IASB/FASB Meeting
Week commencing 11 April, 2011

IASB Agenda reference **1I**

FASB Agenda reference **163**

Staff Paper

Project **Leases**

Topic **Lessor Accounting – Other-than-finance leases**

Objective

1. The objective of this paper is to analyze initial and subsequent recognition and measurement and presentation by lessors for other-than-finance leases. All of the approaches in this paper reflect a view that the lessor has key elements in the arrangement to perform throughout the lease term despite the lessor providing the lessee with the right to use the underlying asset at lease commencement, and therefore, income is recognized over the lease term.

2. This paper should be read with the series of papers on this topic and follows from the discussion in:

   (a) Agenda paper 1F / FASB Memo 160 – Types of Leases – Is more than one accounting approach necessary?

   (b) Agenda paper 1G / FASB Memo 161 – Determining a lease to be a finance lease or an other-than-finance lease.

3. The structure of the paper is as follows:

   (a) Staff recommendations

   (b) Summary of proposals in ED

   (c) Feedback received

   (d) Staff analysis

      (i) Topic I – Statement of Financial Position (SFP) Initial Recognition & Measurement and Presentation

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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.

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(ii) Topic II – Subsequent Accounting – SFP and Income Statement

(iii) Topic III – Impairment considerations

(iv) Appendix A – Illustrative examples

Staff Recommendations

4. Some staff members support Approach 2 whereby a lessor accounts for other-than-finance leases as follows:

   (a) The lessor should recognize a lease receivable, measured as the present value of lease payments, and a lease contract liability at lease commencement. The lease receivable and lease contract liability would be presented on a net basis on the SFP and on a gross basis in disclosures. The lessor would not derecognize the underlying asset and would present it separately from other property, plant, and equipment.

   (b) The subsequent accounting for the lease receivable and lease contract liability would be consistent with the approach proposed in Agenda Paper 1H / FASB Memo 162 Lessee Accounting – other-than-finance leases.

   (c) The total lease income would be recognized over the lease term consistent with the pattern of benefits, typically on a straight-line basis.

   (d) The income recognized by a lessor should be presented as a single line item within operating income (for example, lease income).

   (e) Further guidance would need to be developed regarding the recognition and measurement of impairment of a lessor's assets if other-than-finance leases are accounted for under this alternative approach.

5. Some staff members recommend that, for a lessor in an other-than-finance lease transaction, the lessor account for the lease contract consistent with current guidance for operating leases. That is, rental income would be

recognized on an accrual basis and the underlying asset would remain on the SFP, presented separately from other property, plant, and equipment. Lease assets or liabilities would only be recognized to the extent the pattern of cash payments does not equal the pattern of benefits provided.

Summary of proposals in ED

6. The ED proposes that, if a lessor retains exposure to significant risks or benefits associated with an underlying asset, the lessor should apply the performance obligation approach.

7. When applying the performance obligation approach, at the date of inception of the lease, a lessor should measure:

   (a) The right to receive lease payments at the sum of the present value of the lease payments, discounted using the rate the lessor charges the lessee, and any initial direct costs incurred by the lessor.

   (b) The lease liability at the present value of the lease payments, discounted using the rate the lessor charges the lessee.

8. After the date of commencement of the lease, under the performance obligation approach, a lessor should:

   (a) Measure the right to receive lease payments at amortized cost using the interest method.

   (b) Measure the remaining lease liability determined on the basis of the pattern of use of the underlying asset by the lessee. If the lessor cannot reliably determine the remaining lease liability in a systematic and rational manner on the basis of the pattern of use of the underlying asset by the lessee, it should use the straight-line method.

   (c) Present in profit or loss interest income on a right to receive lease payments, lease income resulting from satisfaction of a lease liability and depreciation expense on an underlying asset separately from other interest income and depreciation expense.

