Project **Leases**

Topic **Lessor Accounting–Presentation**

Objective

1. The objective of this paper is to discuss how a lessor's assets, liabilities, expenses, and cash flows arising from a lease contract should be presented in the financial statements.

Structure of the Paper

2. The structure of the paper is as follows:

   (a) Staff Recommendation

   (b) Background Information

   (c) Presentation (Gross or Net)

      (i) All Three Items Gross

      (ii) Lease Receivable Net of the Performance Obligation

      (iii) Leased Asset Net of the Performance Obligation

      (iv) All Three Items Net

   (d) Presentation in the Statement of Financial Position (SFP)

      (i) Lease Receivable

      (ii) Performance Obligation

      (iii) Underlying Leased Asset

(e) Presentation in the Statement of Comprehensive Income (SCI)

(f) Presentation in the Statement of Cash Flows (SCF)

(g) Consideration of the Boards' Tentative Decisions in the Financial Statement Presentation (FSP) Project.

Staff Recommendation

SFP

3. Staff recommendations on whether the lease receivable, performance obligation, and leased asset should be presented gross or net in the SFP are mixed. Some staff members support a gross presentation; while other staff members support netting the performance obligation against the leased asset.

4. In accordance with current presentation requirements (and assuming that these items are not presented net) the staff recommends that a lessor:

   (a) Present lease receivables separate from other financial receivables in the SFP

   (b) Present lease performance obligations separate from other liabilities in the SFP

   (c) Present leased assets separate from other property, plant, and equipment (PP&E) in the SFP.

5. If the performance obligation is netted against the leased asset, the staff recommends that a lessor:

   (a) Present lease receivables separate from other financial receivables in the SFP

   (b) Present the net of the performance obligation and the leased asset as a separate net lease asset or net lease liability in the SFP.

SCI

6. The staff has the following recommendations for the SCI:

(a) Present interest income and lease income arising from lease contracts separate from other income (and separate from each other) either on the face of the SCI or in the notes to the financial statements

(b) Present depreciation of leased assets separate from other depreciation expense either on the face of the SCI or in the notes to the financial statements.

SCF

7. The staff has the following recommendations for the SCF:

(a) Classify cash payments received of amounts attributable to the principal of the lease receivable as investing activities in the SCF

(b) Cash received of amounts attributable to the interest income of the lease receivable as operating activities in the SCF.

Background Information

8. In May 2009, the Boards tentatively decided that a right-of-use model would be applied to lessors under a performance obligation approach. Under this approach, the lessor would:

(a) Recognize an asset representing its right to receive rental payments (a lease receivable); and

(b) Recognize a liability representing its performance obligation under the lease—that is, its obligation to permit the lessee to use one of its assets (the leased asset). The lessor would recognize revenue as that performance obligation is satisfied over the lease term.

9. In July 2009, the Boards discussed the presentation of the lessor's leased asset, lease receivable, and performance obligation. However, no decisions were reached.

10. In October 2009, the Boards reconfirmed their support of the performance obligation approach for lessors.

Presentation (Gross or Net)

11. At initial measurement the lessor will have a lease receivable that is equal to its performance obligation. The lessor also will have the leased asset remain in its SFP. The staff considered the following approaches to address whether those items should be presented gross or net in the SFP:

    (a) Present all three items gross (the leased asset, the lease receivable, and the performance obligation).

    (b) Present the lease receivable net of the performance obligation.

    (c) Present the leased asset net of the performance obligation.

    (d) Present all three items net as a distinct item in the SFP.

Approach A–Present all three items gross

12. Approach A clearly presents each line item arising in a lease transaction separately. Separate line item presentation may allow users to better understand the gross cash flows arising from assets and liabilities in a lease contract. For example, a lessor has the ability to securitize a lease receivable arising in a lease contract. Any changes to the lease receivable, performance obligation, and underlying asset arising in a lease contract would be immediately more apparent as opposed to net presentation in which changes to the assets and liabilities balance would not be known absent additional disclosures.

