IASB Staff Paper October 2011

Effect of board redeliberations on Exposure Draft *Leases*

About this staff paper

This staff paper indicates how the proposals in the Exposure Draft *Leases* would change as a result of the IASB's and FASB's tentative decisions to date. It reflects tentative decisions of the IASB and FASB made up to and including their meeting on 19 October 2011.

This paper is not an official pronouncement of the IASB and it is not official guidance for applying the IFRS once finalised.

[Draft] International Financial Reporting Standard X
Leases

This table shows how the tentative decisions made by the IASB and FASB would affect the proposals in Exposure Draft *Lease* (ED).

Objective

4 **This [draft] IFRS establishes principles that lessees and lessors shall apply to report relevant and representationally faithful information to users of financial statements about the amounts, timing and uncertainty of the cash flows arising from leases.**

Scope

5 An entity shall apply this [draft] IFRS to all leases, including leases of *right-of-use assets* in a *sublease*, except:

(a) leases of intangible assets (see IAS 38 *Intangible Assets*).

(b) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (see IFRS 6 *Exploration for and Evaluation of Mineral Resources*).

(c) leases of biological assets (see IAS 41 *Agriculture*).

(d) leases between the *date of inception* and the *date of commencement* of a lease if they meet the definition of an onerous contract (see IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*).

At their 2 March 2011 meeting the boards tentatively decided that leases of intangibles are not required to be accounted for in accordance with the Leases standard.

The boards unanimously affirmed the decision in the ED that the following are within the scope of the Leases standard:

(a) right-of-use assets in a sublease;

(b) leases of non-core assets; and

(c) long-term leases of land.

The boards also unanimously affirmed the decision in the ED that the following are not within the scope of the Leases standard:

(a) leases for the right to explore for or use minerals, oil, natural gas and similar non-regenerative resources;

(b) leases of biological assets (IFRSs); and

(c) leases of service concession arrangements within the scope of IFRIC 12 *Service Concession Arrangements*.

Click here for observer notes [2/3/11].

At their 21-22 March 2011 meeting the boards affirmed the proposal in the ED to exclude lease contracts that meet the definition of an onerous contract from the scope of the Leases standard between the date of inception and the date of commencement. Such leases would be accounted for in accordance with IAS 37, Provisions, Contingent Liabilities and Contingent Assets, until the date of commencement.

Click here for observer notes [21/3/11].

At their 13 June 2011 meeting the boards discussed the accounting for subleases under the proposed leases requirements for lessees and lessors and tentatively decided the following:

(a) A head lease and a sublease should be accounted for as separate transactions.

(b) An intermediate lessor, as a lessee in a head lease arrangement, should account for its assets and liabilities arising from the head lease in accordance with the decisions to date for all lessees.

(c) An intermediate lessor, as a lessor in a sublease arrangement, should account for its assets and liabilities arising from the sublease in accordance with the decisions to date for all lessors.

(d) If the Boards decide that there should be more than one approach to lessor accounting, an intermediate lessor, as a lessor in a sublease, should evaluate its right-of-use asset, not the underlying asset, to determine the appropriate lessor accounting approach to apply to the sublease.

Click here for observer notes [13/6/11].

At their 20 July 2011 meeting the boards tentatively decided that an entity should assess whether a lease contract includes embedded derivatives that should be bifurcated and accounted for in accordance with applicable US GAAP and IFRS requirements on derivatives.

Click here for observer notes [20/7/11].

At their 19 September 2011 meeting the boards tentatively decided not to provide a scope exclusion from the leases standard for assets that are often treated as inventory, such as non-depreciating spare parts, operating materials, and supplies, and that are associated with the leasing of another underlying asset. The forthcoming revised exposure draft will provide an example illustrating the effect of this decision.

Click here for observer notes [19/9/11].

6 An entity shall apply this [draft] IFRS to a contract that contains service components and lease components (see paragraphs B5–B8), except as follows:

(a) A lessee shall apply *Revenue from Contracts with Customers* to a service component of a contract that contains service components and lease components if the service component is distinct and the lessee is able to do so.

(b) A lessor shall apply *Revenue from Contracts with Customers* to a service component of a contract that contains service components and lease components if the service component is distinct and the lessor is able to do so.

(c) When a lessor applies the derecognition approach (see paragraphs 28 and 29), it shall apply *Revenue from Contracts with Customers* to a service component of a contract that contains service components and lease components, even if that service component is not distinct.

At their 21-22 March 2011 meeting the boards tentatively decided that an entity should be required to identify and separately account for the lease and the non-lease components of a contract.

Click here for observer notes [21/3/11].

7 An entity shall apply this [draft] IFRS to *investment property* that it holds under a lease. However:

(a) after initial recognition, a lessee may measure a right-of-use asset in accordance with the fair value model in IAS 40 *Investment Property*. The lessee shall recognise in profit or loss changes in the liability to make lease payments arising after initial recognition in accordance with IAS 40.

(b) a lessor shall apply IAS 40 and not this [draft] IFRS to leases of investment properties that are measured at fair value in accordance with IAS 40.

8 An entity shall not apply this [draft] IFRS to the following contracts, which represent a purchase or sale of an *underlying asset*:

(a) a contract that results in an entity transferring control of the underlying asset and all but a trivial amount of the risks and benefits associated with the underlying asset to another entity (see paragraphs B9 and B10); and

(b) a lease after the lessee has exercised a purchase option specified in the lease. A contract ceases to be a lease when such an option is exercised and becomes a

At their 14 March 2011 meeting the boards tentatively decided that guidance should not be provided in the Leases standard for distinguishing a lease of an underlying asset from a purchase or a sale of an underlying asset. That is, if an arrangement does not contain a lease, it should be accounted for in accordance with other applicable standards (for example, property, plant, and equipment or revenue recognition).

Click here for observer notes [14/3/11].

purchase (by the lessee) or sale (by the lessor).

9 Except as specified in paragraphs 30 and 46, an underlying asset in a lease is not within the scope of this [draft] IFRS.

Lessee

Recognition

10 At the date of commencement of a lease, a lessee shall recognise in the statement of financial position a right-of-use asset and a liability to make *lease payments*.

At their 21-22 March 2011 meeting the boards tentatively decided that the Leases standard would require a lessee and a lessor to recognise and initially measure lease assets and lease liabilities (and derecognise any corresponding assets and liabilities) at the date of commencement of the lease.

The boards also tentatively decided that the Leases standard would include application guidance on the accounting for lease payments made by the lessee before the date of commencement of a lease.

Click here for observer notes [21/3/11].

At their 21-22 March 2011 meeting the boards tentatively decided that the Leases standard would include application guidance on the accounting for costs incurred by the lessee before the date of commencement of a lease.

Click here for observer notes [21/3/11].

At their 16 February 2011 meeting the boards tentatively decided to identify a principle for identifying two types of leases, with different profit and loss effects, as follows:

(a) a finance lease with a profit or loss recognition pattern that is consistent with the proposals in the exposure draft; and

(b) an other-than-finance lease with a profit or loss recognition pattern that is consistent with an operating lease under existing IFRSs/US GAAP.

Click here for observer notes [16/2/11].

At their April 2011 meeting, the boards tentatively decided that there should be two accounting approaches for lessees. Lessees would use guidance similar to that in IAS 17 to determine which accounting approach to apply. For both lessee accounting approaches, the boards affirmed their proposals in the Leases exposure draft that a lessee would:

(a) initially recognize a liability to make lease payments and a right-of-use asset, both measured at the present value of lease payments.

(b) subsequently measure the liability to make lease payments using the effective interest method.

Click here for observer notes [12/4/11].

At their 17 May 2011 meeting the boards tentatively decided that lessees should apply a single accounting approach for all leases consistently with the approach proposed in the Leases exposure draft. This accounting approach would require a lessee to:

(a) initially recognise a liability to make lease payments and a right-of-use asset, both measured at the present value of the lease payments;

(b) subsequently measure the liability to make lease payments using the effective interest method; and

(c) amortise the right-of-use asset on a systematic basis that reflects the pattern of consumption of the expected future economic benefits.

Click here for observer notes [17/5/11].

11 A lessee shall recognise the following items in the statement of comprehensive income, except to the extent that another IFRS requires or permits its inclusion in the cost of an asset:

(a) interest expense on the liability to make lease payments (see paragraph 16(a)).

(b) amortisation of the right-of-use asset (see paragraphs 16(b) and 20).

(c) revaluation gains and losses as required by IAS 38, when a right-of-use asset is revalued in accordance with paragraph 21 (see paragraphs 21–23).

(d) any changes in the liability to make lease payments resulting from reassessment of the expected amount of *contingent rentals* or expected payments under term option penalties and *residual value guarantees* relating to current or prior periods (see paragraph 18(a)).

(e) any impairment losses on a right-of-use asset (see paragraph 24).

Measurement

Initial measurement

12 At the date of inception of the lease, a lessee shall measure:

At their 21-22 March 2011 meeting the boards tentatively decided that the Leases standard would require a lessee and a lessor to recognise and initially measure lease assets and lease liabilities (and derecognise any corresponding assets and liabilities) at the date of commencement of the lease.

Click here for observer notes [21/3/11].

(a) the liability to make lease payments at the present value of the lease payments (see paragraphs 13–15), discounted using the *lessee's incremental borrowing rate* or, if it can be readily determined, the *rate the lessor charges the lessee* (see paragraph B11).

At their 21-22 March 2011 meeting the boards tentatively reaffirmed the proposals in the ED, with regards to discount rates, but clarified that the lessee would use the rate the lessor charges the lessee when that rate is available; otherwise the lessee would use its incremental borrowing rate.

Click here for observer notes [21/3/11].

(b) the right-of-use asset at the amount of the liability to make lease payments, plus any initial direct costs incurred by the lessee (see paragraphs B14 and B15).

At their 21-22 March 2011 meeting the boards affirmed the decision in the ED that lessees and lessors should capitalise initial direct costs by adding them to the carrying amount of the right-of-use asset and the right to receive lease payments, respectively.

The boards also tentatively decided that the Leases standard would include application guidance on the accounting for incentives provided by the lessor to the lessee. This would clarify that a lessee will deduct all lease incentives from the initial measurement of the right-of-use asset.

Click here for observer notes [21/3/11].

Present value of lease payments

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

At their 16 February 2011 meeting, the boards tentatively decided that the lease term should be defined as ‘the non cancellable period for which the lessee has contracted with the lessor to lease the underlying asset, together with any options to extend or terminate the lease when there is a significant economic incentive for an entity to exercise an option to extend the lease, or for an entity not to exercise

14 A lessee shall determine the present value of lease payments payable during the lease term determined in accordance with paragraph 13 on the basis of expected outcome, determined using all relevant information. 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). In determining the present value of lease payments payable, a lessee shall include:

(a) an estimate of contingent rentals payable. If the contingent rentals depend on an index or a rate, the lessee shall determine the expected lease payments using readily available forward rates or indices. If forward rates or indices are not readily available, the lessee shall use the prevailing rates or indices.

an option to terminate the lease'.

Click here for observer notes [16/2/11].

At their 16 February 2011 meeting the boards tentatively decided that:

(a) The lessee's liability and lessor's receivable should include:

i. lease payments that depend on an index or rate;

ii. lease payments for which the variability lacks commercial substance; and

iii. lease payments that meet a high recognition threshold (such as reasonably certain).

(b) Variable lease payments that depend on an index or a rate should be measured initially based on the spot rate.

(c) Recognition of variable lease payments by a lessee and lessor should be subject to the same reliable measurement threshold. However, the need for such a threshold will depend on the basis for recognising variable lease payments.

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Having considered the feedback received and additional staff analysis, at their April 2011 meeting the boards:

(a) confirmed that the measurement of the lessee's liability and the lessor's receivable should include lease payments that are in-substance fixed lease payments but are structured as variable lease payments in form.

(b) changed their tentative decision in relation to lease payments that meet a high threshold and decided that in such cases (ie when the payments are less certain) those amounts should not be included in the measurement of the lessee's liability and the lessor's receivable.

The boards will discuss lease payments that depend on an index or a rate, including reassessment, at a future meeting. In addition, the boards asked the staff to consider appropriate disclosures for variable lease payments for future discussions.

Click here for observer notes [12/4/11].

At their 20 July 2011 meeting the boards discussed the measurement of lease payments that depend on an index or on a rate that is included in the lessee's liability to make lease payments and the lessor's right to receive lease payments and tentatively decided that:

(a) Lease payments that depend on an index or a rate should be measured initially using the index or rate that exists at the date of commencement of the lease.

(b) Lease payments that depend on an index or a rate should be reassessed using the index or rate that exists at the end of each reporting period.

(c) Lessees should reflect changes in the measurement of lease payments that depend on an index or a rate (a) in net income to the extent that those changes relate to the current reporting period and (b) as an adjustment to the right-of-use asset to the extent that those changes relate to future reporting periods.

The boards will discuss at a future meeting how a lessor should reflect changes in the measurement of lease payments that depend on an index or a rate.

Click here for observer notes [20/7/11].

(b) an estimate of amounts payable to the lessor under residual value guarantees. Residual value guarantees that are provided by an unrelated third party are not lease payments.

