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**International
Accounting Standards
Board**

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

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: 18 October 2007, London

Project: Leases

Subject: Purpose of meeting and overview of papers
(Agenda paper 12)

Purpose of Meeting and Overview of Papers

1. This cover memo provides a summary of the tentative decisions to date of both the IASB and the FASB on the leases project. This summary is for informational purposes only and will not be discussed at the October meetings. This memo also provides a summary of the project plan.
2. At the October Board meetings, the following papers will be discussed:
 - a. Other Lessee Obligations (IASB Agenda Paper 12A/FASB Memo #13)—
This paper analyses three groups of lessee obligations (obligations to: incur costs to return the leased item, return the leased item in a specified condition, and maintain the leased item) to determine:
 - (1) Whether they meet the definition of a liability and when the liability arises
 - (2) How the debit arising on recognition of a liability should be treated

(3) How any liabilities arising out of these obligations should be measured

(4) Whether these obligations give rise to assets for the lessor.

b. Variable Rental Payments (IASB Agenda Paper 12B/FASB Memo #14)—
This paper seeks Board views on recognition and measurement of variable lease payments; that is, lease payments that increase or decrease as a result of changes in factors, other than the passage of time, occurring subsequent to the start of the lease

3. The FASB meeting will be an *informational Board meeting*, which is why there is no education session. In order for the discussion to be webcast and minutes to be prepared for our constituents who are following this project, the staff chose an informational Board meeting as opposed to an education session. Our goal is to solicit Board members' views, obtain some direction from Board members on these topics, and hear Board members' tentative conclusions on the questions for consideration.

Summary of Tentative Decisions to Date

Scope (April 2007)

4. The project will initially focus on accounting for those arrangements within the scope of existing lease accounting literature. As the project progresses and before publishing a Preliminary Views, the Boards will consider whether to extend the scope of the project to other arrangements that convey a right to use another entity's asset.

Analysis of Rights and Obligations in a Simple Lease Contract (March 2007)

5. The lessee has an asset for the right to use the leased item over the lease term and a liability for the obligation to make payments over the lease term. The lessee's obligation to return the leased item does not meet the definition of a liability; however, liabilities may exist because of asset retirement obligations or requirements to return the equipment in a specified condition. The lessor has an asset for the right to receive payments over the lease term. Analysis of whether

rights and obligations arising in a lease contract meet the definition of an asset or a liability should be based on the definitions in the existing conceptual framework; however, the staff should monitor proposed revisions to the framework made in the conceptual framework project and consider if those revisions would change the staff's analyses.

Analysis of Different Possible Accounting Models (March 2007)

6. The staff should continue to develop the right-of-use model with the understanding that decisions pertaining to measurement, presentation, derecognition, recognition, and scope could affect preliminary conclusions. In the right-of-use model, the lessee recognizes as an asset its right to use the leased item and as a liability its obligation to pay for that item. The lessor recognizes as an asset its right to receive payments from the lessee and its residual interest in the leased item at the end of the lease term; the lessor does not have a liability for its obligation to permit the lessee to use the leased item.

Measurement of a Lessee's Liability to the Lessor, Measurement of a Lessee's Right to Use Asset, and Initial Recognition of Assets and Liabilities in Lease Contracts (June 2007)

7. The Boards discussed alternative approaches to the initial and subsequent measurement of a lessee's obligation to make payments to the lessor arising under a simple lease contract. The Boards generally agreed that the lessee's obligation to make payments to the lessor is a financial liability and directed the staff to further explore the following approaches:
 - a. The lessee would initially measure its obligation to pay for the right to use asset at fair value.
 - b. The lessee would subsequently measure that liability using the effective interest method; however, the lessee also would have an option to subsequently measure the liability at fair value.
8. The Boards considered the following three alternative approaches for the initial and subsequent measurement of a lessee's right to use asset arising under a simple lease contract: (a) intangible asset approach, (b) nature of the leased item

approach, and (c) separate accounting model approach. The IASB expressed a preference for the nature of the leased item approach. Under that approach, the right to use the asset arising in a lease of property, plant, and equipment would be measured (both initially and subsequently) in the same way as property, plant, and equipment under IAS 16. The IASB noted that under this approach it would still be possible to present leased assets separately from owned assets. The FASB generally agreed with alternative (c), noting that a lessee's right to use the asset is neither an intangible asset nor an asset that is similar in nature to the leased item. For that reason, the FASB generally agreed that existing guidance for the initial measurement of an intangible or tangible asset may not be the most relevant measure of a lessee's right to use asset. The FASB directed the staff to develop an approach for the initial and subsequent measurement of a lessee's right to use asset for consideration at a future meeting.

9. The Boards also discussed whether assets and liabilities arising in a lease contract should be recognized upon signing of the lease contract or upon access to or delivery of the leased item, but did not reach any tentative conclusions. The IASB instructed the staff to further analyze the rights and obligations arising in lease contracts between contract signing and acceptance of the leased item.

Options to Extend or Terminate a Lease (May 2007)

10. The Boards discussed lease contracts that give the lessee an option to extend the lease for an additional period or an option to terminate the lease early.
11. The Boards discussed some of the factors that affect whether a lessee will exercise an option to extend or terminate the lease, and considered whether it is possible to view a lease with an option to extend as equivalent to a longer-term lease with an option to terminate. The Boards then discussed whether the rights and obligations that arise under a simple lease with an option to extend the lease term meet the definitions of assets and liabilities under the conceptual framework.
12. The Boards discussed the following four approaches to accounting for options to extend or terminate a lease, but did not reach any decision:
 - a. Approach 1—The lessee obtains the right to use up to the option exercise date, and an option to extend the lease.

b. Approach 2—The lessee obtains a right to use for the period of the lease including any possible extensions, and an option to terminate the lease.

c. Approach 3—The lessee obtains a right to use either for the period of the lease including any possible extensions or for the period to the option exercise date. The assets and liabilities recognized are based on the most probable lease term after considering all of the substantive terms of the lease and the nature of the item being leased. Under this approach, options are not separately recognized.

d. Approach 4—The lessee obtains a right of use of which measurement is based upon the expected value of the payments under the lease. Under this approach, options are not separately recognized.

