Project **Leases**

Topic **Lessor Disclosures**

Purpose of paper

1. The purpose of this paper is to discuss the disclosure requirements for **lessors** in general purpose financial statements. The staff notes that the paper is drafted in accordance with the performance obligation approach to lessor accounting. Further discussion regarding disclosures for a derecognition model will be discussed at a later meeting if necessary.

Structure

2. Similar to recent board decisions in various projects relating to disclosures, the staff has structured this analysis relating to lease disclosures using the Investors Technical Advisory Committee (ITAC) Disclosure Framework as a guideline. This paper is structured as follows:

   (a) Background

   (b) Leases Disclosure Principle

   (c) Nature of the lease arrangement

      (i) Leased asset

      (ii) Lease receivable

      (iii) Performance obligation

   (d) Composition: roll-forward

(e) Assumptions and uncertainties: risks

(f) Short-term lease arrangements

3. Furthermore, Appendix A provides proposed language regarding how the disclosure requirements would look in the proposed new leases guidance.

4. The staff has also prepared appendices B1 through B3 comparing the proposed disclosure requirements in this paper to existing disclosure requirements in the leases guidance of Topic 840 of the *FASB Accounting Standards Codification*™, IAS 17, and IFRS 7, *Financial Instruments: Disclosures*, respectively. The staff has not included the appendices in the board package in an effort to decrease the volume of material. However, the staff will distribute the appendices upon request.

Background

5. The Discussion Paper, *Leases: Preliminary Views* (DP), was published without any preliminary views on disclosure requirements but acknowledged that disclosures would need to be considered when developing the proposed new leases requirements.

Leases Disclosure Principle

6. The objective in developing disclosures is to provide information that should complement the financial statements to achieve the objective of financial reporting which is to provide useful information for users to make decisions and to predict cash flows.

7. In March 2010, the boards agreed to develop a disclosure principle to provide a basis for developing the leases disclosure requirements. In doing so, this would create consistency between the leases project and the objective of the disclosure framework project.

8. The staff has incorporated in the boards recommended changes to the disclosure principle put forth in the March meeting and proposes the following disclosure principle for leases:

An entity shall disclose the quantitative and qualitative financial information that:

(a) **identifies and explains the amounts recognized in its financial statements arising from lease contracts; and**

(b) **enables users to evaluate the nature and extent of the amount, timing and uncertainty of cash flows arising from lease contracts and how the entity manages those cash flows.**

Question 1
Do the boards agree with the staff's proposed disclosure principle? If not, what revisions do the boards recommend?

Nature of the Lease Arrangement

General

9. In accordance with the ITAC disclosure framework, the staff proposes that an entity should provide disclosures of sufficient detail about leases to permit a user to understand the composition and nature of the items included (and/or netted) within a specific caption.

10. Paragraph 840-10-50-4 states that:

> If leasing, exclusive of leveraged leasing, is a significant part of the lessor's business activities in terms of revenue, net income, or assets, a lessor shall disclose in the financial statements or footnotes thereto a general description of the lessor's leasing arrangements.

11. Guidance in IAS 17 also states that the lessor shall disclose a general description of the lessor's leasing arrangements. Further, in accordance with existing GAAP (in paragraphs 122 and 125 of IAS 1, *Presentation of Financial Statements*,

paragraph 36 of IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors,* and guidance in sections 235-10-50, 275-10-50, 250-10-50-4) an entity is required to disclose the basis for selecting a particular assumption, judgment, or estimation of uncertainty and any changes in those assumptions, judgment, or estimations that have a material impact in the determination of the underlying data and estimates.

12. The staff notes that providing a narrative description of these judgments would enhance the relevance and completeness and, therefore, would more faithfully represent the nature of a lease arrangement. Additionally, this will allow users to more accurately project cash flows and provide users with the necessary inputs to accurately determine expected benefits based on management's subjective assessment.

Staff Recommendation

13. The staff recommends the following disclosures relating to the nature of the lease arrangement, if leasing arrangements are a significant part of the lessor's business activities in terms of revenue, net income, or assets:

(a) A general description of those leasing arrangements

(b) The existence and terms of renewal, termination and purchase options

(c) The accounting policy for determining the impact of contingent rentals on the carrying amounts of the lease receivable and performance obligation and the impact of contingent rent on income for each period for which an income statement is presented

(d) Initial direct costs incurred by lessors in a lease arrangement

14. The staff also recommends that the current disclosure referenced in paragraph 11 be specified within the proposed leases guidance. Further, the staff recommends that lessors be required to disclose any significant estimates and assumptions used in determining the lease term as significant judgment will be used in estimating the options to extend or terminate a lease arrangement.

