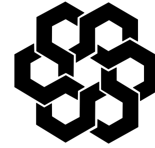

30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: www.iasb.org

International Accounting Standards Board

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These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: **19 June 2007, London**

Project: **Leases**

Subject: **Measurement of a Lessee's Right to Use Asset (Agenda paper 4B)**

Introduction

1. The purpose of this paper is to analyze alternative approaches for the initial and subsequent measurement of a lessee's right to use asset arising under a simple lease contract. That is, a non-cancellable lease with a fixed term, no options to extend or purchase, and no residual value guarantees. The Boards have tentatively concluded (March 2007 IASB, March 21, 2007 FASB) that under such a lease, the lessee's contractual right to use the item being leased meets the definition of an asset.

2. It should be emphasized that this paper only considers the simple lease contract described above. More complex leases, for example, leases that include options to renew, terminate, or purchase, will be considered later. Furthermore, this paper does not attempt to fully analyze the treatment of various transaction costs. Those issues will be considered at a later date.

3. Board members should also consider that decisions reached about the date the lessee's right to use asset is initially recognized could affect the amount of the initial measurement (and possibly subsequent measurements). The initial

recognition date is analyzed in IASB Agenda Paper 4C / FASB Memorandum #11.

4. This paper considers three approaches to determining the initial and subsequent measurement of a lessee's right to use asset:

    - Alternative A—Intangible Asset Approach: A lessee's right to use asset is deemed similar in nature to an intangible asset acquired outside of a business combination. Thus, the initial and subsequent measurements should be consistent with the Boards' existing standards on accounting for intangible assets acquired outside of a business combination (IAS 38 and FAS 142).

    - Alternative B—Nature of the Leased Item Approach: A lessee's right to use asset is deemed similar in nature to the item the lessee obtains the use of via the lease contract. Thus, a lease of property, plant and equipment (PP&E) should have initial and subsequent measurements consistent with the Boards' existing standards on accounting for PP&E acquired outside of a business combination (IAS 16, FAS 141, and ARB 43, Ch. 9). Similarly, a lease of an intangible asset (if within the scope of the revised standard) should have initial and subsequent measurements consistent with the Boards' existing standards on accounting for intangible assets acquired outside of a business combination (IAS 38 and FAS 142).

    - Alternative C—Separate Accounting Model Approach: Either (a) a lessee's right to use asset is deemed different in nature from both an intangible asset and the nature of the item being leased or (b) another measurement approach would result in more decision-useful information and the incremental benefits of that approach exceed the incremental costs. In either case, a separate accounting model should be developed for the initial and subsequent measurement of a lessee's right to use asset. That measurement approach might make greater use of fair value.

Alternative A—Intangible Asset Approach

5. Under this approach, a lessee's right to use asset is deemed similar in nature to an intangible asset acquired outside of a business combination regardless of the nature of the item being leased (tangible or intangible). The lessee's right to use

asset is initially and subsequently measured consistent with the Boards' existing standards on accounting for intangible assets acquired outside of a business combination.

6. This approach emphasizes that a lessee is acquiring the right to use an item, which is different from acquiring the item itself (a purchase). The right to use an item lacks physical substance, and thus, is an intangible asset, no matter the nature of the item itself. (Paragraph 8 of IAS 38 defines an intangible asset as "an identifiable non-monetary asset without physical substance." The glossary of FAS 142 defines intangible assets as "assets (not including financial assets) that lack physical substance.")

Initial Measurement

7. Under IFRS, an intangible asset acquired outside of a business combination is initially measured at cost (IAS 38, paragraph 24). Cost is "the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition" (IAS 38, paragraph 8). Thus, if that IFRS guidance was initially applied to a lessee's right to use asset, the right to use asset would be measured as the fair value of the consideration given (the lessee obligation to the lessor).

