease over the lease term;

(b) any partial or full guarantee, by the government or a third party related to the government, of the residual value of the leased property at the end of the lease term. When the government agrees to make up a deficiency in the lessor's realization of the residual value below a stated amount, the guarantee to be included in the minimum lease payments would be the stated amount rather than an estimate of the deficiency to be made up;

(c) any penalty required to be paid by the government for failure to renew or extend the lease at the end of the lease term; and

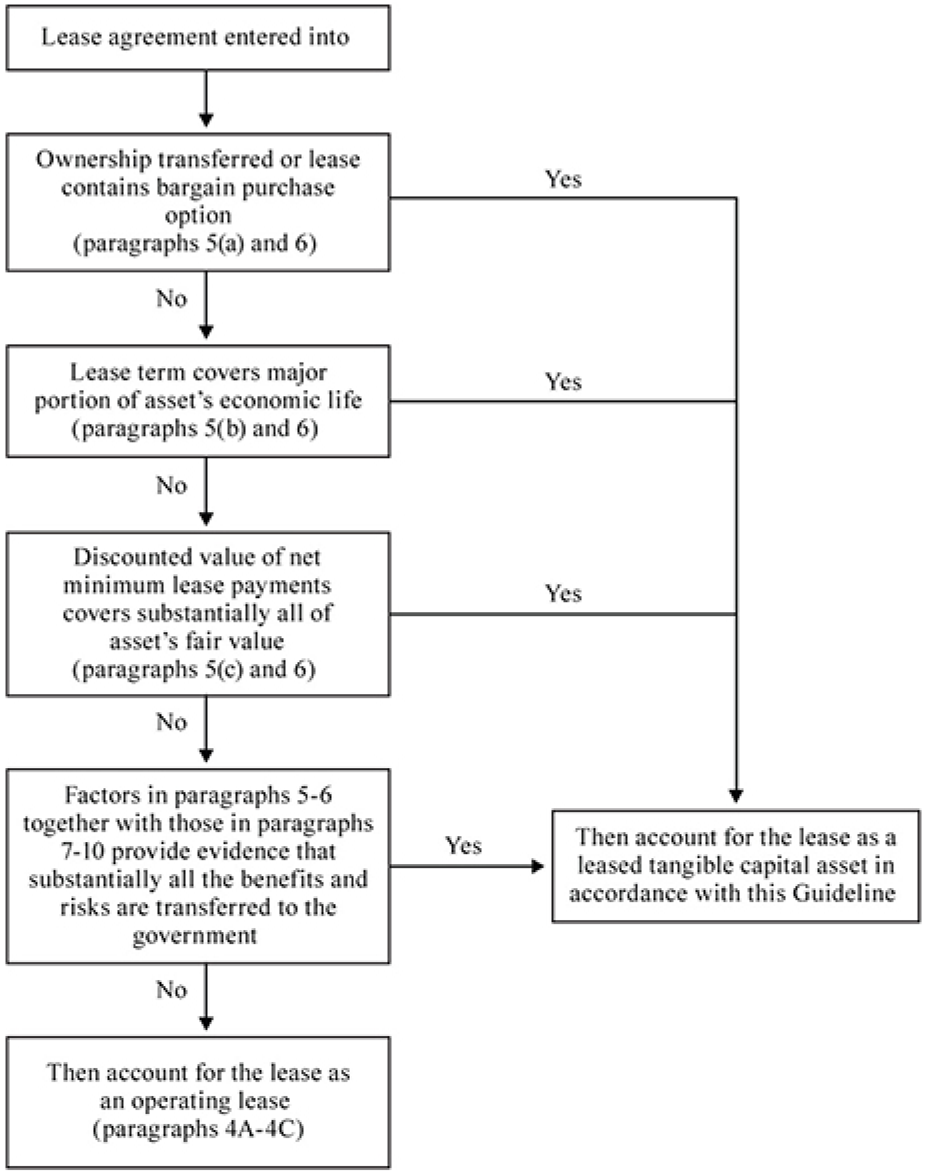
(d) additional rentals that can be reasonably estimated at inception of the lease (e.g., those that relate to a minimum estimable amount of usage, such as expected school enrolment);

provided that if the lease contains a bargain purchase option, only the total of the minimum rental payments over the lease term and the payment called for by the bargain purchase option would be included in minimum lease payments.

**APPENDIX A**

**DECISION TREE — LEASED TANGIBLE CAPITAL ASSETS**

The following decision tree is illustrative only. While illustrative, this Appendix is a primary source of GAAP, as identified in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, paragraph PS 1150.03(d)(iii).




# Footnotes

* Guideline revised June 2005, February 2007 and October 2023.

1. Throughout this Guideline, terms that appear in bold type are defined in the Glossary (Appendix A).

2. Although this Guideline is intended to apply to governments' financial statements, governmental organizations may also find the guidance useful in assessing whether their lease agreements should be classified as leased tangible capital assets.

3. *Transfers* are addressed in GOVERNMENT TRANSFERS, Section PS 3410.

4. *Loans receivable* are addressed in LOANS RECEIVABLE, Section PS 3050.

5. *Loan guarantees* are addressed in LOAN GUARANTEES, Section PS 3310.

6. See paragraph 23 for related guidance on financial statement presentation.