Disclosures relating to the leased asset

15. Under the performance obligation model, the leased asset in a lease arrangement will remain on the lessor's financial statements. As such, the staff thinks disclosures should be required to provide information regarding the underlying asset.

16. The staff notes disclosures relating to the leased asset should also be in accordance with the prescribed disclosures for property, plant, and equipment (PPE) stated in paragraph 360-10-50-1 and IAS 16 for U.S. GAAP preparers and IFRS preparers, respectively.

17. In addition, lease arrangements may place restrictions on the leased assets which may prevent the lessor from maximizing potential cash flows arising from that asset. For example, an entity that has assets under a lease may not have the flexibility to utilize the asset to its maximum potential because of restrictions preventing the lessor from selling the asset while under lease.

18. A description of the existence and terms of any residual value guarantees should also be included in the notes to the financial statements of lessors. The staff thinks disclosure surrounding any residual value guarantees will provide, and more faithfully represent, additional information to users of the financial statements relating to the potential for cash flows subsequent to the lease arrangement that a leased asset may have.

Staff Recommendation

19. In addition to those disclosures already required under existing GAAP for the leased asset, the staff recommends the following additional disclosures in the proposed new leases guidance:

    (a) A description of any additional restrictions placed on the leased assets as a result of any lease arrangements; and

    (b) A description of the existence and terms of any residual value guarantees.

Disclosures relating to the lease receivable

Fair value disclosures

20. IFRS 7 requires the disclosure of the fair value of each class of financial asset in a way that permits it to be compared with its carrying amount (if measured other than at fair value). In addition, an entity would have to disclose the methods, valuation techniques and assumptions used in determining the fair value.

21. However, in U.S. GAAP there is currently no requirement to disclose the fair value of the receivable arising from a lease contract as lease receivables are not deemed within the scope of disclosures relating to financial instruments.

22. The staff thinks requiring lessors to disclose the fair values of their lease receivable would be useful because these disclosures would:

    (a) permit comparisons of financial instruments with similar economic characteristics; and

    (b) indicate the effects of an entity's decisions to incur, maintain or discharge its financial assets.

23. Currently, under IFRS 7, a finance lessor is required to disclose the fair value of its lease receivable. However, the staff acknowledges that determining the fair value of a finance (or capital lease in accordance with U.S. GAAP) lease receivable is much easier than determining the fair value of a lease receivable under the proposed model, which will incorporate options, contingencies and residual value guarantees.

24. Consequently, the staff does not recommend, for cost-benefit reasons, that a lessor should be required to disclose the fair value of its lease receivable. The boards have tentatively decided that the lessor's receivable will be measured at amortized cost noting that it is simpler and less costly for preparers to provide. Requiring an entity to calculate the fair value of the lease receivable at each reporting date for the purposes of disclosures would reintroduce the cost and complexity that the boards previously decided to not undertake in the decision to measure the receivable at amortized cost.

25. Further, in March 2010, the boards decided not to require fair value disclosures in relation to the lessee's obligation to pay.

Other disclosures for the lease receivable

26. Topic 840 requires certain disclosures for future minimum lease payments to be received for each of the five succeeding fiscal years as of the date of the latest balance sheet presented. The staff thinks that this disclosure would provide users of financial statements useful information, and therefore should be carried forward to the proposed leases guidance.

27. IAS 17 requires lessors to disclose the total future minimum lease payments at the end of the reporting period and their present value for each of the following periods:

    (i) not later than one year

    (ii) later than one year and not later than five years

    (iii) later than five years.

28. However, in U.S. GAAP (paragraph 840-30-50-4) a similar disclosure is required to be made for each of the five succeeding fiscal years.

29. The staff thinks carrying forward this disclosure requirement for a maturity analysis of the lease receivable (undiscounted cash flows) showing the remaining (i) contractual maturities and (ii) other obligations including contingent rentals would assist users to understand and evaluate the nature and extent of expected and potential cash flows.

30. Separate disclosures of remaining minimum contractual maturities and total obligation may be beneficial to users because it would present the extent of the lessor's receivables that are contractual and those which are contingent upon an event occurring. Take, for example, that a lessor determines it will lease an asset for 7 years, based on a 5-year contractual minimum and a 2-year option to renew. The lessor would disclose 5 years of receivables as contractual receivables, and 7 years of receivables as total receivables.