13. In a lease arrangement, while the initial measurement of the lease receivable and the performance obligation would be equal, the subsequent measurement would not. The subsequent measurement of the lease receivable would be accounted for under the effective interest method, and the subsequent measurement of the performance obligation would be a reduction to the performance obligation, presumably on a straight-line basis for many leases, over the lease term. The staff plans to bring a future paper to the Boards to discuss further when and how performance obligations are satisfied in a lease contract. This could result in differences in the subsequent measurement of these items. Gross presentation of the lease receivable and the performance obligation would clearly show the changes to those balances over the lease term in the SFP.

14. The Boards have tentatively concluded that if control of the underlying asset is transferred at the end of the lease term, those contracts are not within the scope of the proposed new leases requirements. Therefore, in a lease contract the lessor *controls* the leased asset; hence, the leased asset would be presented gross in the SFP. Further, presenting the leased asset gross could allow for additional categorization of an entity's PP&E (see paragraphs 48-53).

15. It should be noted that the revenue recognition project proposes that revenue recognition should be based on a single asset or liability—an entity's contract with a customer. The combination of the rights and obligations in that contract gives rise to a (net) contract asset or a (net) contract liability. The rationale in the revenue recognition project relies on the interdependency between the contractual rights (customer consideration) and contractual obligations (performance obligations). That interdependency often means that the rights and obligations under a contract are not readily separable.

16. However, the lease receivable and the performance obligation arising in a lease contract are readily separable. In a lease contract, once the lessor has delivered the underlying asset, it has satisfied one of its performance obligations. Delivery of the underlying asset results in a lease liability for the lessee and a lease receivable for the lessor. Unlike the revenue recognition project, which has a net contract asset or liability, the leases project has a lease *receivable*. In the revenue recognition project, once a contract right becomes a receivable, it is no longer accounted for as a net contract position. That lease receivable can be readily separable from the performance obligation (for example, that lease receivable can be securitized). Therefore, Approach A would account for that lease receivable gross in the SFP.

17. As the lessor still has a remaining contractual obligation to permit the lessee to use the underlying asset and, therefore, will recognize revenue as that obligation is satisfied over the lease term, Approach A would present that performance obligation gross in the SFP as well.

18. The staff note that the problems associated with net presentation could be solved through disclosures. However, if this was the case, information about the gross

assets and liabilities would not be available at the time of the entity's press release. This issue was raised by some board members during discussions on the revenue recognition project.

19. In addition, gross presentation of the lease receivable would be symmetrical with the tentative conclusion of a gross presentation for the lessee. In the leases Discussion Paper, the obligation to pay rentals and the right-of-use asset are presented separately by the lessee in the SFP.

20. The following disadvantages are noted for Approach A:

    (a) Some would argue that gross presentation of the lease receivable and the leased asset results in double counting of the lessor's assets. This could be an argument for some form of net presentation (Approaches B, C, and D).

    (b) The carrying amount of the lessor's receivable and the underlying asset are supported by the same set of cash flows – the rentals during the lease term. Consequently, if the underlying asset is viewed in isolation, it could be argued to be impaired. Some form of net presentation (Approaches B, C, or D) would solve this problem

    (c) Gross presentation could distort performance measures, for example, resulting in a lower return on assets and a higher leverage than under the existing lessor accounting requirements.

21. Approaches B, C and D explore ways in which some of these concerns could be addressed.

Approach B - Present the lease receivable net of the performance obligation

22. Some do not like the gross-up effect on the balance sheet that results from presenting the leased asset, the lease receivable, and the performance obligation individually in the SFP.

23. Some think that the lease receivable and the performance obligation are interdependent and that the presentation of these items in the financial statements should reflect this interdependency.

