



Project **Leases**

Topic **Scope – Intangibles and other possible scope exclusions**

Purpose of this Paper

1. This paper is one of four that explores the scope of the proposed guidance on leases¹.
2. It does not address how to:
 - (a) differentiate service contracts from lease contracts, or
 - (b) account for multi-element contracts (ie contracts that include service components and lease components).

We intend to bring papers on these issues to the boards in the forthcoming months.

3. In our research, we have consulted a number of interested parties including the Leases Working Group and the IASB's Global Preparer's Forum for examples of leases of biological assets (living plants, animals) and leases of intangible assets that are currently accounted for under IAS 17 *Leases*. Our outreach activities could not identify any leases of intangible assets that are currently within the scope of IAS 17.

¹ Throughout this paper, we use the term guidance or standards interchangeably. For the purposes of this paper, they mean the same thing.

This paper has been prepared by the technical staff of the FASB and the IASCF for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

Comments made in relation to the application of IFRSs or U.S. GAAP do not purport to be acceptable or unacceptable application of IFRSs or U.S. GAAP.

The tentative decisions made by the FASB or the IASB at public meetings are reported in FASB *Action Alert* or in IASB *Update*. Official pronouncements of the FASB or the IASB are published only after each board has completed its full due process, including appropriate public consultation and formal voting procedures.

IASB/FASB Staff paper

Background***Preliminary views***

4. In the discussion paper, the boards' tentatively decided that the scope of the proposed new standard should be based on the scope of the existing standards. The boards also acknowledged that differences between US GAAP and IFRSs would need to be reconciled before a new standard was issued.
5. The boards rejected a fundamental reconsideration of what constitutes a lease. This approach would potentially change the scope of any proposed new leases standard and would require the boards to determine (among other things):
 - (a) The distinction between contracts that would convey a right to use to the lessee and contracts that do not (eg some service contracts)
 - (b) When a lease conveys a right to use a component of a larger asset
 - (c) Whether licences of some intangible assets are leases.

What is excluded from the scope of the existing leases standards?

6. Lease accounting guidance under US GAAP (ASC Topic 840 *Leases*) only applies to leases of property, plant and equipment. For IFRSs, IAS 17 applies to all leases, apart from the transactions specified below.
7. Both standards exclude from their scope:
 - (a) Leases to explore for or use natural resources, such as minerals, oil and natural gas.
 - (b) Licensing agreements for such items as motion pictures, plays, manuscripts, patents and copyrights.
8. In addition, biological assets (eg living animals, plants) held by lessees under finance leases and biological assets provided by lessors under operating leases are measured in accordance with IAS 41 *Agriculture*. ASC 840 explicitly excludes leases of timber and other natural resources because those assets are not depreciable.

IASB/FASB Staff paper

9. Similarly for IFRS preparers, (a) property held by lessees that is accounted for as investment property or (b) investment property provided by lessors under operating leases is measured in accordance with IAS 40 *Investment Property*. However, ASC 840 applies to all investment property leases.

Staff analysis

10. Ideally, a leases standard should be a comprehensive one that deals with all types and forms of leases. This would improve comparability and ensure consistent accounting for all leases. However, the boards may decide to exclude some types of lease because:
- (a) The costs of applying the new leases guidance to some leases exceeds the benefits, or
 - (b) Other standards provide better information to users.
11. For this paper, we have assumed that the boards continue to think that the scope of the proposed guidance should be based on existing standards, but that it is necessary to reconcile any differences between US GAAP and IFRSs. Therefore, this paper analyses existing scope exclusions.

Leases to explore for or use natural resources, such as minerals, oil and natural gas

12. We think that the future leases standard should exclude leases to explore for or use natural resources, such as minerals, oil and natural gas because:
- (a) Accounting practices for exploration and evaluation assets are diverse and they differ from how other types of assets are accounted for. For example, some question if some of the exploration and evaluation assets are actually assets as defined in the conceptual framework. Consequently, we do not think the boards' tentative decisions on leasing transactions should be applied to these types of transactions.
 - (b) These industries are specialised, and so the boards may not be able to comprehensively address the challenges posed by them within a tight

IASB/FASB Staff paper

timeframe to improve existing leases standards. Moreover, the IASB has a specific research project on this issue.

Question 1

We recommend that the leases to explore for or use natural resources, such as minerals, oil and natural gas is excluded from the propose guidance on leases.

Do you agree?