At their 16 February 2011 meeting the boards tentatively decided to clarify that lease payments should include amounts expected to be payable under residual value guarantees, except for amounts payable under guarantees provided by an unrelated third party.

Click here for observer notes [16/2/11].

(c) an estimate of expected payments to the lessor under term option penalties.

At their 16 February 2011 meeting the boards tentatively decided that the accounting for term option penalties should be consistent with the accounting for options to extend or terminate a lease. That is, if a lessee would be required to pay a penalty if it did not renew the lease and the renewal period has not been included in the lease term, then that penalty should be included in the recognised lease payments.

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15 The exercise price of a purchase option included in a lease is not a lease payment and the purchase option is not included in determining the present value of lease payments payable.

At their 14 March 2011 meeting the boards tentatively decided that lease payments should include the exercise price of a purchase option (including bargain purchase options) in the measurement of the lessee's liability to make lease payments and the lessor's right to receive lease payments, if the lessee has a significant economic incentive to exercise the purchase option.

Click here for observer notes [14/3/11].

Subsequent measurement

16 After the date of commencement of the lease, a lessee shall measure:

(a) the liability to make lease payments at amortised cost using the effective interest method, subject to the requirements in paragraphs 17–19.

(b) the right-of-use asset at amortised cost unless paragraphs 21–24 apply.

Reassessment of the liability to make lease payments

17 After the date of commencement of the lease, the lessee shall reassess the carrying amount of the liability to make lease payments arising from each lease if facts or circumstances indicate that there would be a significant change in the liability since the previous reporting period. When such indications exist, a lessee shall:

At their 1 June 2011 meeting the boards discussed the accounting by lessees for leases denominated in a foreign currency. The boards tentatively decided that foreign exchange differences related to the liability to make lease payments should be recognised in profit or loss, consistently with foreign exchange guidance in existing IFRSs and US GAAP.

Click here for observer notes [1/6/11].

(a) reassess the length of the lease term in accordance with paragraph 13 and adjust the right-of-use asset to reflect any resulting change to the liability to make lease payments arising from changes to the lease term.

At their 16 February 2011 meeting the boards tentatively decided that a lessee and a lessor should reassess the lease term only when there is a significant change in relevant factors such that the lessee would then either have, or no longer have, a significant economic incentive to exercise any options to extend or terminate the lease.

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At their 14 March 2011 meeting the boards tentatively indicated a preference for specifying the same reassessment guidance for purchase options as was tentatively decided for options to extend or terminate a lease. However, the boards instructed the staff to seek input through targeted outreach on the costs and benefits of requiring reassessment.

Click here for observer notes [14/3/11].

At their 17 May 2011 meeting, The boards discussed how lessees and lessors should reassess whether a lessee has a significant economic incentive to exercise:

(a) an option to extend or terminate a lease, and

(b) an option to purchase the underlying asset.

The boards tentatively decided that a lessee and a lessor should consider contract-based, asset-based and entity-based factors in reassessing whether a lessee has a significant economic incentive to exercise an option. The boards noted that all these factors should be considered together and the existence of only one factor does not necessarily, by itself, signify a significant economic incentive to exercise the option.

The boards also tentatively decided that the thresholds for evaluating a lessee's economic incentive to exercise options to extend or terminate a lease and options to purchase the underlying asset should be the same for both initial and subsequent evaluation, except that a lessee should not consider changes in market rates after lease commencement when evaluating whether a lessee has a significant economic incentive to exercise an option. Also, they decided that changes in lease payments that is due to a reassessment in the lease term should result in a lessee adjusting its obligation to make lease payments and its right-of-use asset.

Click here for observer notes [17/5/11].

(b) reassess the expected amount of any contingent rentals and expected payments under term option penalties and residual value guarantees in accordance with paragraph 14. A lessee shall recognise any resulting changes to the liability to make lease payments in accordance with paragraph 18.

At their 1 June 2011 meeting the boards discussed the subsequent measurement of residual value guarantees by lessees (excluding guarantees provided by an unrelated third party) and tentatively decided that:

(a) The amounts expected to be payable under residual value guarantees included in the measurement of the lessee's right-of-use asset should be amortised consistently with how other lease payments that are included in the measurement of a right-of-use asset are amortised. That is, amortisation should be on a systematic basis from the date of commencement of the lease to the end of the lease term, or over the useful life of the underlying asset, if this is shorter. The method of amortisation should reflect the pattern in which the economic benefits of the right-of-use asset are consumed or otherwise used up. If that pattern cannot be determined reliably, a straight-line amortisation method should be used.

(b) The amounts expected to be payable under residual value guarantees that are included in the measurement of the lessee's liability to make lease payments should be reassessed when events or circumstances indicate that there has been a significant change in the amounts expected to be payable under residual value guarantees. An entity would be required to consider all relevant factors to determine whether events or circumstances indicate that there has been a significant change.

(c) The amount of the change to the lessee's liability to make lease payments arising from changes in estimates of residual value guarantees should be recognised (a) in net income to the extent that those changes relate to current or prior periods and (b) as an adjustment to the right-of-use asset to the extent those changes relate to future periods. The allocation for changes in estimates of residual value guarantees should reflect the pattern in which the economic benefits of the right-of-use asset will be consumed or were consumed. If that pattern cannot be determined reliably, an entity should allocate changes in estimates of residual value guarantees to future periods.

Click here for observer notes [1/6/11].

18 A lessee shall distinguish changes in contingent rentals and expected payments under term option penalties and residual value guarantees that relate to current or prior periods from those that relate to future periods. A lessee shall recognise changes in the expected amount of such payments:

(a) in profit or loss, to the extent that those changes relate to current or prior periods.

(b) as an adjustment to the right-of-use asset to the extent that those changes relate to future periods.

For example, when lease payments depend on the amount of the lessee's sales, changes relating to sales in the current or prior periods are recognised in profit or loss, whereas changes relating to expectations of future sales are recognised as an adjustment to the right-of-use asset.

At their 17 May 2011 meeting the boards discussed whether there are circumstances that would require a lessee or a lessor to reassess the discount rate that is used to measure the present value of lease payments. The boards tentatively decided that the discount rate should not be reassessed if there is no change in the lease payments.

The boards also tentatively decided that the discount rate should be reassessed when the changes below are not reflected in the initial measurement of the discount rate:

(a) when there is a change in lease payments that is due to a change in the assessment of whether the lessee has a significant economic incentive to exercise an option to extend a lease or to purchase the underlying asset.

(b) when there is a change in lease payments that is due to the exercise of an option that the lessee did not have a significant economic incentive to exercise.

The boards also decided that a lessee or lessor should determine a revised discount rate using the spot rate at the reassessment date and should then apply that rate to the remaining lease payments (ie to the remaining payments due in the initial lease plus the payments due during the extension period or upon exercise of a purchase option).

Click here for observer notes [17/5/11].

19 A lessee shall not change the rate used to discount the lease payments except to reflect changes in reference interest rates when contingent rentals are based on those reference interest rates. When contingent rentals are based on reference interest rates, a lessee shall recognise any changes to the liability to make lease payments arising from changes in the discount rate in profit or loss.

Amortisation of the right-of-use asset

20 If a lessee measures the right-of-use asset at amortised cost, it shall amortise the asset on a systematic basis from the date of commencement of the lease to the end of the lease term or over the useful life of the underlying asset if shorter. The lessee shall select the amortisation method and review the amortisation period and amortisation method in accordance with IAS 38.

At their 14 March 2011 meeting the boards tentatively decided that if it is determined that the lessee has a significant economic incentive to exercise the purchase option, the right-of-use asset recognised by the lessee should be amortised over the economic life of the underlying asset, rather than over the lease term.

Click here for observer notes [14/3/11].

Revaluation of the right-of-use asset

21 A lessee may measure a right-of-use asset at its fair value at the date of revaluation less any amortisation and impairment losses arising after the date of revaluation if it revalues all owned assets in that class of property, plant and equipment, in accordance with IAS 16 *Property, Plant and Equipment*. For the purposes of this revaluation, fair value need not be determined by reference to an active market. If a lessee measures a right-of-use asset at a revalued amount, it shall revalue all right-of-use assets relating to the class of property, plant and equipment

At their 1 June 2011 meeting the board (IASB only) discussed revaluation of the lessee's right-of-use asset. The IASB tentatively decided to reaffirm the proposals in the Leases exposure draft allowing revaluation of the right-of-use asset.

Click here for observer notes [1/6/11].

to which the underlying asset belongs.

22 If the lessee revalues a right-of-use asset in accordance with paragraph 21, it shall perform revaluations with such regularity that at the end of the reporting period the carrying amount of the asset does not differ materially from its fair value.

23 If the lessee revalues a right-of-use asset in accordance with paragraph 21, it shall recognise gains and losses on revaluation in the statement of comprehensive income in accordance with IAS 38.

Impairment of the right-of-use asset

24 A lessee shall apply IAS 36 Impairment of Assets at each reporting date to determine whether the right-of-use asset is impaired and shall recognise any impairment loss in accordance with IAS 36.

At their 1 June 2011 meeting the boards discussed impairment of the lessee's right-of-use asset. The boards tentatively decided to reaffirm the proposal in the exposure draft to refer to existing guidance in IFRSs and US GAAP for impairment of the right-of-use asset.

Click here for observer notes [1/6/11].

Presentation

25 A lessee shall present the following items in the statement of financial position:

At their 17 May 2011 meeting the boards decided that at a future meeting, they will further consider the presentation and disclosure of additional information about amortisation of the right of use asset, interest expense on the liability to make lease payments, total lease expense and lease payment cash flows.

Click here for observer notes [17/5/11].

(a) liabilities to make lease payments, separately from other financial liabilities.

(b) right-of-use assets as if they were tangible assets within property, plant and equipment or investment property as appropriate, separately from assets that the lessee does not lease.

At their 20 July 2011 meeting the boards discussed presentation in the lessee statement of financial position and tentatively decided that a lessee should:

(a) Separately present in the statement of financial position, or disclose in the notes to the financial statements, right-of-use assets and liabilities to make lease payments. If right-of-use assets and liabilities to make lease payments are not separately presented in the statement of financial position, the disclosures should indicate in which line item in the statement of financial position the right-of-use assets and liabilities to make lease payments are included.

(b) Present the right-of-use asset as if the underlying asset were owned. The boards also decided that it is not necessary to clarify whether the right-of-use asset is a tangible or an intangible asset.

Click here for observer notes [20/7/11].

26 A lessee shall present amortisation of the right-of-use asset and interest expense on the liability to make lease payments separately from other amortisation and interest expense, either in profit or loss or in the notes.

At their 20 July 2011 meeting the boards also tentatively decided that a lessee should:

(a) Present or disclose separately interest expense and interest paid relating to leases.

(b) Not combine interest expense and amortisation expense and present it as lease or rent expense.

Click here for observer notes [20/7/11].

27 A lessee shall classify cash payments for leases as financing activities in the statement of cash flows and present them separately from other financing cash flows.

At their 20 July 2011 meeting the boards discussed the lessee's statement of cash flows and tentatively decided that a lessee should:

(a) Classify cash paid for lease payments relating to the principal within financing activities.

(b) Classify or disclose cash paid for lease payments relating to interest in the statement of cash flows in accordance with applicable IFRSs or US GAAP.

(c) Classify as operating activities cash paid for variable lease payments that are not included in the measurement of the liability to make lease payments.

(d) Classify as operating activities cash paid for short-term leases that are not included in the liability to make lease payments.

Click here for observer notes [20/7/11].

Lessor

When to apply the performance obligation or derecognition approach

28 At the date of inception of the lease, a lessor shall assess whether a lease is accounted for in accordance with the performance obligation approach or the derecognition approach on the basis of whether the lessor retains exposure to significant risks or benefits associated with the underlying asset either:

(a) during the expected term of the lease; or

(b) after the expected term of the lease by having the expectation or ability to generate significant returns by re-leasing or selling the underlying asset

(see paragraphs B22–B27).

At their April 2011 meeting the boards tentatively decided that there should be two accounting approaches for leases for lessors. Lessors would use guidance similar to that in IAS 17 to determine which accounting approach to apply. The boards discussed the two accounting approaches that would be applied by lessors, but did not make any decisions.

Click here for observer notes [12/4/11].

At their 17 May 2011 meeting the boards discussed the accounting by lessors under a right-of-use model. They discussed whether there should be one or two approaches to lessor accounting. The boards will continue discussing this issue at a future meeting, at which they will consider the implications of their decision to require a single approach to lessee accounting. The boards requested the staff to provide further analysis at a future meeting that compares the accounting described below with the accounting for lessors that are applying operating lease accounting in existing IFRS and US GAAP.

The boards discussed the one approach to lessor accounting. The boards discussed accounting for the underlying asset and the residual asset if there is a single approach to lessor accounting. If a single approach is used, the boards tentatively decided that:

(a) the lessor would derecognise a portion of the carrying amount of the underlying asset.

(b) the lessor would initially measure the residual asset as an allocation of the carrying amount of the underlying asset. All board members present agreed.