24. Some may argue that Approach B is more consistent with the revenue recognition project. The revenue recognition Discussion Paper states that there is a strong interdependency between the contractual rights (customer consideration) and the contractual obligations (performance obligations), and that those rights and obligations give rise to a single asset or liability. The contract asset or contract liability reflects the entity's net position in the contract with respect to its remaining rights and obligations. However, the staff notes that the revenue recognition project nets contract *rights* against the performance obligation. Once those rights become unconditional, they are recognised separately as a receivable. Unconditional rights to receive cash (receivables) are not netted against performance obligations in the revenue recognition project.

25. Approach B still presents the underlying asset gross in the SFP because the lessor still has control of the underlying asset. Approach B combines the rights and obligations that arise in a lease contract (the lease receivable and the performance obligation) and presents the contract net. That is consistent with the current accounting for a forward contract. Under this approach the gross assets and liabilities would be disclosed in the notes to the financial statements.

26. However, as noted in paragraph 13, the net contract position would generally be nil on day 1 because, presumably, the lease receivable will equal the performance obligation. However, the net contract position will change after day one because the receivable would be subsequently accounted for under the effective interest method, and subsequent measurement of the performance obligation would be a reduction in the performance obligation as that obligation is satisfied over the lease term. Therefore, there would be a net contract liability in the early years of the lease and a net contract asset in the later years of the lease assuming the performance obligation is satisfied on a straight-line basis. The staff will bring a future paper to the Boards to discuss when performance obligations are satisfied in a lease contract.

27. The staff note the following disadvantages to Approach B:

    (a) It is unclear how a lessor would account for the net contract position if the receivable is sold to a third-party (securitized). That is, when a receivable is sold, it would be derecognized from the SFP. This calls into question how to derecognize a net contract position that includes that receivable.

(b) How to reconcile this net presentation with the lessees' gross presentation of the obligation to make rental payments.

(c) Nowhere else do we present a receivable net, unless the offset rules are met.

Approach C - Present the leased asset net of the performance obligation

28. The performance obligation represents the lessor's obligation to permit the lessee to use its owned asset. Consequently, it could be argued that the performance obligation represents a restriction on the lessee's ability to use the leased asset. Therefore, it could be argued it is appropriate to net the performance obligation against the leased asset. Under this approach the gross assets and liabilities would be disclosed in the notes to the financial statements.

29. Approach C has the following advantages:

(a) It avoids the double counting and impairment problems associated with a gross presentation.

(b) It reflects the fact that the performance obligation is linked to the leased asset. It would not be possible to sell the leased asset without either transferring the performance obligation to the purchaser or cancelling the lease contract.

(c) Unlike Approach B, the lessor's right to receive payments under the lease is presented separately, reflecting that it may be possible to dispose of this asset separately (eg through a securitization)

30. However, there are a number of disadvantages associated with Approach C:

(a) There is no precedent for allowing an entity to net a performance obligation against an owned asset.

(b) If the measurement of the performance obligation exceeds the amount of the leased asset, the lessor will recognise a negative asset balance. This will happen because the underlying asset will normally be carried at historical cost but the performance obligation will equal the customer consideration received. This has also been noted in previous discussions with the Boards as a mismatch in the measurement of the underlying leased asset and the measurement of the performance obligation. If the underlying asset were measured at fair value, this approach would make more sense. US GAAP currently has no option to fair value PP&E. While IFRS currently has the option to fair value PP&E it is generally investment properties that adopt a fair value model, and investment properties have been scoped out of the proposed new leases requirements if they are, in fact, measured at fair value.

(c) It could be argued that presenting the leased asset net would be inconsistent with presenting and accounting for the lessor's owned assets that are not leased.

Approach D - Present all three items net as a distinct item in the SFP

31. Under this approach the lessor would present the lease receivable, the performance obligation, and the leased asset net as a single item in the SFP. Under this approach the gross assets and liabilities would be disclosed in the notes to the financial statements. The advantages of this approach are as follows:

(a) It avoids the double counting and impairment problems with gross presentation

(b) It is unlikely to result in a net liability position

(c) It reflects the fact that all the elements of the lease contract are in some way interlinked.

