FASB/IASB Joint Lease Working Group Meeting – 11 April 2011

Project **Leases**

Topic **Agenda**

Time	Description
10:00 –10:15	Welcome and introductions Summary of the decisions made to-date
10:15 – 11:15	Definition of a lease
11:15 – 12:15	Lessee accounting
12:15 – 13:00	Lunch
13:00 – 14:00	Lessor accounting
14:00 – 14:45	Accounting for variable lease payments
14:45 – 15:00	Break
15:00 – 15:45	Transition
15:45 – 16:00	Concluding Remarks
16:00	Close

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Key Points for Discussion

Topic 1: Definition of a lease

ED proposals

Appendix A (the definition of a lease)

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.

Appendix B (identifying a lease)

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:

- Targeted outreach feedback
- Should the definition of a lease refer to a specific or specified asset, meaning an asset that is uniquely identified or identifiable, or to an asset of a particular specification? As a consequence, how do rights to substitute an asset affect whether that asset is a specified asset?
- Can both a physically distinct portion (eg a floor of a building) and a non-physically distinct portion (eg a capacity portion of a pipeline) of a larger asset be the subject of a lease?
- Should the final standard address assets that are incidental to the delivery of services?
- When does a customer have the right to control the use of a specified asset?

Topic 2: Lessee accounting:

ED Proposals

The ED proposes a single lessee pattern of subsequent measurement. This approach requires that for *all* leases a lessee:

(a) recognises a right-of-use asset and a liability to make lease payments;

(b) amortises the right-of-use asset over the lease term or useful life of the underlying asset if shorter (typically on a straight-line basis); and

(c) incurs interest expense on the liability to make lease payments, using the effective interest method.

As a consequence of the combination of straight-line amortisation of the right-of-use asset and use of the effective interest method to recognise interest expense, a lessee would typically recognise higher expenses in the earlier years of a lease than in the later years.

Main discussion points:

- Targeted outreach feedback
- When considering lessee accounting do you think that more than one pattern of subsequent measurement should be recognised?
- If there are different patterns of subsequent measurement, what are the indicators that a lessee could use to distinguish leases that should apply the different subsequent measurement patterns?
- How should leases be presented in the statement of financial position, statement of comprehensive income and the statement of cash flows for lessees? For example, what items should be shown gross rather than net? Should amortisation expense and interest expense always be presented rather than an operating expense? How should cash flows generated by leases be presented eg operating or financing?

Topic 3: Lessor accounting

ED Proposals

The ED proposes two approaches for lessors—a derecognition approach and a performance obligation approach.

According to the performance obligation approach, a lessor:

(a) recognises a lease receivable and a lease liability equal to the present value of lease payments; and

(b) continues to recognise the asset that is the subject of the lease

A lessor would apply the performance obligation approach when the lessor's exposure to the risks and benefits associated with the underlying asset is significant.

In all other circumstances, the lessor would apply the derecognition approach, which is similar to a lessor's accounting for finance leases in current IFRSs and US GAAP. According to this approach the lessor:

(a) recognises a right to receive lease payments in the statement of financial position;

(b) derecognises from the statement of financial position the portion of the carrying amount of the underlying asset that represents the lessee's right to use the underlying asset during the term of the lease; and

(c) reclassifies as a residual asset the remaining portion of the carrying amount of the underlying asset that represents the rights in the underlying asset that the lessor retains.

Main discussion points:

- Targeted outreach feedback
- When considering lessor accounting do you think that different accounting approaches should be required?
- If there are different accounting approaches to be applied, what are the indicators that a lessor could use to distinguish one approach from another?
- If different accounting approaches are applied, should they all have a similar profit or loss recognition pattern for lessors?
- How should leases be presented in the statement of financial position, statement of comprehensive income and the statement of cash flows for lessors? For example, what items should be shown gross rather than net? How should cash flows generated by leases be presented eg operating or financing?

Topic 4: Accounting for variable lease payments

ED Proposals

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:

- Targeted outreach feedback
- What types of lease payment do you think should be accounted for as 'disguised minimum lease payments'?
- Should contracts that have 100% variable lease payments be treated differently?
- Do you think that, in addition to 'disguised minimum lease payments', contingent rents that meet a high threshold (such as reasonably certain) should be including in the calculation of lease assets and lease liabilities?
- How should changes in rates and indices be reflected in the calculation of lease assets and lease liabilities? What in your view would be the costs and benefits of reassessing estimates of these amounts?
- What disclosures may help users understand the nature and effect of contingent rental arrangements without creating undue cost burden for preparers?

Topic 5: Transition

ED proposals

The ED proposes a simplified retrospective approach.

Lessees are required (unless the lease is a "simple" capital/finance lease prior to application of the proposals) to recognize the following at the date of initial application:

(a) A liability to make lease payments for each outstanding lease, measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate *on the date of initial application*. For a short-term lease, (that is, a lease that, at the date of inception of the lease, has a maximum possible lease term, including options to renew or extend, of 12 months or less), the liability recorded would be undiscounted.

(b) A right-to-use asset for each outstanding lease measured at the amount of the related liability to make lease payments, subject to impairment adjustments and adjusted for any prepaid/accrued rent previously recognized.

Lessors should present a right to receive lease payments (lease receivable) measured at the present value of remaining lease payments, discounted using the rate charged in the lease determined at the date of inception of the lease, adjusted for any impairment, and either:

(a) A lease liability for each outstanding lease, measured at the amount of the lease receivable and an underlying asset measured at depreciated cost, determined as if the asset had never been derecognized (subject to any adjustments required to reflect impairment) if the lessor applies the performance obligation approach, or

(b) A residual asset measured at fair value determined at the date of initial application if the lessor applies the derecognition approach.

Main discussion points:

- Leveraged leases.
- Sale and leaseback transactions.
- The date of determination for lease classification.
- Discount rate to be applied at transition.
- Grandfathering.
- Other matters including definition of a lease, separation of lease and non-lease components of a contract, scope and other transition accounting adjustment matters.