8. Under U.S. GAAP, an intangible asset acquired outside of a business combination is initially measured on the basis of the fair values exchanged. In exchange transactions, the fair values of the net assets acquired and the consideration paid are assumed to be equal, absent evidence to the contrary. If the form of consideration given is in the form of liabilities incurred (as in a lease transaction), measurement is based on the fair value of the consideration given or the fair value of the asset acquired, whichever is more clearly evident, and thus, more reliably measurable (FAS 141, paragraphs 5 and 6).

9. If that U.S. GAAP guidance was applied to a lessee's right to use asset, the staff believes the right to use asset would almost always be measured at the fair value of the consideration given. The fair value of a set of contractual cash flows would seem to almost always be considered "more reliably measurable" than the fair value of the right to use an item of PP&E or an intangible asset for a defined period of time. Markets for contractual cash flows are generally much more active than markets for the right to use items of PP&E or intangible assets.

Therefore, a measurement of the fair value of the consideration given could make use of significantly more market-based information (credit-adjusted discount rates) than a measurement of the fair value of the right to use asset.

10. Under this approach, an initial measurement under IFRS could be different from an initial measurement under U.S. GAAP for the following reasons:

    - IFRS and U.S. GAAP define *fair value* differently and contain different additional guidance for measuring fair value. In November 2006, the IASB issued a discussion paper entitled *Fair Value Measurements.* Part 1, Issue 2 of that paper analyzes the differences between the definitions of fair value in FAS 157 and IFRSs. Constituents were asked to comment whether the exit price measurement objective in FAS 157 differs from fair value measurements in IFRS as applied in practice (Q6 of the Invitation to Comment).

    - Under U.S. GAAP, if the fair value of the right to use asset is more clearly evident and more reliably measurable than the fair value of the consideration given, the fair value of the right to use asset would be used as the initial measurement. Under IAS 38, the fair value of the consideration given ("cost") is always used as the initial measurement.

    - The "fair value of the other consideration given to acquire the asset" under IAS 38 includes some costs that may not be included under U.S. GAAP. Paragraph 27 of IAS 38 extends its paragraph 8 definition of *cost* to include both the purchase price and "any directly attributable cost of preparing the asset for its intended use." Such costs include costs of employee benefits and professional fees arising directly from bringing the asset to its working condition and costs of testing whether the asset is functioning properly. It is unclear whether those costs would be capitalized as part of the initial measurement under U.S. GAAP. On one hand, since those costs are not part of the "exchange" between the lessor and lessee, those costs would not seem to be part of the initial measurement under U.S. GAAP. On the other hand, since it would be generally acceptable to capitalize those costs if the asset were constructed instead of acquired, it seems likely that capitalizing those costs as part of the cost of the right to use would also be accepted in practice.

Subsequent Measurement

11. IAS 38 permits two models for the subsequent accounting for a recognized intangible asset with a finite life: the cost model (IAS 38, paragraph 74) and the revaluation model (IAS 38, paragraph 75).

12. Under the revaluation model, after initial recognition, an intangible asset is carried at a revalued amount, which is its fair value at the date of revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. A revaluation increase is recognized directly in equity under the heading of revaluation surplus, but a revaluation increase that reverses a revaluation decrease previously recognized in profit or loss is also recognized in profit or loss (IAS 38, paragraph 85). A revaluation decrease is recognized in profit or loss, but a revaluation decrease that reverses a revaluation increase previously recognized directly in equity is also recognized directly in equity (IAS 38, paragraph 86). Revaluations are to be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

13. However, the revaluation model can only be elected for an intangible asset if there is an *active market* for that asset. Paragraph 8 of IAS 38 defines an active market as "a market in which all of the following conditions exist: (a) the items traded in the market are homogeneous; (b) willing buyers and sellers can normally be found at any time; and (c) prices are available to the public."

14. Further, paragraph 78 of IAS 38 states:

> It is uncommon for an active market with the characteristics described in paragraph 8 to exist for an intangible asset, although this may happen. For example, in some jurisdictions, an active market may exist for freely transferable taxi licenses, fishing licences or production quotas. However, an active market cannot exist for brands, newspaper mastheads, music and film publishing rights, patents or trademarks, because each such asset is unique. Also, although intangible assets are bought and sold, contracts are negotiated between individual buyers and sellers, and transactions are relatively infrequent. For these reasons, the price paid for one asset may not provide sufficient

evidence of the fair value of another. Moreover, prices are often not available to the public.

