



**Leases Roundtable Meeting
Monday, 20 December 2010**

09.30hrs – 12.30hrs

**Hong Kong Institute of Certified Public Accountants, 37th Floor, Wu Chung House, 213
Queen's Road East, Wanchai, Hong Kong**

AGENDA

Welcome and introductions

We have arranged this roundtable meeting to listen to your views and to develop further our understanding of the issues you raise or alternatives you propose in your comment letters.

We expect to allocate around 30 minutes to cover each of the following topic areas:

- Topic 1: Definition of a lease
- Topic 2: Lessor accounting model
- Topic 3: Lease term
- Topic 4: Variable lease payments

We will then allow some time for all participants to raise any additional issues they would like to discuss at the end of the session.

Topic 1: Definition of a lease

ED proposals

Appendix A Lease – A contract in which the right to use a specified asset (the underlying asset) is conveyed, for a period of time, in exchange for consideration.

B1. At the date of inception of a contract, an entity shall determine whether the contract is, or contains, a lease on the basis of the substance of the contract, by assessing whether:

- (a) the fulfilment of the contract depends on providing a specified asset or assets (the 'underlying asset') (paragraphs B2 and B3); and
- (b) the contract conveys the right to control the use of a specified asset for an agreed period of time (paragraph B4).

Main discussion points:

- Specified asset principle including the componentisation or pooling of the underlying asset(s)
- Right to control the use conditions, including:
 - fixed or market price
 - determination of what constitutes all but an insignificant amount of the output
- Separation of lease and service components of a contract



Topic 2: Lessor accounting model

ED Proposals

- 28.** At the date of inception of the lease, a lessor shall assess whether a lease is accounted for in accordance with the performance obligation approach or the derecognition approach on the basis of whether the lessor retains exposure to significant risks or benefits associated with the underlying asset either:
- (a) during the expected term of the lease; or
 - (b) after the expected term of the lease by having the expectation or ability to generate significant returns by re-leasing or selling the underlying asset.
- (see paragraph B22 – B27)
- 29.** If a lessor retains exposure to significant risks or benefits associated with an underlying asset, the lessor shall apply the performance obligation approach to the lease. If a lessor does not retain exposure to significant risks or benefits associated with an underlying asset, the lessor shall apply the derecognition approach to the lease. A lessor shall not change the lessor accounting approach after the date of inception of the lease.

Main discussion points:

- Principles for determining whether to apply the Performance Obligation or Derecognition approach
- Interaction with the *Revenue from Contracts with Customers* exposure draft and pattern of income recognition
- Consistency with the lessee accounting model
- Impairment assessment of asset recognised under the Performance Obligation approach
- Measurement of residual asset recognised under the Derecognition approach

Topic 3: Lease Term

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Appendix A Lease term – The longest possible term that is more likely than not to occur.

Paragraphs 13, 34 and 51 A lessee/lessor shall determine the *lease term* by estimating the probability of occurrence for each possible lease term, taking into account the effect of any options to extend or terminate the lease (see paragraphs B16 – B20).

B16. [First sentence omitted] An entity determines the lease term considering all explicit and implicit options included in the contract and given effect by the operation of statutory law.

B20. At each reporting date, the lessee or lessor reassesses which outcome it considers to be most likely to occur on the basis of any new facts or circumstances that indicate that there would be a significant change The lessee and lessor may have different information on the likelihood of an option being exercised; therefore, they may reach different decisions about what is the most likely outcome.

Main discussion points:

- Cost and complexity associated with estimating and re-assessing the lease term
- Implications of an alternative measurement approach (eg reasonably or virtually certain threshold) or only recognising contractual minimum lease periods
- Treatment of market rate extension options
- Treatment of statutory and implicit renewal terms
- Separate recognition and measurement of options



Topic 4: Variable lease payments

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Appendix A Lease payments – Payments arising under a lease including fixed rentals and rentals subject to uncertainty, including, but not limited to, contingent rentals, and amounts payable by the lessee under residual value guarantees and term option penalties.

Paragraphs 14,35, and 52 A lessee/lessor shall determine using all relevant information, the present value of lease payments payable/receivable during the lease term determine in accordance with paragraph 13/34/51 on the basis of expected outcome. The expected outcome is the present value of the probability-weighted average of the cash flows for a reasonable number of outcomes (see paragraph B21). [Remainder of paragraph omitted]

B21. Estimating expected outcome involves:

- (a) identifying each reasonably possible outcome. An entity need not assess every possible outcome to identify the reasonably possible outcomes included in the expected present value of the cash flows.
- (b) estimating the amount and timing of the cash flows for each reasonably possible outcome.
- (c) determining the present value of those cash flows.
- (d) estimating the probability of each outcome.

Main discussion points:

- Reliability of expected outcome estimates
- Cost and complexity associated with reassessments
- Contingent rentals estimates in the contractual minimum lease term period versus those in optional renewal periods
- Differences between contingent rentals based on indices, performance or usage
- Treatment of 100% contingent rental contracts
- Possible disclosures that may help users understand the nature and effect of contingent rental arrangements

Other topics