Leases for biological assets (including living plants, animals)

13. Leases of biological assets include leases of timber, leases of vineyards and leases for breeding purposes.
14. Some may view that leases of biological assets should be included within the scope of the proposed leases standard because:
 - (a) It ensures that leases of biological assets are comparable to other types of leases.
 - (b) It could result in converged accounting because, for example, the measurement requirements in IAS 41 and ASC Topic 05 *Agriculture* differ. IAS 41 is fair-value-based but allows entities to use cost less accumulated depreciation or impairment under some circumstances. On the other hand, ASC 905 is cost-based, but allows fair value under some circumstances.
15. Others think that leases of biological assets should be excluded from the proposed leases standard. This is because leases of biological assets would not otherwise be comparable with other owned biological assets. Some may also view that biological assets are specialised and that it is better that specific standards that deal with biological assets should also include leases of biological assets.

IASB/FASB Staff paper

Staff Recommendation

16. We think that leases of biological assets should be excluded from the scope of the leases standard because:
- (a) The measurement of leases will be principally cost-based. However for IFRS constituents, we think that the current requirements to measuring leases of biological assets at fair value better reflects the economics of biological assets. It could otherwise be considered a step backwards to require cost accounting for such transactions.
 - (b) It ensures relevant requirements pertaining to biological assets are found in one place.
 - (c) It is more familiar for US-GAAP constituents because it is consistent with current guidance.

Question 2

We recommend that the leases for biological assets are excluded from the proposed guidance on leases.

Do you agree?

Intangible assets (including those currently excluded from both leases standards)

17. This section deals with leases of all intangible assets, including those currently included in IAS 17.
18. Respondents to the DP had mixed views as to whether intangible assets should be included or excluded from the scope of the new leasing guidance. For example, some supported the scope of current US GAAP, which excludes all intangible assets. Other respondents suggested that leases of intangible assets, such as software licences, should be included in the new leases standard.
19. There are three options on how to deal with this issue:
- (a) Consider all leases of intangible assets within the scope of the leases standard.

IASB/FASB Staff paper

- (b) Exclude all leases of intangible assets from a leases standard
 - (c) Exclude all leases of intangible assets now, but consider leases of intangible assets as part of a second phase of a leases standard.
20. Conceptually, it is very hard to argue why the leases standard should exclude intangible assets. A lease of an intangible asset conveys a right to use an asset. The fact that the underlying asset does not have physical substance should not affect the accounting.
21. It is also not clear why leases of intangible assets have been excluded from existing guidance. The G4+1 papers on leases also suggested excluding intangible assets, but stated that entities were not precluded from applying the proposals to leases of intangible assets.
22. If intangible assets are included within the leases standard, the boards will have to consider whether licences or franchises (which some may consider to be a type of lease of an intangible) shall be accounted for within the leases standard. We think this may act as an impediment, because it may shift the focus of the project from lease accounting to a general intangible assets accounting. This would require additional time to develop the ED to comprehensively address this question².
23. If the boards were to exclude leases of all intangible assets, this would not be a significant change in practice. This is because:
- (a) It is consistent with current US GAAP requirements.
 - (b) In theory, IAS 17 includes within its scope some leases of intangible assets. However, in practice very few, if any, leases of intangible assets are accounted for under IAS 17. In our research we could not identify any leases of intangible assets that were included within IAS 17. (IAS 17 excludes licensing agreements which excludes most leases of intangible assets.) Many transactions that could be viewed as a lease of

² In 2008, both boards considered whether to add to their agendas a project on intangible assets but decided not to. Subsequently, the IASB put a project on intangible assets as part of its research agenda. As this project is not active, we do not anticipate that the requirements and guidance on how to account for intangible assets would change soon.

IASB/FASB Staff paper

an intangible asset are accounted for under IAS 38 *Intangible Assets*. Consequently, excluding leases of intangibles will not represent a significant change for most IFRS constituents.

24. However, even if the boards excluded all leases of intangible assets:
- (a) preparers, particularly IFRS preparers, are not precluded from applying the guidance in the future leases standard for leases of intangible assets. (This is because IAS 8 allows entities to apply by analogy the requirements in IFRSs dealing with similar and related issues.)
 - (b) as a right-of-use asset is considered a type of intangible asset, the boards will also have to explain why and how the requirements in a leases standard should and would differ from other intangible assets standards.

Staff Recommendation

25. We think that leases of all intangible assets (except a right to use an asset) should be excluded from the proposed guidance on leases for the reasons given in paragraphs 2122 and 23.
26. We are also not adverse to option c (exclude all leases of intangible assets now, but consider leases of intangible assets as part of a second phase of a leases standard). However, we think that any considerations on leases of intangible assets should be done when the boards have comprehensively considered the issues on intangible assets.

Question 3

We recommend that leases of all intangible assets should be excluded from the proposed guidance on leases.

Do you agree?