(c) the lessor would subsequently measure the residual asset by accreting the amount of the residual asset over the lease term, using the rate that the lessor charges the lessee.

The boards then discussed the two approaches to lessor accounting. The boards tentatively decided that if there are two approaches to lessor accounting, distinguishing between those two approaches would be based on indicators relating to a definition of whether the lease transfers substantially all of the risks and rewards incidental to ownership of the underlying asset (all board members present agreed). These indicators would:

(a) include a 'fair value indicator'.

(b) include a 'variable rent indicator'; and

(c) not include an 'embedded or integral services indicator'.

The boards also discussed the accounting for the underlying asset and the residual asset if there are two approaches to lessor accounting. If substantially all of the risks and rewards of ownership of the underlying asset are transferred to the lessee and the lessor does not apply operating lease accounting in existing IFRS and US GAAP, the boards indicated a preference that the lessor would:

(a) derecognise the entire carrying amount of the underlying asset.

(b) initially measure the residual asset at the present value of the estimated value of the underlying asset at the end of the lease term, discounted using the rate that the lessor charges the lessee.

(c) subsequently measure the residual asset by accreting the amount of the residual asset over the lease term using the rate the lessor charges the lessee.

Click here for observer notes [17/5/11].

At their 13 June meeting the boards continued discussing the accounting by lessors under a right-of-use model.

The boards discussed a single approach to lessor accounting whereby the lessor would recognise a lease receivable and a residual asset at lease commencement. The boards will consider at a future meeting whether, and if so when, under such an approach, it is appropriate for a lessor to recognise profit at lease commencement. The boards will also consider at a future meeting whether there should be different lessor models for (a) a lease of a portion of an asset and (b) a lease of an entire asset.

The boards did not make any decisions about lessor accounting at this meeting

Click here for observer notes [13/6/11].

At their 20 July 2011 meeting the boards tentatively decided that a lessor should apply a 'receivable and residual' accounting approach as follows:

(a) The lessor would recognise a right to receive lease payments and a residual asset at the date of the commencement of the lease.

(b) The lessor would initially measure the right to receive lease payments at the sum of the present value of the lease payments, discounted using the rate that the lessor charges the lessee.

(c) The lessor would initially measure the residual asset as an allocation of the carrying amount of the underlying asset and would subsequently measure the residual asset by accreting it over the lease term using the rate that the lessor charges the lessee.

(d) If profit on the right-of-use asset transferred to the lessee is reasonably assured, the lessor would recognise that profit at the date of the commencement of the lease. The profit would be measured as the difference between (a) the carrying amount of the underlying asset and (b) the sum of the initial measurement of the right to receive lease payments and the residual asset.

(e) If profit on the right-of-use asset transferred to the lessee is not reasonably assured, the lessor would recognise that profit over the lease term. In that case, the lessor would initially measure the residual asset as the difference between the carrying amount of the underlying asset and the right to receive lease payments. The lessor would subsequently accrete the residual asset, using a constant rate of return, to an amount equivalent to the underlying asset's carrying amount at the end of the lease term as if the underlying asset had been subject to depreciation.

(f) If the right to receive lease payments is greater than the carrying amount of the underlying asset at the date of the commencement of the lease, the lessor would recognise, as a minimum, the difference between those two amounts as profit at that date.

The boards also tentatively decided that the following should be excluded from the scope of the 'receivable and residual' approach to lessor accounting:

(a) Leases of investment property measured at fair value

(b) Short-term leases.

For those excluded leases, a lessor should (1) continue to recognise and depreciate the underlying asset and (2) recognise lease income over the lease term on a systematic basis.

Click here for observer notes [20/7/11].

At their 19 October meeting the boards tentatively decided that a lessor's lease of investment property would not be within the scope of the receivable and residual approach. Instead, for such leases, the lessor should continue to recognise the underlying asset and recognise lease income over the lease term.

The boards discussed the receivable and residual approach and tentatively decided that for all lease contracts within the scope of that approach, a lessor should:

(a) Initially measure the right to receive lease payments at the present value of the lease payments, discounted using the rate that the lessor charges the lessee, and subsequently measure it at amortised cost applying an effective interest method.

(b) Initially measure the residual asset as an allocation of the carrying amount of the underlying asset. The initial measurement of the residual asset comprises two amounts: (a) the gross residual asset, measured at the present value of the estimated residual value at the end of the lease term, discounted using the rate that the lessor charges the lessee and (b) the deferred profit, measured as the difference between the gross residual asset and the allocation of the carrying amount of the underlying asset.

(c) Subsequently measure the gross residual asset by accreting to the estimated residual value at the end of the lease term using the rate that the lessor charges the lessee. The lessor would not recognise any of the deferred profit in profit or loss until the residual asset is sold or re-leased.

(d) Present the gross residual asset and the deferred profit together as a net residual asset.

The boards also tentatively decided that there should be no distinction between when profit is or is not reasonably assured.

Click here for observer notes [19/10/11].

29 If a lessor retains exposure to significant risks or benefits associated with an underlying asset, the lessor shall apply the performance obligation approach to the lease. If a lessor does not retain exposure to significant risks or benefits associated

with an underlying asset, the lessor shall apply the derecognition approach to the lease. A lessor shall not change the lessor accounting approach after the date of inception of the lease.

Recognition: performance obligation approach

30 At the date of commencement of a lease, a lessor shall recognise in the statement of financial position a right to receive lease payments and a *lease liability*. The lessor shall not derecognise the underlying asset.

At their 17 May 2011 meeting the boards discussed the accounting by lessors under a right-of-use model. They discussed whether there should be one or two approaches to lessor accounting. However, neither of those models considered a performance obligation approach and, therefore, paragraphs 30 to 45 of the ED set out in the left hand column, have no corresponding changes listed in the right hand column.

31 A lessor shall recognise the following items in profit or loss:

(a) interest income on the right to receive lease payments (see paragraph 37(a)).

(b) lease income as the lease liability is satisfied (see paragraph 37(b)).

(c) any changes in the lease liability resulting from reassessment of the expected amount of contingent rentals and expected payments under term option penalties and residual value guarantees when the lessor satisfies that liability (see paragraphs 39 and 40).

(d) any impairment losses on the right to receive lease payments (see paragraph 41).

32 A lessor shall classify lease income as revenue if it arises in the course of a lessor's ordinary activities.

Measurement: performance obligation approach

Initial measurement

33 At the date of inception of the lease, a lessor shall measure:

(a) the right to receive lease payments at the sum of the present value of the lease payments (see paragraphs 34–36), discounted using the rate the lessor charges the lessee (see paragraph B12), and any initial direct costs incurred by the lessor (see paragraphs B14 and B15).

(b) the lease liability at the amount of the right to receive lease payments.

Present value of lease payments

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

35 A lessor shall determine the present value of the lease payments receivable during the lease term determined in accordance with paragraph 34 on the basis of expected outcome, determined using all relevant information. 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). In determining the present value of lease payments receivable, a lessor shall include:

(a) an estimate of contingent rentals receivable that the lessor can measure reliably. If the contingent rentals depend on an index or a rate, the lessor shall determine the expected lease payments using readily available forward rates or indices. If forward rates or indices are not readily available, the lessor shall use the prevailing rates or indices.

(b) an estimate of amounts receivable from the lessee under residual value guarantees that the lessor can measure reliably. Residual value guarantees that are provided by an unrelated third party are not lease payments.

(c) an estimate of expected payments from the lessee under term option penalties.

36 The exercise price of a purchase option included in a lease is not a lease payment and the purchase option is not included in determining the present value of lease payments receivable.

Subsequent measurement

37 After the date of commencement of the lease, a lessor shall measure:

(a) the right to receive lease payments at amortised cost using the effective interest method, unless paragraph 39 or 41 applies.

(b) the remaining lease liability determined on the basis of the pattern of use of the underlying asset by the lessee. If the lessor cannot determine reliably 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 (see paragraph 38), it shall use the straight-line method.

38 Systematic and rational methods of determining the lessor's remaining liability, other than the straight-line method, include:

(a) output methods in which the pattern of use of the underlying asset is based on the number of units produced by the lessee (for example, units delivered, contract milestones, or estimates of goods or services transferred to date relative to the total goods or services to be transferred).

(b) input methods in which the pattern of use of the underlying asset is based on the efforts expended to date by the lessee (for example, machine hours used), relative to total efforts expected to be expended over the lease term.

Reassessment of the right to receive lease payments

39 After the date of commencement of the lease, the lessor shall reassess the carrying amount of the right to receive lease payments arising from each lease if facts or circumstances indicate that there would be a significant change in the right to receive lease payments since the previous reporting period. When such indications exist, a lessor shall:

(a) reassess the length of the lease term in accordance with paragraph 34 and adjust the lease liability to reflect any change to the right to receive lease payments arising from changes to the lease term (see paragraph B28).

(b) reassess the expected amount of any contingent rentals and any expected payments under residual value guarantees that the lessor can measure reliably and any expected payments under term option penalties in accordance with paragraph 35. A lessor shall recognise any resulting changes to the right to receive lease payments:

(i) in profit or loss to the extent that the lessor has satisfied the related lease liability.

(ii) as an adjustment to the lease liability to the extent that

the lessor has not satisfied the related lease liability. However, the lessor shall recognise any changes that would reduce that liability below zero in profit or loss.

40 A lessor shall not change the rate used to discount the lease payments except to reflect changes in reference interest rates when contingent rentals are based on those reference interest rates. When contingent rentals are based on reference interest rates, a lessor shall recognise any changes to the right to receive lease payments arising from changes in the discount rate in profit or loss.

Impairment of the right to receive lease payments

41 A lessor shall apply IAS 39 at each reporting date to determine whether the right to receive lease payments is impaired and shall recognise any impairment loss in profit or loss.

Presentation: performance obligation approach

42 A lessor shall present the following items together in the statement of financial position:

(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.

43 An intermediate lessor shall present the liability to make lease payments under a head lease separately from other assets and liabilities arising from the sublease and shall present the following items together in the statement of financial position:

(a) right-of-use assets (which are the underlying assets in subleases).

(b) rights to receive lease payments under subleases.

(c) lease liabilities.

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

(see paragraph B29).

44 A lessor shall 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, income and depreciation expense.

45 A lessor shall classify the cash receipts from lease payments as operating activities in the statement of cash flows. If the lessor:

(a) applies the direct method, it shall present those cash receipts separately from other cash flows from operating activities.

(b) applies the indirect method, it shall present changes in the right to receive lease payments separately from the changes in other operating receivables.

Recognition: derecognition approach

46 At the date of commencement of a lease, a lessor shall:

(a) recognise a right to receive lease payments in the statement of financial position.

At their 21-22 March 2011 meeting the boards tentatively decided that the Leases standard would require a lessee and a lessor to recognise and initially measure lease assets and lease liabilities (and derecognise any corresponding assets and liabilities) at the date of

(b) **derecognise 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 (see paragraph 50).**

(c) **reclassify 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 (see paragraph 50).**

commencement of the lease.

Click here for observer notes [21/3/11].

47 **A lessor shall recognise the following items in profit or loss:**

(a) **lease income representing the present value of the lease payments and lease expense representing the cost of the portion of the underlying asset that is derecognised at the date of commencement of the lease.**

(b) **interest income on the right to receive lease payments (see paragraph 54).**

(c) **lease income and lease expense upon any reassessment of the lease term required by paragraph 56(a).**

(d) **any changes in the right to receive lease payments resulting from reassessment of the expected amount of contingent rentals and expected payments under term option penalties and residual value guarantees required by paragraph 56(b).**

(e) **any impairment losses on the right to receive lease payments or the residual asset (see paragraphs 58 and 59).**

48 A lessor shall classify lease income as revenue and lease expense as cost of sales if that income and expense arise in the course of a lessor's ordinary activities.

Measurement: derecognition approach

Initial measurement

49 **At the date of inception of the lease, a lessor shall measure:**

At their 21-22 March 2011 meeting the boards tentatively decided that the Leases standard would require a lessee and a lessor to recognise and initially measure lease assets and lease liabilities (and derecognise any corresponding assets and liabilities) at the date of commencement of the lease.

Click here for observer notes [21/3/11].

(a) **the right to receive lease payments at the sum of the present value of the lease payments (see paragraphs 51–53), discounted using the rate the lessor charges the lessee (see paragraph B12), and any initial direct costs incurred by the lessor (see paragraphs B14 and B15).**

At their 21-22 March 2011 meeting the boards tentatively reaffirmed the proposals in the ED, with regards to discount rates, but clarified that the lessor would use the rate the lessor charges the lessee.

Click here for observer notes [21/3/11].

At their 17 May 2011 meeting the boards indicated a tentative preference for measuring a lessor's right to receive lease payments in accordance with the requirements for other similar financial assets. The boards nevertheless requested the staff to analyse whether this would create any unintended consequences, specifically if the boards were to specify two approaches for lessor accounting.

Click here for observer notes [17/5/11].