31. If the boards decide that the lessor should disclose a maturity analysis for the lease receivable, the boards also must choose the level of detail at which the lessor should be required to specify this analysis. The staff notes the following alternatives:

    (a) on a yearly basis (as required by U.S. GAAP)

    (b) something similar to IAS 17 discussed in paragraph 28

    (c) allow the entity to determine the appropriate number of time bands similar to the IFRS 7 for financial liabilities

32. The staff thinks specifying that the maturity analysis to be disclosed on an annual basis for the first five years, with a lump sum figure for the remaining amounts, would increase comparability for leases. Further, this decision would be consistent with the tentative decisions the boards reached on lessee disclosures.

Staff Recommendation

33. The staff recommends requiring the lessor to prepare a maturity analysis on an annual basis for the first five years, and a lump figure for the remaining amounts, comparing the potential differences in cash flow attributable to those which are contractually stated and those cash flows attributable to the total estimated lease receivable.

34. An example of the lessor's maturity analysis for the year ended December 31, 2010 is provided below:

	Contractual receivable CU	Total receivable CU
2010	XX	XX
2011	XX	XX
2012	XX	XX
2013	XX	XX
2014	XX	XX
Thereafter	XX	XX
Total	XXX	XXX

Disclosures relating to the performance obligation

35. In January 2010, the boards tentatively decided to disclose the amount and expected timing of the satisfaction of its remaining performance obligations in contracts relating to the revenue recognition project.

36. The boards reconfirmed this decision in March 2010, specifying that this disclosure would be required for those contracts with original durations of more than one year.

37. The staff recommends the lessor be required to present disclosure information in accordance with the revenue recognition guidance relating to the lessor's performance obligation. As such, a lessor would disclose the information about its performance obligations in the manner of a narrative description.

38. In accordance with the revenue recognition project, the lessor would disclose information relating to the nature of the lease and expected satisfaction of the corresponding performance obligation. Further, a lessor would be required to provide narrative disclosures relating to whether it expects the lessee to pay in advance and whether the lessor has any remaining obligation to permit cancellation or return and repair.

39. Within the revenue recognition project, the boards also tentatively decided to require a maturity analysis surrounding the satisfaction of performance obligations. The staff thinks this disclosure would provide users with information relating to the expected revenue streams and furthermore, estimates relating to the expected returns of an asset under lease or an entity in the case of an entity which consists of primarily leasing activities.

40. For all remaining performance obligations in contracts expected to be completed after one year from contract inception, the staff recommends that an entity disclose the amount of the transaction price allocated to the performance obligations that are expected to be satisfied:

    (a) within one year,

    (b) between one and two years,

(c) between two and three years, and

(d) after three years from the end of the reporting period.

Staff Recommendation

41. The staff recommend that a lessor follow the disclosure requirements in the revenue recognition project for its performance obligations. The staff do not recommend that any additional disclosures be required in the proposed new leases guidance.

Question 2
The staff recommends that a lessor follow the lessor disclosure recommendations relating to a lease arrangement that are proposed in preceding paragraphs. Do the boards agree? Are there any additional disclosures that should be required?

Composition: roll-forward

42. The ITAC disclosure framework guidance proposes that an entity disclose a roll-forward of the activity in the account balances from period to period showing gross (un-netted) changes by the nature of the change, assuming it is considered material to the reader of the financial statements.

43. Consequently, the staff recommends requiring a reconciliation between beginning and ending balances which would include additions, disposals and changes attributable to the lease arrangement throughout the year. This disclosure should provide further information relating to any changes in the performance obligation and lease receivable throughout the year and would assist users in more accurately predicting future cash flows.

44. A proposed roll-forward could appear in the notes as follows:

	Performance obligation CU	Lease receivable CU
Balance at 1 January 20X0	XXXX	XXXX
Changes in estimates		
From:		
Options	XX	XX
Contingent rentals	XX	XX
Residual value guarantees	XX	XX
Additional obligation/receivable	XXX	XXXX
Impairment		(XXX)
Satisfaction of P.O.	(XXX)	
Cash receipts to satisfy receivable		(XXX)
Interest accrued on the receivable		XXX
Disposal of receivable		(XXX)
Balance at 31 December 20X0	XXXX	XXXX

Question 3

Do the boards agree with the staff recommendation relating to the roll-forward for attributes surrounding the determination of the lessor's performance obligation and lease receivable? If not, what revisions do the boards recommend?

Assumptions and uncertainties: Risks

45. The ITAC disclosure framework proposes that an entity disclose risks and uncertainties related to the applicable account (unless immaterial or remote), including an estimate of the range of the potential impact those items could have on the results of operations, financial condition, or liquidity, in either a favorable or unfavorable manner.

46. Entities that use IFRSs are currently required to provide disclosures surrounding the lease receivable in accordance with IFRS 7.