32. Approach D has the following disadvantages:

(a) Information about the individual assets and liabilities is not presented on the face of the SFP.

(b) Similar to approach C, it is inconsistent with how one would present and account for the lessor's owned assets.

(c) It is inconsistent with the gross presentation of the lessee's assets and liabilities.

(d) Nowhere else do we present a receivable net, unless the offset rules are met.

Staff recommendation

33. A comparison of presentation under Approaches A, B, C, and D can be found in the Appendix of this paper.

34. Some staff members recommend Approach A because they think it best depicts the economics of a lease transaction. That is, the lessor still owns the leased asset and should continue to account for and present it in its financial statements, similar to other owned assets. The assets and liabilities arising from a lease contract should be reflected in the financial statements of the lessor as well. These staff think that Approach A is consistent with the revenue recognition project because the lease right will become a lease receivable. However, the lessor still has a performance obligation to permit the lessee to use the leased asset over the lease term. These staff members think that the three items should be presented separately in the SFP and identified as leased items. The notes to the financial statements could show that the underlying asset has a related lease receivable and a related performance obligation attached to it.

35. The staff members that support Approach A would not object to Approach C. That is, presenting the leased asset net of the performance obligation.

36. Some staff members recommend Approach C because it avoids the double counting and impairment problems associated with a gross presentation whilst still providing information about the lessor's leased assets and receivables. The staff members who support Approach C think that this approach is consistent with the revenue recognition project as it results in separate presentation of the lessor's receivable. They also note that information about the gross assets and liabilities would be provided through disclosures.

37. None of the staff members recommend Approaches B and D.

Question 1

Which presentation approach do the Boards support?

Presentation in the SFP

Lease Receivable

38. This section of the paper would only apply if the Boards select Approach A or Approach C in Question 1, because only those approaches recommend separate presentation of the lease receivable.

39. The staff notes three possible ways to present the lease receivable in the SFP:

    (a) Present with all other receivables

    (b) Present with all other receivables with separate disclosures regarding lease receivables

    (c) Present separately in the SFP from all other receivables as a lease receivable.

40. Some argue that lease receivables are essentially no different from other receivables of the lessor. They also argue that presenting with all other receivables would be simpler and less costly to apply.

41. Others note that separately presenting lease receivables from all other receivables would better reflect the differences between the two and would provide more useful information for users. Some would prefer separate disclosures for lease receivables (Option B), while others would prefer separate presentation in the SFP (Option C).

Staff Recommendation

42. The staff recommends Option C, to present lease receivables separately from other receivables in the SFP, for the following reasons:

    (a) It provides users of financial statements with information that is important in understanding the lessor's lease arrangements.

(b) It differentiates contractual receivables from lease receivables, which may include amounts receivable in an optional period or under contingent rental arrangements.

(c) It is consistent with the disaggregation principle in the FSP project

Performance Obligation

43. This section of the paper would only apply if the Boards select Approach A in Question 1, because that is the only approach that recommends separate presentation of the performance obligation.

44. The staff notes three possible ways to present the performance obligation in the SFP:

(a) Present with all other performance obligations

(b) Present with all other performance obligations with separate disclosures regarding lease performance obligations

(c) Present separately in the SFP from all other performance obligations as a lease performance obligation.

45. The staff acknowledges that performance obligations are not currently presented in the SFP. However, in accordance with the proposed revenue recognition model, performance obligations would be recognized in the SFP upon completion of that project.

46. Similar to the lease receivables discussed in paragraphs 38-42, the staff notes that separately presenting lease performance obligations from all other performance obligations would better reflect the differences between them and would provide more useful information for users.

Staff Recommendation

47. The staff recommends Option C, to present lease performance obligations separately from all other performance obligations in the SFP because Option C appropriately differentiates between the two.