(b) **the residual asset at an allocated amount of the carrying amount of the underlying asset (see paragraph 50).**

50 A lessor shall determine the amount derecognised and the initial carrying amount of the residual asset by allocating the carrying amount of the underlying asset at the date of inception of the lease in proportion to the fair value of the rights that have been transferred and the fair value of the rights that have been retained by the lessor. Therefore, the amount derecognised by

the lessor is the carrying amount of the underlying asset multiplied by the fair value of the right to receive lease payments divided by the fair value of the underlying asset (all determined at the date of inception of the lease).

Present value of lease payments

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

At their 16 February 2011 meeting, the boards tentatively decided that the lease term should be defined as 'the non cancellable period for which the lessee has contracted with the lessor to lease the underlying asset, together with any options to extend or terminate the lease when there is a significant economic incentive for an entity to exercise an option to extend the lease, or for an entity not to exercise an option to terminate the lease'.

Click here for observer notes [16/2/11].

52 A lessor shall determine the present value of lease payments receivable during the lease term determined in accordance with paragraph 51 on the basis of expected outcome, determined using all relevant information. 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). In determining the present value of lease payments receivable, a lessor shall include:

(a) an estimate of contingent rentals receivable that the lessor can measure reliably. If the contingent rentals depend on an index or a rate, the lessor shall determine the expected lease payments using readily available forward rates or indices. If forward rates or indices are not readily available, the lessor shall use the prevailing rates or indices.

At their 16 February 2011 meeting the boards tentatively decided that:

(a) The lessee's liability and lessor's receivable should include:

   i. lease payments that depend on an index or rate;

   ii. lease payments for which the variability lacks commercial substance;

   iii. lease payments that meet a high recognition threshold (such as reasonably certain).

(b) Variable lease payments that depend on an index or a rate should be measured initially based on the spot rate.

(c) Recognition of variable lease payments by a lessee and lessor should be subject to the same reliable measurement threshold. However, the need for such a threshold will depend on the basis for recognising variable lease payments.

Click here for observer notes [16/2/11].

Having considered the feedback received and additional staff analysis, at their April 2011 meeting the boards:

(a) confirmed that the measurement of the lessee's liability and the lessor's receivable should include lease payments that are in-substance fixed lease payments but are structured as variable lease payments in form.

(b) changed their tentative decision in relation to lease payments that meet a high threshold and decided that in such cases (ie when the payments are less certain) those amounts should not be included in the measurement of the lessee's liability and the lessor's receivable.

The boards will discuss lease payments that depend on an index or a rate, including reassessment, at a future meeting. In addition, the boards asked the staff to consider appropriate disclosures for variable lease payments for future discussions.

Click here for observer notes [12/4/11].

(b) an estimate of the amounts receivable from the lessee under residual value guarantees that the lessor can measure reliably. Residual value guarantees that are provided by an unrelated third party are not lease payments.

At their 16 February 2011 meeting the boards tentatively decided to clarify that the lease payments should include amounts expected to be payable under residual value guarantees, except for amounts payable under guarantees provided by an unrelated third party.

Click here for observer notes [16/2/11].

At their 19 September 2011 meeting The boards tentatively decided that:

(a) the leases standard would provide guidance on accounting for all residual value guarantees, regardless of whether they are provided by a lessee, a related party or a third party.

(b) a lessor would not recognise amounts expected to be received under a residual value guarantee until the end of the lease. However, the lessor would consider those guarantees when determining whether the residual asset is impaired.

Click here for observer notes [19/9/11].

(c) an estimate of expected payments from the lessee under term option penalties.

At their 16 February 2011 meeting the boards tentatively decided that the accounting for term option penalties should be consistent with the accounting for options to extend or terminate a lease. That is, if a lessee would be required to pay a penalty if it did not renew the lease and the renewal period has not been included in the lease term, then that penalty should be included in the recognised lease payments.

Click here for observer notes [16/2/11].

53 The exercise price of a purchase option included in a lease is not a lease payment, and the purchase option is not included in determining the present value of lease payments receivable.

At their 14 March 2011 meeting the boards tentatively decided that lease payments should include the exercise price of a purchase option (including bargain purchase options) in the measurement of the lessee's liability to make lease payments and the lessor's right to receive lease payments, if the lessee has a significant economic incentive to exercise the purchase option.

Click here for observer notes [14/3/11].

Subsequent measurement

54 After the date of commencement of the lease, a lessor shall measure the right to receive lease payments at amortised cost using the effective interest method, unless paragraph 56(a) or 58 applies.

At their 19 September 2011 meeting the boards tentatively decided that:

(a) A lessor should subsequently measure the right to receive lease payments using the effective interest method.

(b) The leases standard should not contain an option for fair value measurement of the right to receive lease payments.

Click here for observer notes [19/9/11].

55 A lessor shall not remeasure the residual asset unless paragraph 56(a) or 59 applies.

At their 19 September 2011 meeting the IASB tentatively decided that revaluation of the residual asset should be prohibited.

Click here for observer notes [19/9/11].

At their 19 October 2011 meeting the boards discussed the subsequent measurement of a lessor's residual asset when the lease contract includes variable lease payments that are not recognised as a part of the lease receivable at lease commencement.

The boards tentatively decided that:

(a) if the rate that the lessor charges the lessee does not reflect an expectation of variable lease payments, the lessor would not make any adjustments to the residual asset with respect to variable lease payments.

(b) if the rate that the lessor charges the lessee reflects an expectation of variable lease payments, the lessor would adjust the residual asset by recognising a portion of the residual as an expense when the variable lease payments are recognised in profit or loss. The adjustment is made on the basis of the expected variable payments. No adjustment is made to the residual asset for any difference between actual and expected variable lease payments.

Click here for observer notes [19/10/11].

Reassessment of the right to receive lease payments

56 After the date of commencement of the lease, the lessor shall reassess the carrying amount of the right to receive lease payments arising from each lease if facts or circumstances indicate that there would be a significant change in the right to receive lease payments since the previous reporting period. When such indications exist, a lessor shall:

At their 19 October 2011 meeting the boards discussed the measurement of lease receivables held for the purpose of sale and the derecognition guidance to be applied when lease receivables are transferred or sold.

The boards tentatively decided that a lessor:

(a) should not measure a lease receivable at fair value, even if part or all of that receivable is held for the purpose of sale.

(b) should apply existing derecognition requirements (in IFRS 9 *Financial Instruments*) to lease receivables, but allocate the carrying amount of a lease receivable on the basis of its fair value excluding any option elements and variable lease payments that are not transferred.

(c) should apply the disclosure requirements in IFRS 7 *Financial Instruments: Disclosures* transferred lease receivables.

Click here for observer notes [19/10/11].

(c) reassess the length of the lease term in accordance with paragraph 51. When that reassessment results in a change to the residual asset, the lessor shall allocate those changes to the rights derecognised and the residual asset in accordance with paragraph 50 and adjust the carrying amount of the residual asset accordingly (see paragraph B30).

At their 16 February 2011 meeting the boards tentatively decided that a lessee and a lessor should reassess the lease term only when there is a significant change in relevant factors such that the lessee would then either have, or no longer have, a significant economic incentive to exercise any options to extend or terminate the lease.

Click here for observer notes [16/2/11].

At their 14 March 2011 meeting the boards tentatively indicated a preference for specifying the same reassessment guidance for purchase options as was tentatively decided for options to extend or terminate a lease. However, the boards instructed the staff to seek input through targeted outreach on the costs and benefits of requiring reassessment.

Click here for observer notes [14/3/11].

At their 17 May 2011 meeting, The boards discussed how lessees and lessors should reassess whether a lessee has a significant economic incentive to exercise:

(a) an option to extend or terminate a lease; and

(b) an option to purchase the underlying asset.

The boards tentatively decided that a lessee and a lessor should consider contract-based, asset-based and entity-based factors in reassessing whether a lessee has a significant economic incentive to exercise an option. The boards noted that all these factors should be considered together and the existence of only one factor does not necessarily, by itself, signify a significant economic incentive to exercise the option.

The boards also tentatively decided that the thresholds for evaluating a lessee's economic incentive to exercise options to extend or terminate a lease and options to purchase the underlying asset should be the same for both initial and subsequent evaluation, except that a lessee and lessor should not consider changes in market rates after lease commencement when evaluating whether a lessee has a significant economic incentive to exercise an option. In addition, the board tentatively decided that changes in lease payments that is due to a reassessment in the lease term should result in a lessor adjusting its right to receive lease payments and any residual asset, and recognising any corresponding profit or loss (pending the boards' decision on lessor accounting).

Click here for observer notes [17/5/11].

(c) **reassess the expected amount of any contingent rentals and any expected payments under residual value guarantees that the lessor can measure reliably and any expected payments under term option penalties in accordance with paragraph 52. A lessor shall recognise any resulting changes in the expected amount of the right to receive lease payments in profit or loss.**

At their 19 September 2011 meeting the boards tentatively decided that a lessor should recognise immediately in profit or loss changes in the right to receive lease payments due to reassessments of variable lease payments that depend on an index or a rate. .

Click here for observer notes [19/9/11].

57 A lessor shall not change the rate used to discount lease payments except to reflect changes in reference interest rates when contingent rentals depend on those reference interest rates. When contingent rentals are based on reference interest rates, a lessor shall recognise any changes to the right to receive lease payments arising from changes in the discount rate in profit or loss.

At their 17 May 2011 meeting the boards discussed whether there are circumstances that would require a lessee or a lessor to reassess the discount rate that is used to measure the present value of lease payments. The boards tentatively decided that the discount rate should not be reassessed if there is no change in the lease payments.

The boards tentatively decided that the discount rate should be reassessed when the changes below are not reflected in the initial measurement of the discount rate:

(a) when there is a change in lease payments that is due to a change in the assessment of whether the lessee has a significant economic incentive to exercise an option to extend a lease or to purchase the underlying asset.

(b) when there is a change in lease payments that is due to the exercise of an option that the lessee did not have a significant economic incentive to exercise.

The boards also decided that a lessee or lessor should determine a revised discount rate using the spot rate at the reassessment date and should then apply that rate to the remaining lease payments (ie to the remaining payments due in the initial lease plus the payments due during the extension period or upon exercise of a purchase option).

Click here for observer notes [17/5/11].

Impairment of the right to receive lease payments and the residual asset

58 A lessor shall apply IAS 39 at each reporting date to determine whether the right to receive lease payments is impaired. A lessor shall recognise any impairment loss in profit or loss.

At their 19 September 2011 meeting the boards tentatively decided that a lessor should refer to existing financial instruments guidance (IAS 39 Financial Instruments: Classification and Measurement) to assess the impairment of that right to receive lease payments.

Click here for observer notes [19/9/11].

59 A lessor shall apply IAS 36 at each reporting date to determine whether the residual asset is impaired. A lessor shall recognise any impairment loss in profit or loss.

At their 19 September 2011 meeting the boards tentatively decided that a lessor should refer to IAS 36 Impairment of Assets to assess the impairment of the residual asset.

At their 19 September 2011 meeting the boards tentatively decided that a lessor would not recognise amounts expected to be received under a residual value guarantee until the end of the lease. However, the lessor would consider those guarantees when determining whether the residual asset is impaired.

Click here for observer notes [19/9/11].

Presentation: derecognition approach

60 A lessor shall present the following items in the statement of financial position:

(a) rights to receive lease payments, separately from other financial assets, distinguishing those that arise under a sublease.

(b) residual assets, separately within property, plant and equipment, distinguishing those that arise under a sublease.

At their 17 May 2011 meeting the boards tentatively decided that a lessor should present its right to receive lease payments separately from any residual asset. The boards will discuss the presentation of the residual asset at a future meeting.

Click here for observer notes [17/5/11].

At their 19 September 2011 meeting the boards tentatively decided that a lessor should either:

(a) Present the lease receivable and the residual asset separately in the statement of financial position, summing to a total to be called 'lease assets'; or

(b) Present the lease receivable and residual asset together in a single line item—'lease assets'—in the statement of financial position, and separately disclose those two amounts in the notes to the financial statements

Click here for observer notes [19/9/11].

61 A lessor shall present lease income and lease expense in profit or loss either in separate line items or net in a single line item so that the lessor provides information that reflects the lessor's business model. For example:

(a) if a lessor's business model uses leases as an alternative means of realising value from the goods it would otherwise sell, the lessor shall present lease income and lease expense in separate line items. Many manufacturers and dealers regard the lease of an asset as equivalent to selling the asset. Those lessors would present revenue and cost of sales so that income and expenses from sold and leased items are presented consistently.

(b) if a lessor's business model uses leases for the purposes of providing finance, the lessor would present lease income and lease expense net in a single line item.

At their 19 October 2011 meeting the boards discussed presentation requirements for lessors in the statement of comprehensive income. The boards tentatively decided that a lessor should present:

(a) the accretion of the residual asset as interest income.

(b) the amortisation of initial direct costs as an offset to interest income.

(c) lease income and lease expense (for example, revenue and cost of sales) in the statement of comprehensive income either in separate line items (gross) or in a single line item (net), depending on which presentation best reflects the lessor's business model.

The boards also tentatively decided that a lessor should separately identify income and expenses arising from leases either by separate presentation in the statement of comprehensive income or by disclosure in the notes to the financial statements. If disclosed, the notes should reference the line item in which the income is presented.