47. The FASB recently issued a proposed update relating to credit quality and the allowance for credit losses. In accordance with the proposed update, leases (the lessor's receivable in the arrangement) currently classified as *finance leases* and leases classified as *leveraged leases* would be required to make disclosures relating to the credit risk. The staff acknowledge that the disclosures noted in the proposed update have not yet been finalized; however, these disclosures are similar to disclosures required in IFRS 7. As such, upon issuance of the accounting standards update, the staff plans to bring any discrepancies in disclosure requirements between the guidance and the current disclosures required by IFRS to the boards.

Staff recommendations

48. The staff recommends that IFRS preparers be required to disclose information relating to risks surrounding a lease receivable in accordance with IFRS 7 and recommends U.S. GAAP filers be required to disclose in accordance with the proposed Accounting Standard Update relating to credit quality upon final issuance.

Question 4
Do the boards agree with the staff's recommendation relating to the assumptions and risks within the lease arrangement?

Short-term lease arrangements

49. In January 2010, the boards tentatively decided to permit an option relating to short-term lessors when lease arrangements that have a maximum possible lease term of less than 12 months are entered into. As such, if an entity applies the simplified form of lease accounting for such lease arrangements the staff thinks lessors should be required to disclose information relating to the decision to

apply the simplified form of lease accounting and gross amount recognized in the statement of financial position.

50. The staff thinks requiring this disclosure is relevant to users because it allows users to specify those lease arrangements with short-term contractual cash flows which may contribute to analysis surrounding the liquidity of an entity.

Staff Recommendation

51. If an entity applies the simplified form of lease accounting for leases that have a maximum possible lease term of less than 12 months, the staff recommend requiring the following disclosures:

(a) the fact that it applied the simplified form of lease accounting; and

(b) the gross amount recognized in the statement of financial position that were accounted for using the simplified accounting model.

Question 5
Do the boards agree with the staff recommendation relating to short-term lease arrangements?

Appendix A: Draft proposed disclosure section for lessor

Disclosure principles

A1. An entity shall disclose the quantitative and qualitative financial information that:

(a) identifies and explains the amounts recognised in its financial statements arising from lease contracts; and

(b) enables users to evaluate the nature and extent of the amount, timing and uncertainty of cash flows arising from lease contracts and how the entity manages those cash flows.

A2. If the specific disclosures required by this and other IFRSs do not meet the objective in paragraph 1, an entity shall disclose whatever additional information is necessary to meet that objective.

Lessor

A3. A lessor shall disclose information that explains that the nature of lease contracts, if leasing arrangements are a significant part of the lessor's business activities in terms of revenue, net income, or assets. This may include information relating to:

(a) A general description of those leasing arrangements

(b) The existence and terms of renewal, termination and purchase options that were considered when determining the lease term

(c) The accounting policy relating to the basis by which contingent rentals are determined and the amount of contingent rent included in income for each period for which an income statement is presented

(d) Initial direct costs incurred by lessors in negotiating a lease arrangement

A4. A lessor shall disclose any significant estimates and assumptions used in determining the lease term. In addition, a lessor shall disclose the basis for selecting particular assumptions and any changes in assumptions that have a material impact in the determination of the underlying data and estimates in a lease arrangement.

A5. To provide information relating to the leased asset in an arrangement, the lessor shall disclose in accordance with paragraph 360-10-50-1 (or IAS 16). The lessor shall also disclose the existence and terms of any residual value guarantees in the lease arrangement

A6. To provide information relating to the lease receivable in an arrangement, the lessor shall disclose the following:

(a) a maturity analysis of the lease receivable to show remaining contractual maturities and other obligations including contingent rentals on an annual basis for the first five years from the reporting date and thereafter for all the remaining amounts.

(b) information related to the accumulated allowance for uncollectible lease payments attributable the lessor's lease receivable.

A7. To provide information relating to the recognition of revenue attributable to the lessor's performance obligation, the lessor shall provide applicable disclosures in accordance with XXXX-XX [Revenue Recognition standard] required for performance obligations.

A8. To provide information that explains the amounts on the financial statements, the lessor shall disclose a roll-forward reconciling the opening to closing balances for each class[1] of lease receivable and performance obligation.

A9. If an entity applies the simplified form of lease accounting for leases that have a maximum possible lease term of less than 12 months, it shall disclose:

(a) the fact that it applied the simplified form of lease accounting; and

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[1] We have included this as class of assets because both our presentation paper proposes to disclose based on nature of the underlying asset and because IAS 16 *Property, plant and equipment* and Topic 360 *Property, Plant and Equipment* require an entity to disclose its property, plant and equipment by classes of assets.

(b) the gross amount recognized in the statement of financial position that were accounted for using the simplified accounting model.