Leased Asset

48. This section of the paper would only apply if the Boards select Approach A or Approach B in Question 1, because only those approaches recommend separate presentation of the leased asset.

49. The staff notes three possible ways to present the underlying leased asset in the SFP:

    (a) Present with all other owned assets.

    (b) Present with all other owned assets with disclosures regarding leased assets.

    (c) Present separately in the SFP from all other owned assets as leased assets.

50. Some argue that because the asset is still owned by the lessor, there are no differences between the leased asset and all other owned assets. The lessor maintains control of the leased asset at the end of the lease term and still has the ability to sell the underlying asset.

51. Others argue that although the leased asset is still owned by the lessor, some restrictions (ability to use) are imposed by the lease contract, which make these leased assets different from other owned assets. Separately identifying leased assets from other owned assets would provide useful information to users. That could be done in the form of additional disclosures (Option B) or by presenting the leased asset separately on the face of the SFP (Option C).

52. Others may not support that there are now restrictions on the leased asset, but they would support the fact that the leased asset is not similar to an owned asset and that it should be presented separately to differentiate between leased and the owned assets.

Staff Recommendation

53. The staff recommends Option C; to present leased assets separately from all other owned assets in the SFP to differentiate leased assets from owned assets because Option C would appropriately differentiate between the two.

Net Presentation

54. If the Boards were to select Approaches B, C, or D in Question 1, they would need to decide how to present the net asset or net liability.

55. In general, Approach B would result in a net liability in the early years of the lease and a net asset in the later years of the lease due to the differences in the subsequent measurement of the lease receivable and the performance obligation as described in paragraph 26.

56. Approach C could result in a net asset or net liability. A net liability would arise if the present value of the lease payments exceeds the carrying amount of the underlying asset. This is most likely to happen for long lived assets that are subject to more than one lease. This is because of the measurement differences between the leased asset and the performance obligation as explained in paragraph 30 (b).

57. In general, Approach D would result in a net asset because of the measurement of two assets and one liability.

Staff Recommendation

58. The staff recommends that the net asset or net liability position under either Approach B, C, or D be presented separately in the SFP apart from other assets and liabilities and be separately labeled as a net lease asset or a net lease liability. Disclosures in the notes to the financial statements would provide the specific details of the gross asset and liability balances that were used to create the net lease asset or liability.

Presentation in the SCI

Components of the Statement of Comprehensive Income

59. As currently proposed, in a lease arrangement, the lessor would subsequently measure its lease receivable at amortized cost using the effective interest method. Therefore, at each period, the SCI would have a portion of the cash payments received reflected as interest income.

60. In addition, the lessor would subsequently measure its performance obligation to reflect decreases in the obligation to permit the lessee to use the leased asset over the lease term. Therefore, at each period the SCI would report lease income as the performance obligation is satisfied over the lease term.

61. Further, the underlying leased asset would remain in the lessor's SFP. As a result, a charge to income should be recorded in each period representing the depreciation attributable to the leased asset. The method of depreciation should not be affected by the lease. In fact, the accounting for the leased asset should be no different than the accounting for other PP&E. The leases project is not addressing the accounting for PP&E; rather, the leases project is addressing the accounting for a lease contract. However, there may be some separate presentation or disclosure issues related to leases of PP&E.

62. As such, the staff notes that a lease arrangement will result in recognition of the following in the SCI:

    (a) Interest income attributable to the interest component of lease payments received.

    (b) Lease income attributable to the satisfaction of the performance obligation.

    (c) Depreciation expense attributable to the underlying leased asset.

Presentation in the Comprehensive Income Statement

63. The staff thinks that presentation in the SFP of the lease receivable, the performance obligation, and the underlying leased asset, arising in a lease contract should determine the presentation in the SCI.

64. The separate presentation highlights to financial statement users lease income and interest income that relate to lease contracts.

65. In addition, the staff notes that assets that are under lease are different from other owned assets, and therefore it is important to distinguish depreciation expense on assets that are leased from depreciation expense on other owned assets.