Click here for observer notes [19/10/11].

62 A lessor shall present in profit or loss interest income from rights to receive lease payments separately from other interest income.

63 A lessor shall classify cash receipts from lease payments as

At their 19 September 2011 meeting the boards tentatively operating activities in the statement of cash flows. If a lessor:

(a) applies the direct method, it shall present the cash receipts from lease payments separately from other cash flows from operating activities.

(b) applies the indirect method, it shall present the changes in the right to receive lease payments separately from changes in other operating receivables.

decided that a lessor should classify the cash inflows from a lease as operating activities in the statement of cash flows.

Click here for observer notes [19/9/11].

Short-term leases: lessees and lessors

64 At the date of inception of a lease, a lessee that has a *short-term lease* may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (a) the liability to make lease payments at the undiscounted amount of the lease payments and (b) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees shall recognise lease payments in profit or loss over the lease term.

65 At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognise assets or liabilities arising from a short-term lease in the statement of financial position, nor derecognise any portion of the underlying asset. Such lessors shall continue to recognise the underlying asset in accordance with other IFRSs and shall recognise lease payments in profit or loss over the lease term.

At their 14 March 2011 meeting the boards tentatively decided that lessees and lessors may elect:

(a) as an accounting policy for a class of underlying asset(s) to account for all short-term leases by not recognising lease assets or lease liabilities; and

(b) to recognise lease payments in profit or loss on a straight-line basis over the lease term, unless another systematic and rational basis is more representative of the time pattern in which use is derived from the underlying asset.

Click here for observer notes [14/3/11].

At their 13 June 2011 meeting the boards discussed the accounting for short-term leases by lessees. A short-term lease is defined as follows: a lease that, at the date of commencement of the lease, has a maximum possible term, including any options to renew, of 12 months or less.

The boards tentatively decided that, for short-term leases, a lessee need not recognise lease assets or lease liabilities. For those leases, the lessee should recognise lease payments in profit or loss on a straight-line basis over the lease term, unless another systematic and rational basis is more representative of the time pattern in which use is derived from the underlying asset.

The boards also tentatively decided that a lessee may elect to apply the recognition and measurement requirements in the leases guidance to short-term leases.

The boards expressed support for requiring disclosure of the rental expense recognised in the current period and a statement about the extent to which that expense is expected to be representative of rental expense in future periods. The boards will continue to discuss disclosures for short-term leases, as well as lessor accounting for short-term leases, at a future meeting.

Click here for observer notes [13/6/11].

At their 20 July 2011 meeting the boards tentatively decided that short-term leases should be excluded from the scope of the 'receivable and residual' approach to lessor accounting.

For those excluded leases, a lessor should (1) continue to recognise and depreciate the underlying asset and (2) recognise lease income over the lease term on a systematic basis.

Click here for observer notes [20/7/11].

Sale and leaseback transactions

66 If a transferor transfers an asset to another party and leases that asset back from that other party, both the transferor and the transferee shall account for the transfer contract and the lease contract in accordance with paragraphs 67–69 if the contracts are:

(a) entered into at or near the same time;

(b) negotiated as a package with a single commercial objective; or

(c) performed either concurrently or consecutively.

67 The transferor shall account for transactions that meet the criteria in paragraph 66 as follows:

(a) If the transfer meets the conditions for a sale (see paragraphs B9, B10 and B31), the transferor shall account for the sale in accordance with applicable IFRSs and for the lease in accordance with paragraphs 10–27.

(b) If the transfer does not meet the conditions for a sale, the transferor shall account for the contract as a financing. The transferor shall not derecognise the transferred asset and shall recognise any amounts received as a financial liability.

68 The transferee shall account for transactions that meet the criteria in paragraph 66 as follows:

(a) If the transfer meets the conditions for a purchase (see paragraphs B9, B10 and B31), the transferee shall account for the purchase in accordance with applicable IFRSs and for the lease using the performance obligation approach (see paragraphs 30–45).

(b) If the transfer does not meet the conditions for a purchase, the transferee shall not recognise the transferred asset. The transferee shall recognise the amount paid as a receivable in accordance with applicable IFRSs.

69 If the consideration for a purchase or sale or the lease payments specified by the leaseback are not at fair value:

(a) a transferor shall adjust:

(i) the measurement of the right-of-use asset to reflect current market rates for lease payments for that asset.

(ii) the gain or loss on disposal of the underlying asset by any difference between the present value of lease payments based on the terms specified in the lease and the present value of the lease payments based on current market rates.

(b) a transferee shall adjust the carrying amount of the underlying asset and the lease liability it recognises under the performance obligation approach to reflect current market rates for the lease payments for that lease.

At their 21-22 March 2011 meeting the boards affirmed the decision in the ED that when a sale has occurred, the transaction will be accounted for as a sale and then a leaseback. If a sale has not occurred, the entire transaction will be accounted for as a financing.

The boards tentatively decided that an entity should apply the control criteria described in the revenue recognition project to determine whether a sale has occurred.

The boards affirmed the decision in the ED that in a transaction accounted for as a sale and leaseback:

(a) When the consideration is at fair value, the gains and losses arising from the transaction should be recognised when the sale occurs.

(b) When the consideration is not established at fair value, the assets, liabilities, gains and losses recognised should be adjusted to reflect current market rentals.

The boards affirmed the decision in the ED that the seller/lessee would adopt the 'whole asset' approach in a sale and leaseback transaction. The 'whole asset' approach deems that in a sale and leaseback transaction, the seller/lessee sells the entire underlying asset and leases back a right-of-use asset relating to part of the underlying asset.

The boards tentatively decided that the leases guidance would not prescribe a particular type of lessee accounting model for entities that are accounting for the leaseback part of a sale and leaseback transaction.

Click here for observer notes [21/3/11].

Disclosure

70 An entity shall disclose quantitative and qualitative financial information that:

At their 20 July 2011 meeting the boards discussed lessee disclosures and tentatively decided that a lessee should disclose the following:

(a) All expenses relating to leases recognised in the reporting period, in a tabular format, disaggregated into (i) amortisation expense, (ii) interest expense, (iii) expense relating to variable lease payments not included in the liability to make lease payments, and (iv) expense for those leases for which the short-term practical expedient is elected, to be followed by the principal and interest paid on the liability to make lease payments.

In addition, the boards tentatively decided that a lessee is not required to disclose the following:

(a) The discount rate used to calculate the liability to make lease payments.

(b) The range of discount rates used to calculate the liability to make lease payments.

(c) The fair value of the liability to make lease payments.

(d) The existence and principal terms of any options for the lessee to purchase the underlying asset, or initial direct costs incurred on a lease.

(e) Information about arrangements that are no longer determined to contain a lease.

With regard to future contractual commitments:

(a) The IASB tentatively decided that a lessee is not required to disclose the future contractual commitments associated with services and other non-lease components that are separated from a lease contract.

(b) The FASB tentatively decided that a lessee should disclose the future contractual commitments associated with services and other non-lease components that are separated from a lease contract.

Click here for observer notes [20/7/11].

(d) identifies and explains the amounts recognised in the financial statements arising from leases; and

(d) **describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows.**

71 An entity shall consider the level of detail necessary to satisfy the disclosure requirements in paragraphs 73–86 and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics.

72 If the disclosures required by this and other IFRSs do not meet the objectives in paragraph 70, an entity shall disclose the additional information necessary to meet the objectives.

Information that identifies and explains the amounts in the financial statements

73 An entity shall disclose:

(a) the nature of its lease arrangements, including:

(i) a general description of those lease arrangements.

(ii) the basis and terms on which contingent rentals are determined.

(iii) the existence and terms of options, including for renewal and termination. A lessee shall provide narrative disclosure about the options that were recognised as part of the right-of-use asset and those that were not.

(iv) the existence and principal terms of any options for the lessee to purchase the underlying asset.

(v) information about assumptions and judgements relating to amortisation methods and changes to those assumptions and judgements.

(vi) the existence and terms of residual value guarantees.

At their 20 July 2011 meeting the boards discussed lessee disclosures and tentatively decided that a lessee should disclose the information required in paragraphs 73(a)(ii)-73(a)(iii) of the exposure draft (the boards will provide guidance, illustrations, or both about those requirements).

Click here for observer notes [20/7/11].

(vii) initial direct costs incurred during the reporting period and included in the measurement of the right-of-use asset or right to receive lease payments.

(viii) the restrictions imposed by lease arrangements, such as those relating to dividends, additional debt and further leasing.

(b) information about the principal terms of any lease that has not yet commenced if the lease creates significant rights and obligations for the entity.

At their 20 July 2011 meeting the boards discussed lessee disclosures and tentatively decided that a lessee should disclose information about the principal terms of any lease that has not yet commenced, if the lease creates significant rights and obligations for the lessee.

Click here for observer notes [20/7/11].

74 An entity shall identify the nature and amount of significant subleases included in the disclosures provided in accordance with paragraph 73.

75 An entity that accounts for short-term leases in accordance with paragraphs 64 and 65 shall disclose that fact and, for lessees, the amount recognised in the statement of financial position for such short-term leases.

At their 20 July 2011 meeting the boards discussed lessee disclosures and tentatively decided that a lessee should disclose qualitative information to indicate whether circumstances or expectations about short-term lease arrangements are present that would result in a material change to the expense in the next reporting period as compared with the current reporting period.

Click here for observer notes [20/7/11].

76 A lessee that enters into a sale and leaseback transaction shall disclose that fact, disclose the terms and conditions for that transaction and identify any gains or losses arising from such transactions separately from gains or losses on other disposals of assets.

77 A lessee shall disclose a reconciliation of opening and closing balances of right-of-use assets and liabilities to make lease payments, disaggregated by class of underlying asset. The reconciliation shall show separately the total cash lease payments paid during the period.

At their 20 July 2011 meeting the boards discussed lessee disclosures and tentatively decided that a lessee should disclose the following:

(a) A reconciliation of the opening and closing balance of right-of-use assets, disaggregated by class of underlying asset.

(b) A reconciliation of the opening and closing balance of the liability to make lease payments (unlike the proposal in the exposure draft, a lessee would not be required to disaggregate the reconciliation by class of underlying asset).

Click here for observer notes [20/7/11].

78 A lessor shall disclose the information about its exposure to the risks or benefits associated with the underlying asset that it used in determining whether to apply the performance obligation approach or the derecognition approach.

79 A lessor shall disclose impairment losses arising from leases to which it applies the performance obligation approach separately from those to which it applies the derecognition approach.

80 A lessor shall disclose a reconciliation of the opening and closing balances for each of the following:

(a) rights to receive lease payments.

(b) lease liabilities arising from leases to which it applies the performance obligation approach.

(c) residual assets arising from leases to which it applies the derecognition approach.

81 A lessor shall disclose information about the nature and amount of each class of residual asset arising from leases to which it applies the derecognition approach.

82 A lessor shall disclose information about the nature of significant service obligations related to its leases.

Information about the amount, timing and uncertainty of cash flows arising from leases

83 An entity shall disclose information about significant assumptions and judgements and any changes in assumptions and judgements relating to renewal options, contingent rentals, term option penalties, residual value guarantees and the discount rate used when determining the present value of lease payments.

84 Except as described in paragraphs 85 and 86, an entity shall disclose information relating to risks arising from a lease required by paragraphs 31–42 of IFRS 7 *Financial Instruments: Disclosures*.

85 In place of the maturity analyses required by paragraph 39(a) and (b) of IFRS 7, a lessee shall disclose a maturity analysis of the liabilities to make lease payments showing the undiscounted cash flows on an annual basis for the first five years and a total of the amounts for the remaining years. The maturity analysis shall distinguish the minimum obligations specified in the lease (ie excluding contingent rentals and expected payments under term option penalties and residual value guarantees) and the amounts recognised in the statement of financial position.

At their 20 July 2011 meeting the boards discussed lessee disclosures and tentatively decided that a lessee should disclose a maturity analysis of the undiscounted cash flows that are included in the liability to make lease payments. The maturity analysis should show, at a minimum, the undiscounted cash flows to be paid in each of the first five years after the reporting date and a total of the amounts for the years thereafter. The analysis should reconcile to the liability to make lease payments.

Click here for observer notes [20/7/11].

86 In place of the maturity analyses required by paragraph 37(a) of IFRS 7, a lessor shall disclose a maturity analysis of the right to receive lease payments showing the undiscounted cash flows on an annual basis for the first five years and a total of the amounts for the remaining years. The maturity analysis shall distinguish the cash flows attributable to the minimum amounts receivable specified in the lease (ie excluding contingent rentals and expected payments from the lessee under term option penalties and residual value guarantees) and the amounts recognised in the statement of financial position.

Effective date and transition

Effective date

87 An entity shall apply this [draft] IFRS in its annual financial statements for periods beginning on or after [date to be inserted after exposure].

Transition

88 For the purposes of the transition provisions in paragraphs 88–96, the date of initial application is the beginning of the first comparative period presented in the first financial statements in which the entity applies this [draft] IFRS. An entity shall recognise and measure all outstanding contracts within the scope of the [draft] IFRS as of the date of initial application using a simplified retrospective approach as described in paragraphs 90–96.