9. A lessor under the performance obligation approach should present the following items together in the SFP:

    (a) Underlying assets

    (b) Rights to receive lease payments

    (c) Lease liabilities

    (d) The total of (a) – (c) as a net lease asset or a net lease liability.

10. A lessor under the performance obligation approach should apply Topic 310 or IAS 39 at each reporting date to determine whether the right to receive lease payments is impaired and should recognize any impairment loss in profit or loss.

Feedback Received

Comment letter feedback – lessor accounting

11. The majority of the respondents that commented on the lessor model proposed in the ED disagreed with the proposed lessor model, which requires the application of the derecognition approach or performance obligation approach. Some of those respondents clearly stated whether they supported the following:

    (a) Derecognition approach for all leases

    (b) Performance obligation approach for all leases

    (c) Retain current accounting for capital/finance and operating leases.

12. Among these respondents, there was a strong preference for applying the derecognition approach to all leases; this preference was especially pronounced with IFRS constituents. Other respondents also supported current accounting. Very few respondents advocated applying the performance obligation approach to all leases.

13. Many constituents stated that they thought the lessor accounting proposed in the ED is less developed than the lessee accounting model. Some constituents have urged the Boards to perform additional field testing of the new proposals prior

to finalizing the leases guidance. In addition, the following concerns have been raised in our outreach activities:

(a) Is the current lessor model under Topic 840, Leases/IAS 17, *Leases,* "broken"? Additionally, can adjustments be made to the current guidance rather than creating a new model for lessor accounting?

(b) Are the lessor accounting proposals in the ED considered to be an improvement to current financial reporting?

> The current IAS 17 accounting model for lessors is conceptually sound and results in information that is useful and understandable for decision making purposes (CL #181).

14. Many have pointed out the fact that lessor accounting is inseparable from revenue recognition and, therefore, if changes are made to the present model for lessor accounting they should be fully aligned with the revenue recognition proposals that are currently being redeliberated.

15. Many operating lessors think that the economics of their lease arrangements are not the sale of a right-of-use asset that is financed. Those lessors disagree with the provisions of the ED that require the presentation of interest on the lease receivable as interest income. They would prefer to present only rental income or lease income in the profit/loss statement. Many of those lessors also think that the profit/loss statement should reflect straight-line revenue, excluding the effects of variable lease payments, throughout the lease term.

Comment letter feedback – performance obligation approach

16. Most constituents that support the performance obligation (PO) approach for all leases think that the transfer of the right-of-use asset is a continuous transfer of benefit over the lease term. However, those that do not support the PO approach think the lessor has yet to fulfill its obligation at lease commencement and thus should not record a receivable.

17. Some respondents view the PO approach as a "grossing up" of the balance sheet for the assets by including recognition of both the underlying asset and the lease receivable.

18. Some respondents noted concerns about the impairment of the lease receivable under the performance obligation approach. Those respondents think that the ED does not adequately discuss this issue.

> Should the Boards retain the performance obligation approach, further clarification needs to be provided with respect to the interaction between the impairment assessment of the right to receive lease payments (i.e. lease receivable) and the unamortised performance obligation (CL #142).

Targeted outreach during March and April 2011

19. In response to the comment letter feedback received, in February 2011 the Boards discussed whether there are two different types of leases with different profit and loss effects:

    (a) a finance lease with a profit or loss recognition pattern consistent with the proposals in the ED, and

    (b) an other-than-finance lease with a profit or loss recognition pattern on a straight-line basis.

20. The Boards asked the staff to perform further outreach regarding two types of leases. Agenda Paper 1F/Memo 160 discusses the feedback received about two types of leases.

Preparer Feedback

21. Preparers gave the following feedback on a lessor in an other-than-finance lease:

    (a) Most preparers think that the straight-line profit and loss pattern under existing operating leases guidance is more appropriate than the financing profile proposed in the ED for some types of leases, especially those in which the variability elements of lease payments are recognized on an ‘as incurred’ basis.