Staff Recommendation

66. The staff recommends that all line items in the SCI attributable to a lease arrangement should be presented separately and should be distinguishable from similar comprehensive income components attributable to assets that are not under lease. The staff would support the separate presentation either in the SCI or in the notes to the financial statements. If the Boards were to decide on a net presentation in the SFP, then the staff would support a net presentation in the SCI with separate presentation in the notes to the financial statements.

Presentation in the SCF

67. Under the proposed lessor accounting model, the lessor is viewed as providing a loan to the lessee in exchange for the right to use the lessor's underlying asset. Rental payments received by the lessor under this model include both (a) interest income components and (b) repayments of principal on the receivable. Requiring cash flows from interest received to be separated from the repayments of principal would be consistent with existing cash flow guidance.

68. Both the guidance in IAS 7, *Statement of Cash Flows*, and the guidance on the statement of cash flows in Topic 230 require cash flows to be classified as operating, investing, or financing. Under both sets of guidance, cash received from the repayment of loans made to other parties is classified as investing activities.

69. IAS 7 permits interest received to be classified as operating, investing, or financing. However, the guidance in Topic 230 requires interest received to be classified as an operating cash flow if an indirect method is used.

Staff Recommendation

70. The staff recommends, consistent with the current SCF guidance, the cash payments received that are attributable to the principal repayment of the lease receivable should be classified as investing activities.

71. The staff also recommends, consistent with the current SCF guidance, the cash payments received that are attributable to the interest income components of the lease receivable should be classified as operating activities.

Question 2

The staff recommends that a lessor present:

a. lease receivables separately from all other receivables in the SFP (if lease receivable are presented gross)

b. lease performance obligations separately from all other performance obligations in the SFP (if performance obligations are presented gross)

c. leased assets separately from all other owned assets in the SFP (if leased assets are presented gross)

d. interest income, lease income, and depreciation expense arising from leases separately from similar comprehensive income components attributable to assets that are not under lease, either in the SCI or in the notes to the financial statements

e. cash received of amounts attributable to the principal of the lease receivable as investing activities; and

f. cash received of amounts attributable to the interest income of the lease receivable as operating activities.

Do the Boards agree?

Consideration of the Boards' Tentative Decisions in the FSP Project

72. In October 2008, the Boards published a joint Discussion Paper, *Preliminary Views on Financial Statement Presentation* (FSP). Currently, the Boards are reconsidering their proposals in the FSP project and looking to publish an Exposure Draft in April 2010.

73. As currently proposed, the SFP, the SCI, and the SCF will each have two main sections—business and financing. At the October 2009 joint meeting, the Boards tentatively decided that the **business section** of the financial statements should have two defined categories—operating and investing. Assets and liabilities that are part of a reporting entity's day-to-day business activities (and the business activity generates revenue through a process that requires the interrelated use of

the net resources of the entity) should be presented in the operating category. The investing category includes business activities that generate non-revenue income (and no significant synergies are created from combining assets).

74. At the December 2009 joint meeting, the Boards tentatively decided:

(a) To require an entity to apply the cohesiveness principle at the category level in the SFP, the SCI, and the SCF

(b) To indicate that, generally, an entity would classify items in the financial statements by reference to how the related assets and liabilities are classified on the SFP

(c) To add a subcategory to the operating category in the SFP and the SCI labeled *financing arising from operating activities.*

75. At the February 2010 joint meeting, the Boards tentatively defined the financing arising from operating activities subcategory to include items:

(a) That do not meet the definition of *financing* (i.e., the financing section shall include items that are part of a reporting entity's activities to obtain [or repay] capital),

(b) That are initially long term, and

(c) That have a time value of money component that is evidenced by either interest or an accretion of the liability due to the passage of time.

76. Several respondents to the leases Discussion Paper stated that the Boards' presentation decisions in leases should be consistent with the FSP project.