At their 19 October 2011 meeting , to ease the potential burden of applying the final standard in the first year of application, the boards tentatively decided that lessees and lessors may elect the following reliefs:

(a) An entity is not required to evaluate initial direct costs for contracts that began before the effective date.

(b) An entity may use hindsight in comparative reporting periods including the determination of whether or not a contract is a lease or contains a lease.

Click here for observer notes [19/10/11].

89 An entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had been applied from the beginning of the earliest period presented.

Lessees

90 Unless paragraphs 91–93 apply, at the date of initial application, a lessee shall:

At their 19 September 2011 meeting the boards discussed the transition requirements for lessees when first applying the proposed leases standard. The boards will continue to discuss lessee transition when they discuss lessor transition at a future meeting.

Click here for observer notes [19/9/11].

(a) recognise 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.

At their 19 October 2011 meeting the boards tentatively decided that for each operating leases at the beginning of the earliest comparative period presented, a lessee should recognise liabilities to make lease payments at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of the effective date for each portfolio of leases with reasonably similar characteristics. The incremental borrowing rate for each portfolio of leases should take into consideration the lessee's total leverage, including leases in other portfolios.

Click here for observer notes [19/10/11].

(b) recognise a right-of-use asset for each outstanding lease, measured at the amount of the related liability to make lease payments, subject to any adjustments required to reflect impairment.

At their 19 October 2011 meeting the boards tentatively decided that for each operating leases at the beginning of the earliest comparative period presented, a lessee should recognise right-of-use assets on the basis of proportion of the liability to make lease payments at lease commencement, relative to the remaining lease payments. A lessee should record to retained earnings any difference between the liabilities to make lease payments and the right-of-use assets at transition.

Click here for observer notes [19/10/11].

91 When lease payments are uneven over the lease term, a lessee shall adjust the right-of-use asset recognised at the date of initial application by the amount of any recognised prepaid or accrued lease payments.

At their 19 October 2011 meeting the boards also tentatively decided that when lease payments are uneven over the lease term, a lessee should adjust the right-of-use asset recognised at the beginning of the earliest comparative period presented by the amount of any recognised prepaid or accrued lease payments.

Click here for observer notes [19/10/11].

92 For leases that were classified in accordance with IAS 17 *Leases* as finance leases and do not have options, contingent rentals, term option penalties or residual value guarantees, the carrying amount at the date of initial application of the right-of-use asset and the liability to make lease payments shall be the carrying amount of the lease asset and liability under that standard.

At their 19 October 2011 meeting the boards tentatively decided that for capital or finance leases existing at the beginning of the earliest comparative period presented, a lessee would not be required to make any adjustments to the carrying amount of the lease assets and lease liabilities. However, the entity would reclassify the lease assets and lease liabilities as right-of-use assets and liabilities to make lease payments.

Click here for observer notes [19/10/11].

93 For each short-term lease that the lessee accounts for in accordance with paragraph 64, at the date of initial application a lessee shall recognise a liability to make lease payments measured at the undiscounted amount of the remaining lease payments and a right-of-use asset at the amount of the liability recognised.

Lessors: performance obligation approach

94 At the date of initial application, a lessor shall:

(a) recognise a right to receive lease payments for each outstanding lease, measured at the present value of the remaining lease payments, discounted using the rate charged in the lease determined at the date of inception of the lease, subject to any adjustments required to reflect impairment.

(b) recognise a lease liability for each outstanding lease, measured at the amount of the related right to receive lease payments.

(c) reinstate previously derecognised underlying assets at depreciated cost, determined as if the asset had never been derecognised, subject to any adjustments required to reflect impairment and revaluation.

Lessors: derecognition approach

95 At the date of initial application, a lessor shall:

(a) recognise a right to receive lease payments for each outstanding lease, measured at the present value of the remaining lease payments, discounted using the rate charged in the lease determined at the date of inception of the lease, subject to any adjustments required to reflect impairment.

(b) recognise a residual asset at fair value determined at the date of initial application.

At their 19 October 2011 meeting the boards tentatively decided that for finance- or sales-type leases and direct finance leases existing at the beginning of the earliest comparative period presented, a lessor would not be required to make adjustments to the carrying amount of the assets associated with those leases.

For operating leases existing at the beginning of the earliest comparative period presented, the boards tentatively decided that a lessor should:

(a) Recognise a right to receive lease payments, measured at the present value of the remaining lease payments, discounted using the rate charged in the lease that was determined at the date of commencement of the lease, subject to any adjustments that are required to reflect impairment.

(b) Recognise a residual asset that is consistent with the initial measurement of the residual asset under the receivable and residual approach, using information available at the beginning of the earliest comparative period presented.

(c) Derecognise the underlying asset.

The boards also tentatively decided that when lease payments are uneven over the lease term, a lessor should adjust the cost basis in the underlying asset that is derecognised at the date of the earliest comparative period presented by the amount of any recognised prepaid or accrued lease payments.

Click here for observer notes [19/10/11].

Disclosure

96 An entity shall provide the transition disclosures required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, without the disclosure of adjusted basic and diluted earnings per share.

At their 19 October 2011 meeting the boards also tentatively decided that lessees and lessors should provide transition disclosures that are consistent with IAS 8 *Accounting Policies, Changes in Estimates and Errors,* but that they would not need to disclose the effect of the change on income from continuing operations, net income, any other affected financial statement line item, and any affected per-share amounts for the current period and any prior periods adjusted retrospectively. In addition, if an entity elects any of the available reliefs, the entity should disclose which reliefs it elected. Notwithstanding all of the above tentative decisions on transition, the boards tentatively decided that a lessee or lessor could choose to apply the requirements in the new leases standard retrospectively in accordance with IAS 8.

Click here for observer notes [19/10/11].

Withdrawal of other IFRSs

97 This [draft] IFRS supersedes the following IFRSs:

(a) IAS 17

(b) IFRIC 4 *Determining whether an Arrangement contains a Lease*

(c) SIC-15 *Operating Leases—Incentives*

(d) SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

98 [This paragraph in the FASB exposure draft is not used in the IASB exposure draft.]

Appendix A
Defined terms

This appendix is an integral part of the [draft] IFRS.

contingent rentals	**Lease payments** that arise under the contractual terms of a **lease** because of changes in facts or circumstances occurring after the **date of inception of the lease**, other than the passage of time.	
date of commencement of the lease	The date on which the **lessor** makes the **underlying asset** available for use by the **lessee**.	
date of inception of the lease	The earlier of the date of the **lease** agreement and the date of commitment by the parties to the **lease** agreement.	
initial direct costs	Recoverable costs that are directly attributable to negotiating and arranging a **lease** that would not have been incurred had the **lease** transaction not been made.	At their 21-22 March 2011 meeting the boards tentatively defined initial direct costs as follows: Costs that are directly attributable to negotiating and arranging a lease that would not have been incurred had the lease transaction not been made. Click here for observer notes [21/3/11].
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.	At their April 2011 meeting the boards tentatively decided the following in relation to applying the definition of a lease an entity would determine whether a contract contains a lease on the basis of the substance of the contract, by assessing whether: (a) the fulfilment of the contract depends on the use of a specified asset; and (b) the contract conveys the right to control the use of a specified asset for a period of time. Click here for observer notes [12/4/11].
lease liability	The **lessor**'s obligation to permit the **lessee** to use the **underlying asset** over the **lease term**.	
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.	
lease term	The longest possible term that is more likely than not to occur.	At their 16 February 2011 meeting, the boards tentatively decided that the lease term should be defined as 'the non cancellable period for which the lessee has contracted with the lessor to lease the underlying asset, together with any options to extend or terminate the lease when there is a significant economic incentive for an entity to exercise an option to extend the lease, or for an entity not to exercise an option to terminate the lease'. Click here for observer notes [16/2/11].
lessee	An entity that enters into a contract to provide another entity with consideration in return for the right to use an asset for a period of time.	
lessor	An entity that enters into a contract to provide another entity with the right to use an asset for a period of time in return for consideration.	

lessee's incremental borrowing rate	The rate of interest that, at the **date of inception of the lease,** the **lessee** would have to pay to borrow over a similar term, and with a similar security, the funds necessary to purchase a similar **underlying asset**.	
rate the lessor charges the lessee	A discount rate that takes into account the nature of the transaction as well as the specific terms of the **lease** such as **lease payments**, **lease term** and **contingent rentals**.	
residual asset	An asset representing the rights to the **underlying asset** retained by the **lessor** under the derecognition approach for lessor accounting.	
residual value guarantee	A guarantee made by the **lessee** that the fair value of the **underlying asset** that the **lessee** will return to the **lessor** will be at least a specified amount. If the fair value is less than that amount, the **lessee** is obliged to pay the difference to the **lessor**.	
right-of-use asset	An asset that represents the **lessee**'s right to use, or control the use of, a specified asset for the **lease term**.	
short-term lease	A **lease** that, at the **date of commencement of the lease**, has a maximum possible **lease term** including options to renew or extend, of twelve months or less.	At their 14 March 2011 meeting the Boards tentatively decided that a short-term lease is defined as 'a lease that, at the date of commencement of the lease, has a maximum possible term, including any options to renew, of 12 months or less'. Click here for observer notes [14/3/11].
sublease	A transaction in which an **underlying asset** is re-leased by the original **lessee** (or 'intermediate **lessor**') to a third party, and the lease agreement (or 'head lease') between the original **lessor** and **lessee** remains in effect.	
underlying asset	The asset for which a right of use is conveyed in a **lease**.	

The term 'investment property' is defined in IAS 40 *Investment Property* and is used in the [draft] IFRS with the meaning specified in IAS 40.

The term 'effective interest method' is defined in IAS 39 *Financial Instruments: Recognition and Measurement* and is used in the [draft] IFRS with the meaning specified in IAS 39.

The term 'performance obligation' is used in the [draft] IFRS with the meaning proposed in the exposure draft *Revenue from Contracts with Customers.*

Appendix B
Application guidance

DEFINITION OF A LEASE

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Contract conveys the right to control the use of a specified asset

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Contracts that contain both service components and lease components

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OR THE DERECOGNITION APPROACH

LESSOR: PERFORMANCE OBLIGATION APPROACH

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LESSOR: DERECOGNITION APPROACH

Accounting for changes in lease term

Example 4 – When the assessed lease term decreases
Example 5 – When the assessed lease term increases

SALE AND LEASEBACK TRANSACTIONS

Determining whether the underlying asset has been purchased or sold

Appendix B
Application guidance

This appendix is an integral part of [draft] IFRS X.

Definition of a lease (Appendix A)

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).

At their April 2011 meeting the boards tentatively decided the following in relation to applying the definition of a lease an entity would determine whether a contract contains a lease on the basis of the substance of the contract, by assessing whether:

(a) the fulfilment of the contract depends on the use of a specified asset; and

(b) the contract conveys the right to control the use of a specified asset for a period of time.

Click here for observer notes [12/4/11].

Fulfilment of the contract depends on providing a specified asset

B2 In assessing whether fulfilment of the contract depends on providing a specified asset or assets (the 'underlying asset') to the lessee, it may be necessary to consider whether the asset or assets are implicitly or explicitly identified. An asset is implicitly 'specified' if it is (a) infeasible or impractical for a lessor to provide alternative assets in place of the underlying asset during the lease term or (b) if a lessor can substitute another asset for the underlying asset but rarely does so in practice. For example, in a lease of an aircraft, it may not be practical to substitute another aircraft if the lessee has made extensive changes to the underlying asset (the aircraft) to suit the lessee's image, brand and requirements.

B3 A contract that permits an entity to substitute a similar asset for the specified asset after the date of commencement of the lease does not contain a lease because the underlying asset is not specified, even if the contract explicitly identifies a specified asset. For example, if a supplier of a specified quantity of goods or services has the right and current ability to provide those goods or services using assets not specified in the arrangement, the underlying assets are not specified and the contract does not contain a lease. However, a contract that permits or requires the supplier to substitute other assets only when the specified asset is not operating properly may be a lease. In addition, a contractual provision (contingent or otherwise) that permits or requires a supplier to substitute other assets for any reason on or after a specified date does not preclude lease treatment before the date of substitution.

At their 16 February 2011 meeting the boards expressed support for defining a 'specified asset' as an asset of a particular specification. The boards also discussed an alternative approach that defines a 'specified asset' as a uniquely identified or identifiable asset, which is closer to the application of current requirements in IFRSs and US GAAP. The boards will seek input on both of those approaches.

The boards also expressed support for clarifying that both physical and non-physical portions of a larger asset can be specified assets. The boards tentatively decided that such a clarification would be made only in conjunction with revising the definition of the right to control the use of an asset. This is to maintain consistency with how control is articulated in the revenue recognition exposure draft *Revenue from Contracts with Customers*. The boards also discussed an alternative approach of clarifying only that physically distinct portions of a larger asset can be specified assets. The boards will seek input on both approaches.

Click here for observer notes [16/2/11].

At their April 2011 meeting the boards tentatively decided the following in relation to applying the definition of a lease:

(a) A 'specified asset' refers to an asset that is explicitly or implicitly identifiable.