    (b) Most preparers also think that if there is a straight-line income pattern on the income statement, it should be one line item in operating income such as rental income.

    (c) Some preparers think there is no financing element in an other-than-finance lease transaction and so there should not be an interest income

component. However, there were some preparers that noted that, although it can be relatively small, there is a financing component in every lease.

(d) Those respondents supporting a straight-line income pattern asked how it would be achieved.

User Feedback

22. Most users agreed that, for a lessor in an other-than finance lease, there should be a straight-line pattern of income recognition on the income statement and there should be only one line item in operating income. One user suggested that if there is one line item in operating income that represents income from leases, then there should be disclosure that disaggregates the rental income between a financing component and a nonfinancing component. Most users noted that the straight-line pattern of income recognition is more practical and reflective of the economics of other-than-finance leases.

Topic I – Initial Recognition & Measurement and Presentation

Possible approaches

23. The staff has analyzed three approaches to the initial recognition and measurement and presentation for lessors in an other-than-finance lease. Topic II of this paper discusses the subsequent accounting including the SFP and income statement effects.

(a) **Approach 1 (Per the ED – gross presentation)**: The lessor would recognize a lease receivable and a lease contract liability at initial recognition. The lessor would present these items together with the underlying asset gross on the SFP, with a subtotal for the net lease asset. This approach is consistent with the proposals in the ED.

(b) **Approach 2 (ED amended to net presentation)**: The lessor would recognize a lease receivable and a lease contract liability at initial recognition. The lessor would present the lease receivable net of the lease contract liability on the SFP. The gross amounts of the lease

receivable and lease contract liability would be disclosed in the footnotes. The underlying asset would be presented separately from other property, plant, and equipment on the SFP.

(c) **Approach 3 (Current operating lease accounting)**: The lessor would not recognize a lease receivable or a lease contract liability at initial recognition. The lessor would recognize a lease receivable only when it performs under the terms of the lease (which is over the lease term). The underlying asset would be presented separately from other property, plant, and equipment on the SFP. This approach is consistent with operating lease treatment under IAS 17 and Topic 840.

Approach 1: Recognize a lease receivable and a lease contract liability and present gross

24. Under Approach 1, the lessor recognizes a lease receivable and presents that receivable on the balance sheet, along with the lease contract liability and the underlying leased asset, with those three items subtotaling to a net lease asset. This is the approach in the ED for lessors applying the performance obligation approach.

Arguments for Approach 1

25. The presentation of a separate lease receivable on the SFP is consistent with the lessee's presentation of its lease obligation as a liability on its SFP.

26. Approach 1 clearly presents each line item arising in a lease transaction separately. Separate line item presentation allows 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, lease contract liability, and underlying asset arising in a lease contract would be immediately more apparent as opposed to net presentation in which changes to the balance of the assets and liabilities would not be known absent additional disclosures.

27. Further, information about the assets and liabilities would be available at the time of the entity's press release, giving users transparency regarding the

amount of lease contracts that exist at the end of a reporting period. That observation was raised by some Board members during discussions on the revenue recognition project.

28. Approach 1 clearly depicts the extent to which the underlying leased asset is restricted by the lease contract liability because:

    (a) The lease contract liability is also presented on a gross basis.

    (b) The lease contract liability is presented along with the receivable and the underlying asset, with a subtotal for the net balances of those three figures.

Arguments against Approach 1

29. Some think that after lease commencement the lessor still has a remaining contractual obligation to permit the lessee to use the underlying asset and, therefore, should recognize revenue as that obligation is satisfied over the lease term. Although this is achieved under Approach 1, some argue that a receivable should not be separately recognized and presented at lease commencement because the lessor does not have an unconditional right to the future lease rentals. For instance, in revenue recognition, an entity typically would recognize a separate receivable after it has satisfied a performance obligation. The remaining (unperformed) rights and performance obligations in the contract would be recognized as a single (net) contract asset or contract liability.