77. The staff discussed the proposed observations with members of the FSP project team, who agreed with the staff observations.

Presentation of Lessor Components in the Three Primary Financial Statements

Lease receivable

78. Under the proposed FSP model, if presented gross, the lessor's lease receivable would be considered a business asset, and thus would be presented in the business section of the SFP. Based on the proposed definitions within the FSP project, the

staff thinks that within the business section of the SFP, the lease receivable would be categorized as an operating asset.

79. Applying the cohesiveness principle at the category level would result in the classification of the interest component of the rental payments being categorized in operating income within the SCI.

Performance obligation

80. Under the proposed FSP model, the lessor's performance obligation, if presented gross, also would be presented in the business section of the SFP. The staff thinks that within the business section of the SFP, the performance obligation would further be categorized as an operating liability. The performance obligation would not be presented in the subcategory of financing arising from operating because it does not have interest or accretion due to the passage of time.

81. Similar to the lease receivable, the application of the cohesiveness principle at the category level would result in the classification of the lease income component (the satisfaction of the performance obligation) being categorized in operating income within the SCI.

Statement of cash flows

82. In accordance with the cohesiveness principle at the category level, all cash inflows (both principal and income components) from rental payments received by the lessor should be presented in an operating category in the SCF (investing for investment properties under IFRS).

Staff Observations

83. The staff has made the following observations on the presentation classification of lease contracts in accordance with the proposals in the FSP project:

(a) The lease receivable in the operating category of the business section of the SFP;

(b) The interest income on the lease receivable in the operating category of the business section in the SCI;

(c) The performance obligation in the operating category of the business section of the SFP;

(d) The lease income from the performance obligation as an operating expense in the SCI;

(e) Cash rental payments received in the operating category of the business section in the SCF.

Question 3
The staff observes that the presentation of leases should be consistent with the proposed presentation model in the FSP project. Do the Boards agree with the staff's observations?

Appendix 1

Comparisons of presentation under approaches A, B, C, and D

A1. The following simplified example of a lease of a machine is used to further illustrate the presentation differences between approaches A, B, C, and D. Several simplifying assumptions were made regarding initial and subsequent measurement.

Example 1

A machine is leased for a fixed term of 5 years; the expected life of the machine is 10 years. The lease is non-cancellable, and there are no rights to extend the lease term or to purchase the machine at the end of the term and no guarantees of its value at that point. Lease payments are due at regular intervals over the lease term after the machine has been delivered; these are fixed amounts that are specified in the original agreement. No maintenance or other arrangements are entered into.

- Equipment with an original equipment cost and fair value of a currency unit (CU) of 10,000 is in the lessor's financial statements.
- Salvage value of CU1,000
- Lease term = five years, commencing January 1, 2010, with no renewal options.
- Five annual payments due in arrears (at December 31) of CU2,474 (total payments = CU12,370). Payments are made as scheduled (not delinquent).
- Present value of rental payments at the beginning of the lease = CU9,378.
- Interest component of rental payments = CU12,370 – CU9,378 = CU2,992 .
- The rate the lessee is charging the lessor is 10 percent.

Simplifying Assumptions:

- The obligation to allow the lessee to use the leased asset would be satisfied, and recognized as rental income, on a straight-line basis over the lease term.

Approach A-Gross Presentation

(all amounts in CU)

Line Item	1-Jan-10	Change	31-Dec-10	Change	31-Dec-14
Leased asset, net of accumulated depreciation	10,000	(900)	9,100	(3,600)	5,500
Lease receivable	9,378	(1,536)	7,842	(7,842)	-
Total assets	19,378	(2,436)	16,942	(11,442)	5,500
Performance obligation	(9,378)	1,875	(7,503)	7,503	-
Total liabilities	(9,378)	1,875	(7,503)	7,503	-
Net assets	10,000	(561)	9,439	(3,939)	5,500
Interest income	-	938	938	2,054	2,992
Performance of lease obligation	-	1,875	1,875	7,503	9,378
Total revenues	**-**	2,813	2,813	9,557	12,370
Depreciation expense	-	(900)	(900)	(3,600)	(4,500)
Net income	**-**	1,913	1,913	5,957	7,870