(b) A physically distinct portion of a larger asset of which a customer has exclusive use is a specified asset. A capacity portion of a larger asset that is not physically distinct (eg a capacity portion of a pipeline) is not a specified asset.

Click here for observer notes [12/4/11].

Contract conveys the right to control the use of a specified asset

B4 A contract conveys the right to use an asset if it conveys to an entity the right to control the use of the underlying asset during the lease term. The right to control the use of the underlying asset is conveyed if any one of the following conditions is met:

(a) The entity has the ability or right to operate the asset or direct others to operate the asset in a manner that it

At their 16 February 2011 the boards expressed support for an approach that defines the right to control the use of an asset consistently with how control is articulated in the revenue recognition exposure draft *Revenue from Contracts with Customers*. This approach would state that a customer has the right to control the use of a specified asset if it has the ability to direct the use, and receive the determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.

(b) The entity has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.

(c) The entity will obtain all but an insignificant amount of the output or other utility of the asset during the term of the lease, and the price that the entity will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output. If the price that the entity will pay is contractually fixed per unit of output or at the current market price as of the time of delivery of the output, then the entity is paying for a product or service rather than paying for the right to use the underlying asset.

benefit from use, of the asset throughout the lease term. The boards also discussed an alternative approach of retaining the three conditions in paragraph B4 of the exposure draft but to clarify the principle underlying condition (c) of paragraph B4. The boards will seek input on both approaches.

Click here for observer notes [16/2/11].

At their April 2011 meeting the boards tentatively decided a contract would convey that right to control the use if the customer has the ability to direct, and receive the benefit from, the use of a specified asset throughout the lease term. Guidance on separating the use of a specified asset from other services should be aligned with the boards' tentative decisions in March 2011 relating to the separation of lease and non-lease components.

Click here for observer notes [12/4/11].

At their 17 May 2011 meeting the boards tentatively decided to provide guidance on accounting for changes after the date of inception of the lease as follows:

(a) A modification to the contractual terms of a contract that is a substantive change to the existing contract should result in the modified contract being accounted for as a new contract. The change is a substantive change if it results in a different determination of whether the contract is, or contains, a lease or, if applicable, whether the contract transfers substantially all of the risks and rewards incidental to ownership of the underlying asset.

(b) A change in circumstances other than a modification to the contractual terms of the contract that would affect the assessment of whether a contract is, or contains, a lease should result in a reassessment as to whether the contract is, or contains, a lease.

Click here for observer notes [17/5/11].

Scope

Contracts that contain both service components and lease components (paragraph 6)

B5 An entity shall apply the proposals in the boards' exposure draft *Revenue from Contracts with Customers* to identify separate performance obligations within a contract that contains both service components and lease components. An entity shall account for each component as follows:

(a) If the service component is distinct (see paragraphs B6 and B7), the entity allocates the payments required by the contract between the service components and lease components using the principles proposed in paragraphs 50–52 of *Revenue from Contracts with Customers*. However, if a lessee or a lessor that applies the performance obligation approach is unable to allocate the payments, the lessee or lessor applies this [draft] IFRS to the whole contract.

(b) If the service component is not distinct, a lessee and a lessor that applies the performance obligation approach shall account for the whole contract as a lease.

(c) If a service component is not distinct and a lessor applies the derecognition approach, the lessor shall allocate the payments between service components and lease components on a reasonable basis, eg based on the stand-alone selling price of the service. The lessor recognises a receivable for the lease component only and recognises the service component in accordance with the

At their 21-22 March 2011 meeting the boards tentatively decided that an entity should be required to identify and separately account for the lease and the non-lease components of a contract.

The boards tentatively decided that in allocating payments in a contract between the lease and non-lease components of the contract:

(a) The lessor should allocate payments in accordance with the guidance on revenue recognition. All board members supported this decision.

(b) The lessee should allocate payments as follows:

i. If the purchase price of each component is observable, the lessee would allocate the payments on the basis of the relative purchase prices of individual components;

ii. If the purchase price of one or more, but not all, of the components is observable, the lessee would allocate the payments on the basis of a residual method; or

iii. If there are no observable purchase prices, the principles proposed in paragraphs 50–52 of *Revenue from Contracts with Customers*.

lessee would account for all the payments required by the contract as a lease.

The boards directed the staff to include application guidance on how a lessee should determine what would be an observable price, taking into consideration the relevance of guidance in other projects such as revenue recognition.

Click here for observer notes [21/3/11].

B6 An entity shall determine whether a service component is distinct at the date of inception of the lease considering all concurrently negotiated contracts with another party.

B7 A service component is distinct if either:

(a) the entity, or another entity, sells an identical or similar service separately; or

(b) the entity could sell the service separately because the service meets both of the following conditions:

(i) It has a distinct function—a service has a distinct function if it has a utility either (1) on its own or (2) together with other non-leasing goods and services that the lessee has acquired from the lessor or is provided separately by the lessor or by another entity.

(ii) It has a distinct profit margin—a service has a distinct profit margin if it is subject to distinct risks and the lessor can separately identify the resources needed to provide the service.

B8 If the payments required by a contract that contains both lease and service components change after the commencement of the lease, an entity shall determine the change attributable to the lease and service components. If the amount of the change attributable to each component cannot be determined, the entity shall allocate the change to the service components and lease components in the same proportion as determined at the date of commencement of the contract.

Distinguishing between a lease and a purchase or sale (paragraph 8)

B9 An entity shall not apply this [draft] IFRS to contracts that meet the criteria for classification as a purchase or sale of an underlying asset. A contract represents a purchase or sale of an underlying asset if, at the end of the contract, an entity transfers to another entity control of the entire underlying asset and all but a trivial amount of the risks and benefits associated with the entire underlying asset. That determination is made at inception and is not subsequently reassessed.

At their 14 March 2011 meeting the boards tentatively decided that guidance should not be provided in the Leases standard for distinguishing a lease of an underlying asset from a purchase or a sale of an underlying asset. That is, if an arrangement does not contain a lease, it should be accounted for in accordance with other applicable standards (for example, property, plant, and equipment or revenue recognition).

Click here for observer notes [14/3/11].

B10 An entity shall consider all relevant facts and circumstances when determining whether control of the underlying asset is transferred at the end of the contract. A contract normally transfers control of an underlying asset when the contract:

(a) automatically transfers title to the underlying asset to the transferee at the end of the contract term; or

(b) includes a bargain purchase option. A bargain purchase option is an option to purchase the asset at a price that is expected to be significantly lower than the fair value of the asset at the date that the option becomes exercisable. If the exercise price is significantly lower than fair value, it would be reasonably certain at the inception of the lease that such options will be exercised. An entity that has a bargain purchase option is in an economically similar position to an entity that will automatically obtain title to the underlying asset at the end of the lease term. By exercising its bargain purchase option, the transferee would be able to direct the use of, and receive the benefits from, the whole of the underlying asset for the whole of its life.

Lessee and lessor: initial measurement

Discount rate (paragraphs 12(a), 33(a) and 49(a))

B11 The discount rate used to determine the present value of lease payments for lessees is the lessee's incremental borrowing rate or the rate the lessor charges the lessee if that rate can be reliably determined. The lessee's incremental borrowing rate may be the same as the rate the lessor charges the lessee.

B12 The discount rate used to determine the present value of lease payments for lessors is the rate that the lessor charges the lessee. The rate the lessor charges the lessee could be, for example the lessee's incremental borrowing rate, the rate implicit in the lease (ie the rate that causes the sum of the present value of cash flows and the present value of the residual value of the underlying asset at the end of the lease to equal the fair value of the underlying asset) or, for property leases, the yield on the property.

B13 Both the lessee's incremental borrowing rate and the rate the lessor charges the lessee would reflect the nature of the transaction and the specific terms of the lease, such as lease payments, lease term, expected contingent rentals, expected payments under term option penalties and residual value guarantees, the expected value of the underlying asset at the end of the lease term and security attached to the underlying asset during and at the end of the lease term.

At their 21-22 March 2011 meeting the boards tentatively decided that the Leases standard would require a lessee and a lessor to use a discount rate calculated at the date of commencement when initially measuring lease assets and lease liabilities.

The boards also tentatively reaffirmed the proposals in the ED, with regards to discount rates, but clarified the following:

(a) The lessee would use the rate the lessor charges the lessee when that rate is available; otherwise the lessee would use its incremental borrowing rate.

(b) The lessor would use the rate the lessor charges the lessee.

(c) The rate the lessor charges the lessee could be the lessee's incremental borrowing rate, the rate implicit in the lease, or, for property leases, the yield on the property. When more than one indicator of the rate that the lessor charges the lessee is available, the rate implicit in the lease should be used.

The boards also tentatively decided to provide application guidance for the determination of the discount rate when considering the use of a group discount rate and determining the yield on property.

Click here for observer notes [21/3/11].

Initial direct costs (paragraphs 12(b), 33(b) and 49(a))

B14 Initial direct costs result directly from, and are essential to, acquiring or originating a lease and would not have been incurred had the lease transaction not been made. They may include:

(a) commissions

(b) legal fees

(c) evaluation of the prospective lessee's financial condition

(d) evaluating and recording guarantees, collateral and other security arrangements

(e) negotiating lease terms

(f) preparing and processing lease documents

(g) closing the transaction

(h) other costs that are incremental and directly attributable to negotiating and arranging the lease.

B15 The following items are not initial direct costs:

(a) general overheads, such as rent, depreciation, occupancy and equipment costs, unsuccessful origination efforts and idle time

(b) costs related to activities performed by the lessor for advertising, soliciting potential lessees, servicing existing leases, or other ancillary activities.

Present value of the lease payments

Determining the lease term (paragraphs 13, 34 and 51)

B16 The lease term is defined as the longest possible term that is more likely than not to occur. An entity determines the lease term considering all explicit and implicit options included in the contract and given effect by the operation of statutory law.

At their 16 February 2011 meeting, the boards tentatively decided that the lease term should be defined as 'the non cancellable period for which the lessee has contracted with the lessor to lease the underlying asset, together with any options to extend or terminate the lease when there is a significant economic incentive for an entity to exercise an option to extend the lease, or for an entity not to exercise an option to terminate the lease'.

Click here for observer notes [16/2/11].

B17 The following illustrates how an entity applies paragraphs 13, 34 and 51 to determine the lease term. An entity may have a lease that has a non-cancellable 10-year term, an option to renew for 5 years at the end of 10 years, and an option to renew for an additional 5 years at the end of 15 years. Assume that the entity determines the probability for each term as follows:

(a) 40 per cent probability of 10-year term

(b) 30 per cent probability of 15-year term

(c) 30 per cent probability of 20-year term.

The term will be at least 10 years, there is a 60 per cent chance that the term will be 15 years or longer, but only a 30 per cent chance that the term will be 20 years. Therefore there is a 60 per cent chance that the term will be 15 years, which is the longest possible term more likely than not to occur. Therefore the lease term is 15 years.

B18 An entity considers the following factors in assessing the probability of each possible term:

(a) contractual factors, which are the explicit contractual terms that could affect whether the lessee extends or terminates the lease. Examples of contractual factors are the level of lease payments in any secondary period (bargain, discounted, market or fixed rate), the existence and amount of any contingent rentals or other contingent payments such as payments under term option penalties and residual value guarantees, the existence and terms of any renewal options and costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location.

(b) non-contractual factors, such as statutory law or the financial consequences of a decision to extend or terminate the lease that the contract does not state explicitly. Examples of non-contractual features are local regulations that affect the lease term, the existence of significant leasehold improvements that would be forgone if the lease were terminated or not extended, non-contractual relocation costs, costs of lost production, tax consequences and costs associated with sourcing an alternative item.

(c) business factors, such as whether the underlying asset is crucial to the lessee's operations, or whether the underlying asset is a specialised asset or the location of the asset.

(d) other lessee-specific factors, such as lessee's intentions and past practice.

B19 Leases sometimes include options and residual value guarantees. For example, a lease may have a term of 10 years. At the end of the 10-year period, the contract permits the lessee to return the underlying asset to the lessor or to extend the lease for an additional 5 years. If the lessee returns the leased asset to the lessor, the contract may specify that the lessee will pay the lessor the difference between the expected residual value of the leased asset at the end of 10 years and the actual residual value at the end of 10 years (a residual value guarantee). At the date of inception of the lease, a lessee or lessor shall determine whether exercising the option to extend is more likely than not to occur. At the date of commencement of the lease, the lessee recognises a liability to make lease payments and the lessor recognises a right to receive lease payments that is consistent with that outcome. Thus:

(a) if the lessee or lessor determine that returning the asset at the end of the 10-year period is more likely than not to occur, the lease term for the lessee or lessor is 10 years. In that case:

   (i) the lessee would recognise a liability to make lease payments equal to the present value of 10 years of lease payments plus an estimate of the amount payable under the residual value guarantee.

   (ii) if the lessor retains exposure to significant risks or benefits associated with the underlying asset, the lessor would recognise a receivable and a liability equal to the present value of 10 years of lease payments plus an estimate of the amount receivable under the residual value guarantee. The lessor would continue to recognise the underlying asset.