15. The staff thinks that it would be rare for a right to use asset arising under a lease contract to be eligible for the revaluation model under IAS 38 for the same reasons described in paragraph 78 of IAS 38. Therefore, lessee right use assets would be subsequently measured under the cost model.

16. Under the cost model, a recognized intangible asset with a finite useful life is amortized on a systematic basis over its useful life. The amortization method should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method is to be used. However, there is rarely, if ever, persuasive evidence to support an amortization method that results in an item initially being amortized slower than under the straight-line method.

17. Under both IAS 38's cost model and revaluation model, impairments are recognized in accordance with IAS 36, and subsequent reversal of a previously recognized impairment loss is required (IAS 36, paragraph 114).

18. Under U.S. GAAP, a recognized intangible asset with a finite useful life is amortized over its useful life to the reporting entity. The amortization method should reflect the pattern in which the economic benefits of the intangible asset are consumed or otherwise used up. If that pattern cannot be reliably determined, a straight-line amortization method is to be used (FAS 142, paragraph 12). An impairment loss is recognized in accordance with FAS 144 if the carrying amount of an intangible asset is not recoverable and its carrying amount exceeds its fair value. After an impairment loss is recognized, the adjusted carrying amount of the intangible asset is its new accounting basis. Subsequent reversal of a previously recognized impairment loss is prohibited (FAS 142, paragraph 15).

19. Under this approach, subsequent measurements under IFRS could be different from subsequent measurements under U.S. GAAP primarily due to differences in impairment guidance. The following table summarizes some relevant differences between the impairment requirements of IAS 36 and FAS 144[1]:

[1] Adapted from Deloitte's *IFRSs and US GAAP: A Pocket Comparison* (March 2007).

Topic	IFRS	U.S. GAAP
Impairment methodology for long-term assets (other than goodwill) that are subject to amortization	Impairment is recorded when an asset's carrying amount exceeds the higher of the asset's value-in-use (discounted present value of the asset's expected future cash flows) and fair value less costs to sell.	Impairment is recorded when an asset's carrying amount exceeds the expected future cash flows to be derived from the asset on an undiscounted basis.
Measurement of impairment loss for long-term assets (other than goodwill) that are subject to amortization	Based on the recoverable amount (the higher of the asset's value-in-use and fair value less costs to sell).	Based on fair value, generally based on discounted cash flows.
Subsequent reversal of an impairment loss	Required for all assets, other than goodwill, if certain criteria are met.	Prohibited.

20. The Boards have agreed to a joint short-term convergence project on impairment issues. That project is currently in a preliminary research phase. The Boards have not deliberated any of the convergence issues, and no timeline for convergence has been set.

21. Differences in subsequent measurements could also result from:

- Different initial measurements (described previously).
- Some lessee right to use assets could conceivably meet the active market test and be eligible for the revaluation model under IAS 38.
- U.S. GAAP does not explicitly state that it would be very hard to justify an amortization method that results in an item initially being amortized more slowly than under the straight-line method.

Alternative B—Nature of the Leased Item Approach

22. Under this approach, the nature of the item being leased dictates the initial and subsequent measurements of a lessee's right to use asset. In other words, a lessee's right to use asset arising from a lease of an item of PP&E would initially and subsequently be measured consistent with how an acquisition of PP&E outside of a business combination would be measured. Similarly, a lessee's right to use asset arising from a lease of an intangible asset would initially and

subsequently be measured consistent with how an acquisition of an intangible asset outside of a business combination would be measured.

23. This approach emphasizes that under both a lease and a purchase an entity is obtaining the use of an item for its operations. Therefore, the asset recognized should be subject to the same initial and subsequent measurement guidance regardless of whether that asset was obtained through a purchase or a lease.