30. Some argue that gross presentation of the lease receivable and the leased asset results in double counting of the lessor's assets. That has two consequences:

    (a) That could be an argument for some form of net presentation (Approach 2).

    (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. Additional impairment considerations are discussed in Topic III in this memorandum.

Approach 2: Recognize a lease receivable and lease contract liability but present lease receivable net of lease contract liability

31. Under Approach 2, the lease receivable and lease contract liability would be measured consistently with Approach 1 (ED approach), but the lessor would present the lease receivable net of the lease contract liability on the SFP. The underlying asset would be presented separately from other property, plant, and equipment on the SFP.

32. At initial recognition, assuming there are no initial payments of cash to/from the lessor, the lessor's net contract position would be zero. For instance:

    (a) The lessor has an underlying asset with a carrying value of CU10.

    (b) The lessor leases the asset and records a receivable of CU4, the present value of lease payments, assuming that there are no initial direct costs. The lessor records a corresponding lease contract liability of CU4, which is presented net of the receivable balance.

    (c) The lessor presents only the CU10 underlying asset on its SFP, because the net lease contract position is zero.

    (d) Note that, in this fact pattern, the SFP would be the same under Approach 2 and Approach 3, discussed below and consistent with current operating lease accounting, at lease commencement.

33. Subsequently, the net contract would be zero assuming both of the following:

    (a) the pattern of lease payments and the pattern of economic benefit provided to the lessee are equivalent throughout the lease term.

    (b) the pattern of income would result in the lease contract liability being amortized at the same rate as the lease receivable. See Topic II below for further detail regarding subsequent measurement.

34. However, if there are uneven lease payments and/or the pattern of economic benefit is not even throughout the lease term, the lessor would recognize a lease contract asset or lease contract liability.

35. Under this approach, the lease receivables and lease contract liabilities, determined on a lease-by-lease basis under the same measurement required by

the ED, would be disclosed on a gross basis in the notes to the financial statements. For instance:

(a) A lessor has two 7-year leases (see Appendix A for illustrations):

(i) In the first lease, the lessor grants the lessee rent holidays in earlier periods (discounted rentals for a first year) as an incentive to enter into the lease. At the end of year 3, the lessor has a CU49,902 receivable and a CU34,651 liability, for a net contract asset of CU15,251. See Example B in Appendix A.

(ii) In the second lease, the lessor accepts a substantial down payment from the lessee and reduces future rentals. At the end of year 3, the lessor has a CU24,081 receivable and a CU34,651 liability, for a net contract liability of CU10,570. See Example C in Appendix A.

(iii) The net asset position in the first lease is created by rent holidays granted to the lessee in the first two years. The net liability position in the second lease is the result of an upfront down payment by the lessee for a portion of the rentals. In both leases, if the payments were instead even throughout the lease term, the net contract positions would both be zero. See Example A in Appendix A.

(b) On its SFP at the end of year 3, the lessor would show net lease contract assets of CU15,251 for the first lease and net lease liabilities of CU10,570 for the second lease.

(c) In its lease disclosures, the lessor would disclose total lease receivables for both leases of CU73,983 (CU49,902 + CU24,081) and total lease contract liabilities for both leases of CU69,302 (CU34,651 + CU34,651).

Arguments for Approach 2

36. It is important to note that, under Approach 2, a right exists even though the net contract position is zero at inception. Approach 2, consistent with Approach 1 but in contrast to Approach 3, recognizes that the lessor has a right

to receive lease payments. This is symmetrical with lessee accounting; the lessor's right to receive lease payments should be recorded on the lessor's books because the right-of-use asset has been delivered to the lessee which results in the recognition of the lessee's liability to make lease payments.

37. Approach 2 addresses the concerns of some constituents that do not like presenting the gross-up effect on the SFP that results from presenting the leased asset, the lease receivable, and the performance obligation individually in the SFP under Approach 1.