Approach B-Lease Receivable Presented Net of the Performance Obligation

(all amounts in CU)

Line Item	1-Jan-10	Change	31-Dec-10	Change	31-Dec-14
Leased asset, net of accumulated depreciation	10,000	(900)	9,100	(3,600)	5,500
Lease receivable	9,378	(1,536)	7,842	(7,842)	-
Performance obligation	(9,378)	1,875	(7,503)	7,503	-
Net contract	-	339	339	(339)	-
Total assets	10,000	(561)	9,439	(3,939)	5,500
Total liabilities	-	-	-	-	-
Net assets	10,000	(561)	9,439	(3,939)	5,500
Interest income	-	938	938	2,054	2,992
Performance of lease obligation	-	1,875	1,875	7,503	9,378
Total revenues	-	2,813	2,813	9,557	12,370
Depreciation expense	-	(900)	(900)	(3,600)	(4,500)
Net income	-	1,913	1,913	5,957	7,870

Approach C-Leased Asset Presented Net of the Performance Obligation

(all amounts in CU)

	1-Jan-10	Change	**31-Dec-10**	Change	**31-Dec-14**
Leased asset, net of accumulated depreciation	10,000	(900)	9,100	(3,600)	5,500
Performance obligation	(9,378)	1,875	(7,503)	7,503	-
Net leased asset	622	975	1,597	3,903	5,500
Lease receivable	9,378	(1,536)	7,842	(7,842)	-
Total assets	10,000	(561)	9,439	(3,939)	5,500
Total liabilities	-	-	-	-	-
Net assets	10,000	(561)	9,439	(3,939)	5,500
Interest income	-	938	938	2,054	2,992
Performance of lease obligation	-	1,875	1,875	7,503	9,378
Total revenues	-	2,813	2,813	9,557	12,370
Depreciation expense	-	(900)	(900)	(3,600)	(4,500)
Net income	-	1,913	1,913	5,957	7,870

Approach D- Show all three items net as a distinct item in the SFP

(all amounts in CU)

	1-Jan-10	Change	**31-Dec-10**	Change	**31-Dec-14**
Leased asset, net of accumulated depreciation	10,000	(900)	9,100	(3,600)	5,500
Performance obligation	(9,378)	1,875	(7,503)	7,503	-
Lease receivable	9,378	(1,536)	7,842	(7,842)	-
Net leased asset	10,000	(561)	9,439	(3,939)	5,500
Total assets	10,000	(561)	9,439	(3,939)	5,500
Total liabilities	-	-	-	-	-
Net assets	10,000	(561)	9,439	(3,940)	5,500
Interest income	-	938	938	2,054	2,992
Performance of lease obligation	-	1,875	1,875	7,503	9,378
Total revenues	-	2,813	2,813	9,557	12,370
Depreciation expense	-	(900)	(900)	(3,600)	(4,500)
Net income	-	1,913	1,913	5,957	7,870

Journal Entries

(Note: the journal entries would essentially remain unchanged for each of the four approaches; it is just a matter of presentation.)

January 1, 2010

DR: Lease Receivable	9,378	
CR: Lease Obligation		9,378

December 31, 2010

DR: Cash	2,474	
CR: Lease Receivable		1,536
CR: Interest Income		938
DR: Depreciation Expense	900	
CR: Accumulated Depreciation		900
DR: Lease Obligation	1,875	
CR: Lease Revenue		1,875

Cumulative Entries 2011–2014

DR: Cash	9,896	
CR: Lease Receivable		7,842
CR: Interest Income		2,054
DR: Depreciation Expense	3,600	
CR: Accumulated Depreciation		3,600
DR: Lease Obligation	7,503	
CR: Lease Revenue		7,503