24. This approach is not meant to expand the scope of the leases project beyond the Boards' preliminary decision to limit the scope to transactions within the scopes of existing lease standards, specifically IAS 17 and FAS 13. The majority of transactions within the scopes of IAS 17 and FAS 13 are leases of PP&E. Therefore, the majority of a lessee's right to use assets would initially and subsequently be measured consistent with the Boards' existing standards on PP&E (IAS 16, FAS 142, and ARB 43, Ch. 9). However, paragraph 6 of IAS 38 notes that some finance leases under IFRS are leases of an underlying intangible asset. Under this approach, if any leases of intangible assets remained in the scope of the new joint leases standard (or are added to the scope in a later phase of the project), a lessee's right to use asset for those leases would initially and subsequently be measured consistent with the Boards' existing standards on accounting for intangible assets acquired outside of a business combination (IAS 38 and FAS 142).

25. The accounting for an acquisition of an intangible asset outside of a business combination under both IFRS and U.S. GAAP has already been described as part of the first approach (paragraphs 7–21). Therefore, the description of Alternative B will focus on the accounting for PP&E acquired outside of a business combination under both IFRS and U.S. GAAP.

Initial Measurement

26. Under IFRS, PP&E acquired outside of a business combination is initially measured at cost (IAS 16, paragraph 15). Cost is "the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition" (IAS 16, paragraph 6). Thus, if that IFRS guidance was initially applied to a lessee's right to use asset arising from a lease of an item of PP&E, the right to use asset would be measured at the fair value of the consideration given (the lessee obligation to the lessor).

27. Under U.S. GAAP, the guidance for initially measuring PP&E acquired outside of a business combination is the same as the guidance for initially measuring similarly acquired intangible assets (FAS 141, paragraphs 5 and 6). An analysis of that guidance is found in paragraphs 8 and 9, and the staff concluded that a lessee's right to use asset would almost always be initially measured at the fair value of the consideration given.

28. Under this approach, an initial measurement under IFRS could be different from an initial measurement under U.S. GAAP due to the same two reasons described in paragraph 10(a)–(b). In addition, the "fair value of the other consideration given to acquire the asset" under IAS 16 includes some costs that may not be included under U.S. GAAP. Paragraph 16 of IAS 16 extends its paragraph 6 definition of cost to include:

    - The purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
    - Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. For example, costs of employee benefits arising directly from the acquisition of the item, costs of site preparation, initial delivery and handling costs, installation and assembly costs, and costs of testing whether the asset is functioning properly.
    - The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during the period.

29. It is unclear whether the costs in paragraph 28(b) would be capitalized as part of the initial measurement under U.S. GAAP. (See similar discussion in paragraph 10(c).)

30. Under IFRS, the obligation for the costs in paragraph 28(c) is recognized and measured in accordance with IAS 37. Under U.S. GAAP, the obligation for the costs in paragraph 28(c) is recognized and measured in accordance with FAS 143.

Subsequent Measurement

31. IAS 16 provides two models for subsequent measurement: the cost model and the revaluation model. Subsequent measurements under IAS 16's cost model are similar to those under IAS 38's cost model, which is described in paragraph 16. Subsequent measurements under IAS 16's revaluation model are similar to those under IAS 38's revaluation model, which is described in paragraph 12.

32. However, the requirements to be able to elect the revaluation model are different between IAS 16 (PP&E) and IAS 38 (intangible assets), with the requirements being stricter under IAS 38. IAS 38 requires that revaluations must be determined by reference to an active market. The staff thinks that a lessee's right to use asset arising from a lease of an intangible asset and subsequently accounted for under IAS 38 generally would be ineligible for the revaluation model for that reason (previously discussed in paragraphs 13–15). The revaluation model in IAS 16 (PP&E) is not as restrictive because there is no requirement that revaluations be determined by reference to an active market. Instead, IAS 16 revaluations are permitted if the item's fair value "can be measured reliably." The staff understands that the fair value of some lessee right to use assets arising from leases of PP&E may be able to be "measured reliably." Of course, preparer and auditor judgment would have to be applied in each case based on actual facts and circumstances.