Arguments against Approach 2

38. Some staff members think that Approach 2 introduces asymmetry between the lessee and the lessor due to the net presentation. Some view the presentation of a net contract position in Approach 2 as indicating that the lessor has not yet delivered the right-of-use asset. That is, Approach 1 more clearly depicts that the lessor has delivered the right-of-use asset.

39. Also, 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. That calls into question how to derecognize a net contract position that includes that receivable.

40. Additionally, consistent with Approach 1 impairment considerations would need to be addressed.

Approach 3: Operating lease treatment

41. In general, Approach 3 carries forward current accounting guidance for operating leases.

42. A lessor would account for the lease as follows when applying this to a lease under Approach 3:

    (a) The lease requires monthly payments of CU200 for a total of 3 years.

    (b) The lessor invoices the right-of-use at the end of each month, with the payment due on the tenth day of the following month.

(c) At the end of the first month, the amount billed becomes unconditional because the economic benefit has been delivered to the lessee in that given month. Therefore, a lease receivable for that month is recorded.

(d) Assuming the lessee fails to make the payment and continues to use the asset in the second month, the lessor would have a lease receivable of CU400 at the end of that second month.

Arguments for Approach 3

43. Because it carries forward existing guidance, Approach 3 is the simplest for preparers to apply.

44. Both IAS 17 and Topic 840 provide users some transparency regarding the extent to which the use of underlying leased assets has been restricted via lease contracts by requiring a lessor in an operating lease to disclose the minimum lease payments due under leases in place.

45. Also, some think the asset position under Approach 3 is more supportable because it does not "double count" the assets. Please see the impairment discussion in Topic III for more information.

Arguments against Approach 3

46. Some staff think Approach 3 is inconsistent with both lessee accounting and revenue recognition because the lessor does not record a lease receivable:

(a) It is inconsistent with lessee accounting because the lessee is required to record an obligation to make lease payments.

(b) It is inconsistent with revenue recognition because a lease receivable is not recognized even though the lessor has delivered the right-of-use asset to the lessee.

47. Those staff members think that, unlike Approach 1 and Approach 2, Approach 3 does not acknowledge that the lessor's use of the underlying asset has been restricted, namely to the extent it will be used to fulfill its obligations under the lease contract over the lease term.

48. Approach 3 also will not add incremental value to users as compared to current accounting unless it is accompanied by an improvement to disclosures (for example to align or further align disclosures with those required for lessors of finance leases).

Staff recommendation

49. Some staff members recommend Approach 2. That is, a lessor in an other-than-finance lease should recognize a lease receivable and lease contract liability and present in the SFP the lease receivable net of the lease contract liability and provide disclosure of the recorded balances in the footnotes. The staff members who support Approach 2 put the most weight on the following arguments:

    (a) It is consistent with lessee accounting because the lessor records a receivable, which is congruent with the lessee recording a liability to make lease payments.

    (b) It is also consistent with the notion that the lessor has delivered on the lease contract because the lessee has recorded the right-of-use asset.

    (c) It addresses concerns expressed by constituents regarding the ED approach (Approach 1), specifically with regards to the "double counting" of assets.

50. Some staff members recommend Approach 3, which retains current operating lease accounting for other-than-finance leases. These staff members put the most weight on the following arguments:

    (a) The approach in the ED (Approach 1) was considered by most constituents to not be a significant improvement on current guidance for operating leases.

    (b) Lessors that have operating lease portfolios are familiar with the guidance and can apply it without additional costs. Users of lessor financial statements are likewise familiar with the current guidance, which could be supplemented with additional disclosure information to achieve improvements in lessor financial reporting.

(c) Approach 3 reflects a notion that the lessee derives economic benefit in an other-than-finance lease over the term of the lease. The lessor only has unconditional rights to cash to the extent that the lessee has derived the economic benefits associated with the leased asset, including not only the right to use the asset.

