Project **Leases**

Topic **Derecognition model - Presentation**

Purpose

1. The purpose of this paper is to discuss how a lessor's assets, liabilities, revenues and expenses arising from a lease contract should be presented in the financial statements under a derecognition approach to lessor accounting.

Structure of the paper

2. The structure of the paper is as follows:
   (a) background information
   (b) presentation of lease receivable in the statement of financial position (SFP)
   (c) presentation of residual asset in the SFP
   (d) presentation in the statement of comprehensive income (SCI)
   (e) presentation under a sublease
   (f) staff recommendation.

Background

3. For presentation, the boards tentatively decided that:

   For Lessees

(a) A lessee would present separately its obligation to pay rentals from other financial liabilities on the face of the statement of financial position.

(b) A lessee would present its right-of-use asset with property, plant, and equipment, but separately from other assets that are owned but not leased, on the face of the statement of financial position.

(c) Both amortisation and interest expense arising in lease contracts would be separated from other amortization expense and other interest expense either on the face of the statement of comprehensive income or in the notes of financial statements.

For Lessors (under the performance obligation approach)

(a) The lessor would present the leased asset, the lease receivable, and the performance obligation separately in the statement of financial position totalling to a net lease asset or a net lease liability.

(b) The IASB tentatively decided that interest income, lease income, and depreciation expense would be presented separately in the statement of comprehensive income. The FASB tentatively decided that interest income, lease income, and depreciation expense would be presented separately in the statement of comprehensive income totalling to a net lease income or net lease expense.

Presentation of lease receivable in the statement of financial position

4. The staff note three possible approaches to presenting the lease receivable in the SFP under a derecognition approach:

(a) Present with all other receivables

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

(c) Present separately in the SFP from all other receivables.

5. Some would argue that lease receivables are no different from other receivables of the lessor and presenting with all other receivables would be simpler to apply than separate presentation.

6. However, it can be argued that separately presenting lease receivables from all other receivables would better reflect the difference between the two and would provide more useful information to users.

Staff Recommendation

7. The staff recommend presenting lease receivables separately from other receivables in the SFP because it would provide users with information that is important in understanding the lessor's lease arrangements (consistent with the disaggregation principle in the FSP project).

8. This is consistent with the boards' tentative decision under a performance obligation approach. The staff see no reason for a different conclusion for the presentation of the lease receivable under a derecognition approach.

Presentation of residual asset in the statement of financial position

Gross or net

9. The boards tentatively decided to require a form of linked presentation under the performance obligation approach to lessor accounting for the following reasons:

    (a) to better reflect the linkage between the underlying asset, the receivable and the performance obligation; and

    (b) to address the issue of grossing up of the statement of financial position under the performance obligation approach.

10. No performance obligation is recognised under the derecognition approach to lessor accounting. Consequently, the issue of gross or net presentation does not arise.

Residual asset under a derecognition approach

11. Under the derecognition approach, the lessor is viewed as having transferred a portion or all of the leased asset to the lessee in exchange for a right to receive payments over the lease term. Therefore, the lessor derecognises the leased asset (or a portion of the leased asset) because it no longer controls the right to use that asset during the lease term. However, the lessor continues to recognise those rights that have not been transferred to the lessee (the residual value asset - a non-financial asset).

12. The staff think that because the residual asset represents the lessor's interest in the retained underlying asset at the end of the lease term (which is property, plant and equipment), the lessor should classify the residual asset as property, plant and equipment and present it as such.

13. Also, IAS 1 *Presentation of Financial Statements* states that an entity shall present additional line items, headings and subtotals in the statement of financial position and in the statement of comprehensive income when such presentation is relevant to an understanding of the entity's financial position and financial performance, respectively.

14. Therefore, the staff think that the lessor should present the residual asset as a separate line item (may be called lease residual asset) with property, plant and equipment because:

    (a) It is different from some other property, plant and equipment owned by the lessor;

    (b) It has a different risk profile from other property, plant and equipment and may be measured differently (consistent with the disaggregation principle in the FSP project); and

    (c) It is consistent with presenting the lease receivable separately, and thus providing transparency.

15. Further, the staff think that the residual asset should be broken down by class of asset in the notes to the financial statements to provide users with information about the nature of the underlying asset.

Staff recommendation

16. The staff recommend that an entity should be required to present the residual asset with property, plant and equipment, but separately from other assets that are owned but not leased, on the face of the statement of financial position with disclosure by class of asset. The staff think that this presentation provides users with relevant information that is important to understand that the residual asset is different from an owned asset.

Presentation in the statement of comprehensive Income

17. Under the performance obligation approach, the FASB tentatively decided that interest income, lease income, and depreciation expense would be presented separately in the statement of comprehensive income totalling to a net lease income or net lease expense.

18. The staff note that no performance obligation and thus related lease income are recognised under the derecognition approach to lessor accounting. Consequently, the issue of net presentation does not arise.

19. In addition, consistent with the staff recommendation to present separately the lease receivable and the residual asset on the SFP, the staff think that related interest income and depreciation expense should be presented separately in the statement of comprehensive income without a net total.

Revenue and cost of sales under a derecognition approach

20. Under the derecognition approach, the lessor is viewed as having transferred a portion or all of the leased asset to the lessee in exchange for a right to receive payments over the lease term. Therefore, the exchange results in the lessor derecognising a portion or all of the leased asset and recognising revenue and cost of sales.

21. The question is how to present revenue and cost of sales, either gross or net, in the statement of comprehensive income.

Staff analysis and recommendation

22. The staff think that gross presentation provides better information than net presentation, particularly for manufacturer/dealers who use a lease as an alternative means of marketing their products.

23. However, it can be argued that because the revenue and the cost of sales arising from a lease contract are interdependent, the presentation of these items in the SCI should reflect the interdependency.

24. Some would also argue for net presentation for all leases other than for manufacturer/dealers. In fact, as seen in the staff's direct finance lease example, many lease contracts result in no net profit and thus it could be argued that presenting revenue and cost of sales gross unnecessarily grosses up the SCI.

25. However, the staff note that requiring net presentation other than manufacturer/dealers would introduce complexity to the new leases requirements as the boards would need to define/classify manufacturer/dealers.

26. Leasing is usually the lessor's main business activity, and therefore the revenues and cost of sales under a lease contract should be presented as part of its main business. Therefore, the staff think that gross presentation would provide users with comparable information for all leases that is important to understand the lessor's overall financial performance.

Presentation under a sublease

27. Under a sublease arrangement, the intermediate lessor's right-of-use asset becomes the underlying asset (the residual asset).

28. Consistent with the boards' tentative decision on presenting the right-of-use asset separately with PP&E and the staff recommendation, the intermediate lessor would present its residual asset separately with PP&E in the SFP as illustrated below.

Assets
  Receivables
  Lease receivables

Total receivables

PPE
Lease residual asset
Lease residual asset (right-of-use asset)
Total PPE

Liabilities
Obligation to pay rentals
Total liabilities

Question 1

The staff recommend:

a) presenting lease receivables separately from other receivables in the SFP;

b) presenting lease residual asset separately with property, plant and equipment in the SFP and disclosing by class of asset; and

c) presenting revenue and cost of sales arising from a lease contract, gross in the SCI.

Do the boards agree?