33. Under both IAS 16's cost model and revaluation model, impairments are determined after application of IAS 36 (as discussed above).

34. Under U.S. GAAP, there is no comparable "revaluation model" for either acquired PP&E or intangible assets. PP&E is depreciated in a systematic and rational manner over its useful economic life (ARB 43, Ch. 9, paragraph 5). An intangible asset with finite life is amortized using a method that reflects the pattern in which the economic benefits of the intangible asset are consumed or otherwise used up. If that pattern cannot be reliably determined, a straight-line amortization method is used. Impairments of both PP&E and intangible assets are determined after application of FAS 144.

35. Under this approach, subsequent measurements under IFRS could be different from subsequent measurements under U.S. GAAP due to:
    - Different initial measurements (described previously)
    - Differences between the impairment requirements of IAS 36 and FAS 144 (described in paragraph 19)
    - Some lessee right to use assets might meet the reliably measurable test and be eligible for the revaluation model under IAS 16.

Alternative C—Separate Accounting Model Approach

36. Under this approach, the Boards would create a separate accounting model for the initial and subsequent measurement of a lessee's right to use asset. There are a few reasons why the Boards may want to go with this approach:
    - The Boards may view a lessee's right to use asset as sufficiently different from both currently recognized intangible assets and the nature of the item being leased that different measurement requirements are necessary.
    - The Boards may decide that although a lessee's right to use asset is similar in nature to either an intangible asset or to the item being leased, it would be preferable to create a separate accounting model for leases. Specifically, the Boards may decide that another measurement approach would result in more decision-useful information, and the incremental benefits of that approach exceed the incremental costs.
37. One alternative measurement model would be to require that a lessee's right to use asset be measured at fair value, with changes in fair value recognized in profit or loss (earnings). That approach is analyzed further in this section.
38. Obviously, there are other measurement alternatives that could be created by borrowing aspects of either Board's existing models for PP&E and intangible assets. This section does not attempt to consider every possible alternative for initial and subsequent measurement, including depreciation/amortization methods, revaluation, and impairment testing. If the Boards favor another approach, the staff can develop that approach for the Boards through another paper.

Initially Measure at Fair Value

39. The Boards could require that a lessee's right to use asset be initially measured at fair value (exit price). This is contrasted with Alternatives A and B where the initial measurement is the entry price or cost (depending on the treatment of transaction costs), except in rare cases under U.S. GAAP where the fair value of the right to use asset would be judged to be more reliably measurable than the fair value of the expected contractual lease payments.

40. Supporters of this approach think that the exit price (fair value) is a more relevant initial measurement of a lessee's right to use asset than its entry price or cost. In other words, at initial recognition, what the lessee could get in exchange for the right to use is more relevant than what the lessee paid for the right of use.

41. However, others consider that the exit price (fair value) is not a more relevant initial measurement of a lessee's right to use asset. It may be common for the lessee's principal (or most advantageous) exit market to be different from the market through which the lessee entered into the lease. (For instance, a lessee may only be able to "exit" the lease contract via the lessor.) Requiring the initial measurement of a lessee's right to use asset to be an exit price raises the possibility that a lessee would recognize a day one gain or loss on the lease as the exit price (measurement of the right to use asset) may not equal the entry price (measurement of the obligation to the lessor). Some consider such day one losses to be irrelevant to a user's decisions because no true economic loss has occurred.

42. In cases where the fair value of the lessee's right to use asset is presumed to equal the fair value of the consideration given, it seems likely that the measurement would be reliable, as markets for contractual cash flows are generally active. However, in cases where the principal exit market is different for the lessee, some question how well a measurement based on assumptions about hypothetical market participants would faithfully represent the acquired asset.

43. Also, requiring a lessee's right to use asset to initially be measured at fair value would result in rights to use an item acquired through a lease being measured differently from rights to use an item acquired through a purchase. Those that view such transactions as similar consider that result to be inconsistent with the qualitative characteristic of comparability.