(d) The SFP would not be significantly different from Approach 2. Any differences would be the result of a combination of the following:

(i) Uneven lease payments due under the contract, when the pattern of benefit provided to the lessee is even or otherwise inconsistent with the pattern of payment.

(ii) Discounting the asset and liability positions in Approach 2 but not in Approach 3.

51. The staff notes that the SFP and income statement recognition and presentation in Approach 2 and Approach 3 are approximately the same. In both approaches, no lease asset/liability is presented if lease payments are even over the lease term. If lease payments are uneven over the lease term in applying Approach 2 a net contract asset/liability is presented, whereas in applying Approach 3, prepaid rents are presented as deferred rent liabilities and uncollected rents are presented as receivables. This is illustrated in Appendix A. The staff thinks that the primary differences between Approach 2 and Approach 3 are as follows:

(a) How the two approaches are conceptually articulated, which depends on whether the lessor is determined to have a lease receivable at the date of commencement of the lease because the lessor has delivered the right-of-use asset to the lessee.

(b) There is still a requirement in Approach 2 to measure lease payments, including discounting. Approach 3 would avoid the additional costs of measurement and result in a SFP that is substantially the same as Approach 2.

Question 1
Some staff members recommend Approach 2 (net presentation) while other staff recommends Approach 3 (consistent with current operating lease accounting). Which approach should be used by a lessor for an other-than-finance lease?

Topic II – Subsequent Accounting

52. Topic II discusses the subsequent accounting for a lessor in an other-than-finance lease. The staff recognizes that the Boards could require subsequent accounting according to the provisions of the ED or require an alternative method.

53. If the Boards agree with Approach 1 or Approach 2 in Question 1 above, then the staff thinks that, for other-than-finance leases, the subsequent accounting for the lessor should be consistent with the subsequent accounting for the lessee.

ED Approach

54. In the ED approach, the lessor would use the rate charged in the lease to discount the lease payments and recognize a lease receivable. A corresponding lease contract liability is also recognized at lease commencement. The staff notes the following with respect to the ED method:

    (a) It results in higher income in earlier periods of the lease as compared to the last years of a lease in which lower income is recognized. That is because the interest income component is recognized on an effective yield basis. That is also consistent with revenue recognition. Under revenue recognition, when, when a receivable has a significant financing element, the measurement of such receivable would be the present value of future payments and the seller would record interest income on an effective yield basis.

    (b) The rate of return on the receivable (calculated as interest income divided by the beginning-of-year lease receivable) is consistent throughout the lease period and is the discount rate used in the lease.

(c) The staff received comment letters and other feedback in which, for an other-than-finance lease, it was noted that an income pattern that reflects higher income in earlier periods is not helpful to users of lessor financial statements.

Staff recommendation for approach for lessees in other-than-finance leases

55. In Agenda Paper 1H/FASB Memo 162, the staff discusses various methods to achieve a straight-line profit/loss pattern and presentation of expenses of a lessee. The staff thinks there is no reason that the method for subsequent accounting recommended in that memorandum should not also be used by lessors in other-than-finance leases.

56. The staff recommends that the subsequent accounting for a lessor in an other-than-finance lease transaction be consistent with lessee accounting. The staff notes that either of these approaches would approximate the recognition of profit or loss on a straight-line basis that is consistent with Approach 3 (current operating lease accounting):

    (a) In Agenda Paper 1H/FASB Memo 162, the majority of the staff recommend that the lessor use an annuity-based amortization method to decrease the recorded lease contract liability based on the lessee's usage pattern of benefits over the lease term, a calculation that is independent of the subsequent measurement of the lease receivable.

    (b) Other staff recommend using an OCI approach to achieve an income statement result on a straight-line basis over the lease term unless another systematic method of recognition is more representative.

    (c) Present lease income as a single line item within operating income.

