



Project	Leases
Topic	IFRS 1 <i>First-time Adoption of International Financial Reporting Standards</i>

Purpose

1. The objective of this paper is to provide the staff's analysis and recommendation on how a first-time adopter of IFRSs should apply the proposed leases requirements.

Background

For lessees

2. At their June 2009 joint meeting, the boards tentatively decided that on the date of initial application of the proposed new leases requirements a lessee should recognise and measure all existing lease contracts as follows¹:
 - (a) the obligation to pay rentals should be measured at the present value of the lease payments, discounted using the lessee's incremental borrowing rate
 - (b) the right-of-use asset should be measured on the same basis as the liability, subject to any adjustments required to reflect impairment.

¹ Please see the June 2009 IASB Agenda Paper 11E/FASB Memo 34 for background information on lessee transition.

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.

3. In addition, at the February 2010 joint meeting, the boards tentatively decided that²:
- (a) lessees should apply the proposed transition requirements to leases currently accounted for as finance leases except simple finance leases;
 - (b) For simple finance leases that do not have options, contingent rentals and/or residual value guarantees, the measurement of the assets and liabilities would not be changed on transition or subsequently;
 - (c) For IFRS preparers, the revalued amount of property, plant and equipment can be carried forward as the carrying amount of the asset for simple finance leases;
 - (d) Additional adjustments for prepaid or accrued rentals should be made when lease payments are uneven over the lease term.

For lessors

4. At their March 2010 joint meeting, the boards tentatively decided that on the date of initial application of the new leases requirements a lessor should recognise and measure all existing lease contracts as follows³:
- (a) the receivable should be measured at the present value of the lease payments. The original rate that the lessor is charging the lessee should be used to discount the lease payments
 - (b) the performance obligation should be measured on the same basis as the receivable
 - (c) A lessor should reinstate previously derecognised leased assets at depreciated cost, adjusted for impairment and revaluation.
5. The staff question whether these exceptions should also be applicable for a first-time adopter of IFRSs.

² Please see the February 2010 IASB Agenda Paper 10D/FASB Memo 69 for background information on lessee transition.

³ Please see the March 2010 IASB Agenda Paper 9D/FASB Memo 77 for background information on lessor transition.

Staff analysis

6. IFRS 1 *First-time adoption of International Financial Reporting Standards* provides guidance on how to prepare and present an entity's first IFRS financial statements. The IFRS states that an entity shall prepare and present an opening IFRS statement of financial position at the date of transition to IFRSs. This is the starting point for its accounting in accordance with IFRSs.
7. In regards to accounting policies, IFRS 1 states:

An entity shall use the same accounting policies in its opening IFRS statement of financial position and throughout all periods presented in its first IFRS financial statements. Those accounting policies shall comply with each IFRS effective at the end of its first IFRS reporting period.
8. In addition, IFRS 1 provides exemptions from its requirements in specified areas where the costs of complying with them would likely exceed the benefits to users of financial statements. The IFRS also prohibits retrospective application of some aspects of other IFRSs, particularly where retrospective application would require hindsight (judgments by management about past conditions after the outcome of a particular transaction is already known).
9. When discussing the transitional provisions for the proposed new leases requirements for both lessees and lessors, the boards considered retrospective application. However, the boards tentatively concluded that applying the new requirements retrospectively might prove to be extremely difficult, if not impossible. Therefore, the boards tentatively decided that a lessee and a lessor should recognise and measure its lease assets and liabilities on another basis, measuring all outstanding leases at the present value of the lease payments.
10. The boards have already addressed the cost-benefit and impracticality consideration by not requiring retrospective application to all leases. The specific proposed transitional requirements provide an exception from full retrospective application of the new leases requirements.
11. The staff think the reasons discussed above are as valid as for first-time adopters of IFRSs. Therefore the staff recommend that the exception not to apply retrospectively should be applied to a *first-time adopter*.

Simple finance leases

12. However, the staff think that carrying forward the carrying amount (or the revalued amount for IFRS preparers) of the assets and liabilities for simple finance leases as the carrying amount of the asset for simple finance leases on transition or subsequently should not be applied to a first-time adopter. This is because, the staff do not know what or how a first-time adopter previously accounted for its leases (if ever). Carrying forward amounts recognised and measured under previous GAAP could provide misleading information to users.

Staff recommendation

13. The staff accept that there may be practical difficulties for leases in IFRS 1. The staff note that the proposed transitional requirement provides relief from retrospective application.
14. Therefore, the staff recommend that the same relief should be provided to first-time adopters of IFRSs. That is, a first time adopter should follow the proposed transitional requirements. However, the relief for simple finance leases should not be applied to a first-time adopter.
15. For the lessee, its lease assets and liabilities regarding all outstanding lease contracts should be recognised and measured at the present value of the lease payments, discounted using the lessee's incremental borrowing rate at the date of transition. The lessor should recognise and measure all existing lease contracts at the present value of the lease payments, discounted using the original interest rate that the lessor charged the lessee.

Question 1

The staff recommend that the same proposed transitional requirements should be applied to all leases for first-time adopters of IFRSs. That is, lease assets and liabilities should be recognised and measured at the present value of the lease payments for all leases. The relief for simple finance leases should not be applied to a first-time adopter.

Do the boards agree? If not, why not?