Subsequently Measure at Fair Value

44. The Boards could also decide that a lessee's right to use asset should subsequently be measured at fair value with changes in fair value recognized in profit or loss (earnings). Supporters of this approach contend that the exit price (fair value) is a more relevant subsequent measurement of a lessee's right to use asset than its depreciated/amortized cost. For example, 99 year leases of real estate are common in the United Kingdom, and one can argue that amortized cost is often not very relevant or informative 30 years into the lease.

45. However, it may not be possible to generalize across all types of lease transactions. For some leases, such as long-term leases of appreciating real estate, fair value may be a more relevant measure and give rise to incremental benefits. However, for other leases, such as relatively short-term leases of office equipment, it seems doubtful that measuring the fair value of the right to use as it ultimately decreases to zero over the term of the lease would produce incrementally more relevant or decision-useful information.

46. There are significant concerns about the reliability of subsequent fair value measurements of a lessee's right to use asset. Unlike at initial recognition or in a business combination, there is no arm's-length transaction associated with subsequent measurements that might provide an indication of fair value. Furthermore, markets for exiting leases partway through the term are often much less active than markets for originally entering into leases. Again, it is not necessarily possible to generalize across all lease transactions. For instance, markets for exiting some long-term leases of real estate may be relatively active, and amortized cost may not faithfully represent many right to use assets either.

47. However, even in the most active markets, it seems that it would often be difficult for a lessee to ascertain the fair value of its right to use asset. Lessees are typically not in the business of gathering information about market participants' assessments of the value of their leases. This is because lessees rarely enter into a lease with the intention to exit prior to the end of the contractual term. Hence, a lessee would often require the services of an outside valuation expert in order to fair value its right to use asset, and those services are costly.

48. Again, requiring a lessee's right to use asset to be subsequently measured at fair value with changes in fair value reported in profit or loss (earnings) would result

in rights to use an item acquired through a lease being measured differently from rights to use an item acquired through a purchase. Those that view such transactions as similar consider that result to be inconsistent with the qualitative characteristic of comparability.

Fair Value Option

49. Alternatively, the Boards could give lessees the option to subsequently measure a right to use asset at fair value with changes in fair value recognized in profit or loss (earnings). That option could be permitted to be elected for all leases, for all leases of a class of items, or on a lease-by-lease basis.

Analysis of Approaches

50. An advantage of a fair value approach under Alternative C is that it may provide more decision-useful information based on the qualitative characteristics in the Boards' conceptual frameworks. However, as the analysis presented above indicates, that increase in decision-useful information may be small for many leases, and it is not without potentially significant costs.

51. An advantage of Alternative A and Alternative B is that a lessee's right to use asset would be measured on a consistent basis with other assets of a similar nature. Another advantage of Alternative B is that it prevents accounting arbitrage opportunities from arising due to differences in the accounting requirements for purchasing an item and leasing an item. If Alternative C was selected and initial and subsequent measurements for a lease of an item were different than for a purchase of the item, an accounting arbitrage opportunity would emerge. If the entity perceived the measurement model for lessee right to use assets to be favorable, then it would structure its asset acquisitions as leases rather than purchases. Similarly, if the entity perceived the measurement model for asset purchases to be favorable, then it would structure its asset acquisitions as purchases, perhaps with an associated put option.

52. Either Alternative A or Alternative B would also allow the Boards to avoid attempting to resolve some additional potentially controversial issues within their joint leases project—namely revaluation of PP&E and intangible assets and impairment testing methodology. These issues fundamentally extend beyond the accounting for leases and may best be addressed in separate joint convergence

projects. Furthermore, even if the Boards were to agree on a common platform of revaluation and impairment guidance for lessee right to use assets, that common platform would necessarily be inconsistent with at least one Board's guidance on revaluations and impairments for other accounting areas.

53. However, one disadvantage of Alternative A and Alternative B is that the actual accounting for some leases would likely be different under IFRS compared to U.S. GAAP due to outstanding convergence issues, particularly in the areas of revaluation and impairment testing. Those differences would diminish over time as the Boards continue their convergence activities.