Questions
Q1: *Subsequent measurement* Assuming the Boards do not agree with Approach 3 in Question 1, which approach do the Boards prefer? Q2: *Presentation* Should the recorded income be presented in a single line item by lessors as operating (rental) income within profit or loss for all other-than-finance leases?

Topic III – Impairment Considerations

57. The staff notes that the Boards should be aware of the effects of the different approaches on impairment. The discussion below contrasts amongst the approaches for other-than-finance leases the effect of an impairment of the lease receivable—that is, an impairment resulting from a deterioration in the creditworthiness of the lessee (a "credit impairment")—not an impairment resulting from a deterioration in the expected value of the residual. Under all three approaches, the staff thinks that an impairment resulting from a deterioration in the expected value of the residual would be recorded against the underlying asset consistent with existing impairment guidance for long-lived assets.

58. Under Approach 1, a credit impairment would be clearly presented as a reduction of or an allowance against the lease receivable. The impairment would be reflected on the face of the balance sheet as a reduction against the receivable, because under Approach 1, the lease receivable and the lease contract liability are presented gross.

59. Under Approach 2, the presentation of the lease receivable and lease contract liability on a net basis could result in initial and subsequent measurement of a zero net lease contract position (if the Board decides to "link" the receivable and lease contract liability throughout the lease term and lease payments are even throughout the term). In those cases, when there is a credit impairment recorded against the lease receivable, the lease contract position will be a net liability. However, there may be a question as to what the net liability

represents. For instance, it might be argued that the net liability represents the lessor's obligation to provide the lessee economic benefit for which the lessor does not expect to be able to collect the agreed-upon consideration.

60. Under both Approaches 1 and 2, it is unclear if the lessor would also impair the underlying leased asset by the amount of the credit impairment, because the lease receivable cash flows also support the carrying value of the underlying asset. If so, to avoid double counting the impairment charge, the lessor would need to reduce the lease contract liability by the same amount. For Approach 2, the net liability position described in paragraph 59 above would not exist. For example:

    (a) A lessor has an asset with a carrying value of CU300.

    (b) The lessor enters into a lease that results in a lease receivable of CU100 and a lease contract liability of CU100, for a net contract position of zero.

    (c) The lessor determines that it will not collect CU5 of the CU100.

    (d) Under Approaches 1 and 2, it may not be enough to reduce the carrying value of only the lease receivable for the uncollectible amount because that reduction in expected cash flows should also be reflected in the carrying amount of the underlying asset. Because the CU5 impairment cannot be recorded on the profit/loss statement twice (that is, by a reduction of both the underlying asset and the lease receivable by CU5), the lessor would need to reduce its lease contract liability by CU5 as well.

    (e) The resulting net contract liability is still zero (CU95 lease receivable offset by CU95 lease contract liability) but the carrying value of the underlying asset has been impaired from CU300 to CU295.

    (f) However, the staff noted that the amount of impairment calculated under current guidance could result in a situation in which the receivable is impaired but the underlying asset is not. For instance, under U.S. GAAP, an entity may determine that the underlying asset is not impaired because the undiscounted cash flow expected from that asset exceeded its carrying value. In the example above, if the

receivable is determined to be impaired by CU5 but the underlying asset is not impaired, then there remains a question whether the lease contract liability should also be reduced to reflect the credit impairment.

61. Under Approach 3 a credit impairment would be factored into the impairment assessment required of the underlying asset when applying the property, plant, and equipment impairment guidance that exists in U.S. GAAP and IFRSs. Existing guidance would be sufficient to provide the recognition and measurement accounting for the impairment of lease assets.

62. If the Boards decide on Approach 1 or Approach 2 for a lessor's accounting for other-than-finance leases, the staff will compose a future paper that discusses the recognition and measurement of impairment of the lease receivable and underlying leased asset. If the Boards decide on Approach 3, the staff thinks that no further discussion of impairment for other-than-finance leases would be necessary.