Project Plan

13. The following table shows additional lease topics that will be discussed at future Board meetings, including some of the specific issues related to those topics.

Topic	Issues to Be Covered at a Future Board Meeting
Lessee interests in the residual value of the leased item	<ul style="list-style-type: none"> • Residual value guarantees <ul style="list-style-type: none"> ○ Lessee provided ○ Third party provided ○ What is the nature of this obligation? <ul style="list-style-type: none"> ▪ Insurance contract? ▪ Derivative? ○ How should it be measured? <ul style="list-style-type: none"> ▪ Fair value? Other? ▪ Initially ▪ Subsequently? • Lessee interests in increases in value <ul style="list-style-type: none"> ○ What is the nature? ○ How should it be measured? <ul style="list-style-type: none"> ▪ Initially ▪ Subsequently.

Topic	Issues to Be Covered at a Future Board Meeting
Recognition and measurement of options to terminate/extend lease + options to buy (both from perspective of lessee and lessor)	<ul style="list-style-type: none"> • Can they be measured reliably? <ul style="list-style-type: none"> ○ Initially ○ Subsequently. • How should they be measured? <ul style="list-style-type: none"> ○ Initially ○ Subsequently. • Should the lessor record these options separately or as an adjustment to its residual asset? • How about implicit options?
Contractual terms (including discussion of non-genuine options)	<ul style="list-style-type: none"> • Explicit terms vs. implicit terms • Substantive vs. non-substantive terms • Non-genuine options <ul style="list-style-type: none"> ○ Define ○ How do we account for them? <ul style="list-style-type: none"> ▪ Recognition ▪ Lease term.
Other options (both from perspective of lessee and lessor)	<ul style="list-style-type: none"> • Types <ul style="list-style-type: none"> ○ Options to acquire additional usage ○ Options to exchange (tech refresh/upgrade) ○ Lessor put options. • What is the nature of these options? • How should they be measured <ul style="list-style-type: none"> ○ Initially ○ Subsequently. • Should the lessor record these options separately or as an adjustment to its other assets?
Reconsideration of issues for which there was no decision and where there may have been disagreement between the IASB and the FASB	<ul style="list-style-type: none"> • When assets and liabilities arising in a lease contract should be recognized • Initial and subsequent measurement of a lessee's right to use asset • How to account for options to extend or terminate a lease
Summary of decisions to date	<ul style="list-style-type: none"> • Summary and analysis of the key principles in a right-to-use model for a simple lease (generally on the lessee-side)

Topic	Issues to Be Covered at a Future Board Meeting
Recognition and measurement of lessor receivables	<ul style="list-style-type: none"> • What is the nature of the asset? <ul style="list-style-type: none"> ○ Financial asset? ○ Other? • Initial Measurement • Subsequent Measurement • Should fair value measurement be permitted/required? • Treatment of contingent/variable rentals • Should receivable ever be presented together with the residual asset (e.g., real estate).
Recognition and measurement of equipment expected to be returned (Lessor)	<ul style="list-style-type: none"> • What is the nature of the asset? <ul style="list-style-type: none"> ○ PP&E? ○ Other? • Initial Measurement • Subsequent Measurement <ul style="list-style-type: none"> ○ Should fair value measurement be permitted/required? ○ How should changes in value be reported? ○ Held for Sale vs. Held for Use. • How should residual value guarantees be accounted for by the lessor? <ul style="list-style-type: none"> ○ How should they be measured? ○ Should they be recognized as a separate asset or and adjustment to the value of the residual?
Revenue recognition	<ul style="list-style-type: none"> • Does revenue arise on signing a lease contract? <ul style="list-style-type: none"> ○ Has the lessor “sold” the right of use? ○ Does it depend upon the nature of the lessor (manufacturer/dealer)? • How should interest income be recognised (if applicable)? • How should fair value gains and losses be recognised (if applicable)?
Lessor derecognition issues	<ul style="list-style-type: none"> • When should the lessor derecognise its assets? • Should it derecognise the whole of the physical item on entering into a lease or only a portion?

Topic	Issues to Be Covered at a Future Board Meeting
When (if ever) should the lessee rights be combined and presented as the leased item itself (PP&E)	<ul style="list-style-type: none"> • How do we draw the line between a secured borrowing and a lease contract? • Does a right to use + bargain purchase option = PP&E? • Does right to use for whole life = PP&E? • Does right to use + the residual value guarantee (RVG) = PP&E?
Disclosure + Presentation	<ul style="list-style-type: none"> • Lessees • Lessors.
Scope	<ul style="list-style-type: none"> • Develop a common definition of a lease and scope • Exceptions? <ul style="list-style-type: none"> ○ Immaterial leases ○ Short-term leases ○ executory contracts. • Revisit decision to restrict scope (as discussed at joint Board meeting) <ul style="list-style-type: none"> ○ Consider what makes leases different from service/executory contracts? • Service concessions.
Property leases	<ul style="list-style-type: none"> • Are there any special considerations for property leases? (IAS 40)
Sale and leaseback transaction	<ul style="list-style-type: none"> • How should they be accounted for?
Leveraged leases	<ul style="list-style-type: none"> • Do they get special treatment in the United States?