54. Alternative C would allow the Boards to carve out GAAP for leases and reach a converged answer without waiting for the completion of other convergence activities. Alternative C could also enable the Boards to get measurement "right" for leases, without the Boards being constrained by current measurement guidance for intangible assets or PP&E.

55. Alternative C also gives the Boards the flexibility to require or permit different measurement models to be applied to different types of leases. For instance, different measurement models may be available for real estate leases than for leases of equipment. Similarly, under Alternative C, the Boards could have different measurement models for short-term leases and leases for nearly the entire useful life of an item.

Staff Recommendation

56. The staff recommends that the Boards preliminarily decide on the approach described in Alternative B for initially and subsequently measuring a lessee's right to use asset. That is, a lessee should measure the asset representing its right to use the leased item similarly to how it would have measured the asset had it purchased the leased item.

Alternative B Preferable to Alternative A

57. First, the staff eliminated Alternative A. The staff views the rights (and corresponding asset) acquired when an item is leased to be fundamentally similar in nature to the rights (and corresponding asset) acquired when an item is purchased. If acquired rights associated with an item must be viewed as an intangible asset, then it is unclear why purchased PP&E should not be treated as

an intangible asset as the entity has merely acquired more (all) of the rights associated with the item.

Alternative B Preferable to Alternative C

58. While requiring a lessee's right to use asset to be subsequently measured at fair value under Alternative C may result in more relevant information, the staff does not consider that the incremental benefits would generally exceed the incremental costs. Ultimately, the staff thinks that subsequent fair value measurements of a lessee's right to use asset would often be difficult and costly.

59. The staff views leasing and purchasing as alternative means of financing the acquisition of the right to use items of capital in an entity's operations. Alternative B best ensures that similar transactions, such as purchasing PP&E and leasing PP&E, are accounted for similarly. This result has frequently been requested by investors and other users of financial statements as it enhances comparability and serves to reduce the overall complexity of GAAP. Alternative C would result in similar transactions being accounted for differently.

60. The fundamental flaw with the current lease accounting is that it attempts to differentiate between a purchase and a lease. Alternative B keeps the Boards from having to create rules and bright lines to make that distinction. Under Alternative C, rules may be necessary to distinguish between a lease (to be accounted for under the leases standard) and a purchase (to be accounted for under other GAAP). Furthermore, Alternative B avoids creating an accounting arbitrage opportunity where an entity could structure asset acquisitions as either a purchase or as a lease, depending on whether it finds the measurement model constructed under Alternative C to be advantageous.

61. Alternative B gives the Boards the flexibility to later expand the scope of the project, or to have a later phase of the project, to consider the accounting for leases of intangible assets currently outside the scope of IAS 17 or FAS 13, as well as other "right to use" arrangements. Under both IFRS and U.S. GAAP, purchases of tangible and intangible assets are accounted for differently, and there may be good reasons why that is the case. That fact is recognized under Alternative B, and that approach steers the Boards away from attempting to create a one-size-fits-all approach that may not hold together well if the scope is later expanded.

62. Alternative B does not require the Boards to reach converged answers with regard to several measurement issues where IFRS and U.S. GAAP diverge, specifically asset revaluations and impairment testing. The joint leases project already has its share of issues where reaching a converged issue may be difficult (option measurement; lessor revenue recognition). Asset revaluations and impairment testing seem best addressed broadly in a separate joint convergence project. Addressing those issues within the joint leases project would only delay the most significant improvement resulting from the project—recognizing all leases on the balance sheet in a consistent manner.

Questions for the Boards

1. What approach do you support for the initial and subsequent measurement of a lessee's right to use asset? Why?
    a. Alternative A—Intangible Asset Approach
    b. Alternative B—Nature of the Leased Item Approach
    c. Alternative C—Separate Accounting Model Approach
2. For Board members that support Alternative C, what separate accounting model do you support? Why?
    a. Fair value for initial and subsequent measurements
    b. Another approach. Please describe.