   (iii) if the lessor does not retain exposure to significant risks or benefits associated with the underlying asset, the lessor would recognise a receivable equal to the present value of 10 years of lease payments plus an estimate of the amount receivable under the residual value guarantee and would derecognise a portion of the underlying asset.

(b) if the lessee or lessor determines that renewal is more likely than not to occur, the lease term for the lessee or lessor is 15 years. In that case:

   (i) the lessee would recognise a liability to make lease payments equal to the present value of 15 years of lease payments.

   (ii) if the lessor retains exposure to significant risks or benefits associated with the underlying asset, the lessor would recognise a receivable and a liability equal to the present value of 15 years of lease payments. The lessor would continue to recognise the underlying asset.

   (iii) if the lessor does not retain exposure to significant risks or benefits associated with the underlying asset, the lessor would recognise a receivable equal to the present value of 15 years of lease payments and would derecognise a portion of the underlying asset.

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

Determining the amount of lease payments (paragraphs 14, 35 and 52)

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.

Lessor: when to apply the performance obligation or derecognition approach (paragraphs 28 and 29)

B22 A lessor shall consider the following factors in assessing whether it retains exposure to significant risks or benefits associated with the underlying asset during the expected term of the current lease:

(a) significant contingent rentals during the lease term that are based on the use or performance of the underlying asset.

(b) options to extend or terminate the lease.

(c) material non-distinct services provided under the current lease.

B23 The existence of material non-distinct services may expose the lessor to a significant risk that the lessee will terminate the lease early because of the non-provision of those services. When the risk that the lessee will terminate the lease early is significant, the lessor is likely to be exposed to significant risks or benefits associated with the underlying asset during the term of the lease.

B24 A lessor shall consider the following factors when determining whether it retains exposure to significant risks or benefits associated with the underlying asset after the expected term of the current lease:

(a) whether the duration of the lease term is not significant in relation to the remaining useful life of the underlying asset.

(b) whether a significant change in the value of the underlying asset at the end of the lease term is expected. In making that assessment, the lessor shall consider:

(i) the present value of the underlying asset at the end of the lease term, and

(ii) the effect that any residual value guarantees (including those provided by an unrelated third party) may have on the lessor's exposure to risks or benefits.

B25 In general, a residual value guarantee will reduce a lessor's exposure to downside risk but may give the lessor the potential to benefit from increases in the expected value of the underlying asset at the end of the lease.

B26 The existence of one or more indicators is not conclusive in determining whether the lessor retains exposure to significant risks or benefits associated with the underlying asset.

B27 A lessor shall not consider the risks associated with the counterparty credit risk of the lessee when determining whether it retains exposure to significant risks or benefits associated with the underlying leased asset during the expected term of the current lease.

Lessor: performance obligation approach

Accounting for changes in lease term (paragraph 39(a))

B28 The following examples illustrate how a lessor might apply the performance obligation approach if the lease term increases or decreases after recognition and initial measurement.

Example 1 – When the assessed lease term decreases

Entity A enters into a five-year lease of a machine with an expected useful life of fifteen years. The lease includes an option to terminate after three years. Annual lease payments are CU1,000[(a)] in arrears. The rate the lessor charges in the lease is 8 per cent. The carrying amount of the machine at the commencement of the lease is CU15,000. The lessor initially estimates the lease term is five years. The lessor further determines that it retains exposure to significant risks or benefits associated with the underlying asset after the expected lease term and accounts for the lease using the performance obligation approach.

The present value of five years of lease payments is CU3,993.

The lessor amortises the lease liability on a straight-line basis.

At the end of year 1, the lessor reassesses the lease term and determines that the option will be exercised and the lease will terminate at the end of three years. The present value of the remaining two years of lease payments is CU1,783.

At the date of commencement of the lease, the lessor recognises a right to receive lease payments (lease receivable) and a lease liability:

Dr lease receivable CU3,993

Cr lease liability CU3,993

At the end of year 1, the lessor recognises (1) receipt of the lease payment, (2) interest on the lease receivable, (3) lease income from satisfaction of the lease liability and (4) depreciation expense on the underlying asset:

Dr cash CU1,000

Cr lease receivable CU1,000

Dr lease receivable CU319 (CU3,993 × 8%)

Cr interest income CU319

Dr lease liability CU799 (CU3,993 ÷ 5 years)

Cr lease income CU799

Dr depreciation expense CU1,000 (CU15,000 ÷ 15 years)

Cr accumulated depreciation CU1,000

Following these events, the carrying amount of the lease receivable is CU3,312 (CU3,993 – CU1,000 + CU319), the carrying amount of the lease liability is CU3,194 (CU3,993 – CU799) and the net amount recognised in profit or loss is income of CU118 (lease income of CU799 plus interest income of CU319 less depreciation expense of CU1,000).

At the end of year 1, the lessor reassesses the lease term and decreases its lease receivable to reflect the new expected payments (two years remaining). The lessor makes a corresponding decrease in the lease liability to reflect the shorter term of the lease:

Dr lease liability CU1,529

Cr lease receivable CU1,529 (CU3,312 – CU1,783)

After making this adjustment the carrying amount of the lease receivable is CU1,783 representing the present value of the two remaining CU1,000 lease payments and the carrying amount of the lease liability is CU1,665 representing the lease liability of CU3,194 adjusted for the decrease in the lease receivable of CU1,529.

At the end of year 2, the lessor recognises (1) receipt of the lease payment, (2) interest on the lease receivable, (3) lease income from satisfaction of the lease liability and (4) depreciation expense on the underlying asset:

Dr cash CU1,000

Cr lease receivable CU1,000

Dr lease receivable CU143 (CU1,783 × 8%)

Cr interest income CU143

Dr lease liability CU832 (CU1,665 ÷ 2 years)

Cr lease income CU832

Dr depreciation expense CU1,000 (CU15,000 ÷ 15 years)

Cr accumulated depreciation CU1,000

Following these events, the carrying amount of the lease receivable is CU926 (CU1,783 – CU1,000 + CU143), the carrying amount of the lease liability is CU833 (CU1,665 – CU832) and the net amount recognised in profit or loss is a loss of CU25 (lease income of CU832 plus interest income of CU143 less depreciation expense of CU1,000).

(a) In this [draft] IFRS monetary amounts are denominated in 'currency units (CU)'.

Example 2 –When the assessed lease term increases

Example 2 uses the same facts as in example 1 except that the lessor initially estimates that the lease term is three years. The lessor further determines that it retains exposure to significant risks or benefits associated with the underlying asset after the expected lease term and accounts for the lease using the performance obligation approach.

The present value of three years of lease payments is CU2,577.

At the end of year 1, the lessor reassesses the lease term and determines that the lease term is five years. The present value of four years of lease payments is CU3,312.

At the date of commencement of the lease, the lessor recognises a right to receive lease payments (lease receivable) and a lease liability:

Dr lease receivable CU2,577

Cr lease liability CU2,577

At the end of year 1, the lessor recognises (1) receipt of the lease payment, (2) interest on the lease receivable, (3) lease income from satisfaction of the lease liability and (4) depreciation expense on the underlying asset:

Dr cash CU1,000

Cr lease receivable CU1,000

Dr lease receivable CU206 (CU2,577 × 8%)

Cr interest income CU206

Dr lease liability CU859 (CU2,577 ÷ 3 years)

Cr lease income CU859

Dr depreciation expense CU1,000 (CU15,000 ÷ 15 years)

Cr accumulated depreciation CU1,000

Following these events, the carrying amount of the lease receivable is CU1,783 (CU2,577 – CU1,000 + CU206), the carrying amount of the lease liability is CU1,718 (CU2,577 – CU859) and the net amount recognised in profit or loss is income of CU65 (lease income of CU859 plus interest income of CU206 less depreciation expense of CU1,000).

At the end of year 1, the lessor reassesses the lease term and increases its lease receivable to the newly expected payments (remaining four years) with a corresponding increase in the lease liability to reflect the longer term of the lease:

Dr lease receivable CU1,529 (CU3,312 – CU1,783)

Cr lease liability CU1,529

After making this adjustment the carrying amount of the lease receivable is CU3,312 representing the present value of four CU1,000 lease payments and the carrying amount of the lease liability is CU3,247 representing the lease liability of CU1,718 adjusted for the increase in the lease receivable of CU1,529.

At the end of year 2, the lessor recognises (1) receipt of the lease payment, (2) interest on the lease receivable, (3) lease income from satisfaction of the lease liability and (4) depreciation expense on the underlying asset:

Dr cash CU1,000

Cr lease receivable CU1,000

Dr lease receivable CU265 (CU3,312 × 8%)

Cr interest income CU265

Dr lease liability CU812 (CU3,247 ÷ 4 years)

Cr lease income CU812

Dr depreciation expense CU1,000 (CU15,000 ÷ 15 years)

Cr accumulated depreciation CU1,000

Following these events, the carrying amount of the lease receivable is CU2,577 (CU3,312 – CU1,000 + CU265), the carrying amount of the lease liability is CU2,435 (CU3,247 – CU812) and the net amount recognised in profit or loss is income of CU77 (lease income of CU812 plus interest income of CU265 less depreciation expense of CU1,000).

Presentation by intermediate lessor in a sublease (paragraph 43)

B29 The following example illustrates in italics how an intermediate lessor would present lease assets and liabilities arising from a sublease.

Example 3 – Presentation of information from a sublease

Property, plant and equipment		X
Cash		X
Right-of-use asset	*X*	
Lease receivables	*X*	

Lease liability	*(X)*	
Net sublease asset		*X*
Total assets		X
Trade and other payables		*X*
Liability to make lease payments		*X*
Total liabilities		(X)

Lessor: derecognition approach

Accounting for changes in lease term (paragraphs 56(a))

B30 The following examples illustrate how a lessor might apply the derecognition approach if the lease term increases or decreases after recognition and initial measurement.

Example 4 – When the assessed lease term decreases

Entity A enters into a ten-year lease of a machine. The lease includes an option to terminate after eight years. Annual lease payments are CU1,000 in arrears. The rate the lessor charges in the lease is 8 per cent. The fair value of the machine at the commencement of the lease is CU7,000 and its carrying amount is CU5,000. The useful life of the machine is ten years. The lessor initially estimates the lease term is ten years. The lessor further determines that it does not retain exposure to significant risks or benefits associated with the underlying asset either during or after the expected lease term and accounts for the lease using the derecognition approach.

The present value of ten years of lease payments is CU6,710.

At the end of year 1, the lessor reassesses the lease term and determines that the option will be exercised and the lease will terminate at the end of eight years. The fair value of the machine at the end of year 1 is CU6,250. The present value of seven years of lease payments is CU5,206.

At the date of commencement of the lease, the lessor derecognises the portion of the asset transferred to the lessee, recognises a lease receivable and recognises revenue and cost of sales:

Dr lease receivable CU6,710

Dr cost of sales CU4,793

Cr underlying asset CU4,793 (CU5,000 × CU6,710 ÷ CU7,000)

Cr revenue CU6,710

At the date of commencement of the lease, the lessor recognises a profit from the lease of CU1,917 (CU6,710 – CU4,793).

At the end of year 1, the lessor recognises receipt of a lease payment and interest on the lease receivable:

Dr cash CU1,000

Cr lease receivable CU1,000

Dr lease receivable CU537 (CU6,710 × 8%)

Cr interest income CU537

Following these events, the carrying amount of the residual asset is CU207 (CU5,000 – CU4,793) and the carrying amount of the lease receivable is CU6,247 (CU6,710 – CU1,000 + CU537).

At the end of year 1, the lessor reassesses the lease term and reinstates a portion of the asset, recognises an adjustment to lease receivable, revenue and cost of sales:

Dr revenue CU1,041

Dr residual asset CU34 (CU207 × CU1,041 ÷ CU6,250)

Cr cost of sales CU34

Cr lease receivable CU1,041 (CU6,247 – CU5,206)

The net result of the reassessment of the lease term is a loss of CU1,007 (CU34 – CU1,041).

After making this adjustment the carrying amount of the lease receivable is CU5,206 representing the present value of the seven remaining CU1,000 lease payments and the carrying amount of the residual asset is CU241 (CU207 + CU34).

At the end of year 1, the net amount recognised in profit or loss is income of CU1,447 (initial lease income of CU1,917 plus interest income of CU537 less CU1,007 loss from reassessment).

Example 5 – When the assessed lease term increases

Example 5 uses the same facts as in example 4 except that the lessor initially estimates that the lease term is eight years. The lessor determines that it does not retain exposure to significant risks or benefits associated with the underlying asset either during or after the expected lease term and accounts for the lease using the derecognition approach.

The present value of eight years of lease payments is CU5,747.

At the end of year 1, the lessor reassesses the lease term and determines that the lease term is ten years. The present value of nine years of lease payments is CU6,247.

At the date of commencement of the lease, the lessor derecognises the portion of the asset transferred to the lessee, recognises a lease receivable and recognises revenue and cost of sales:

Dr	lease receivable		CU5,747		
Dr	cost of sales		CU4,105		
	Cr	underlying asset		CU4,105	(CU5,000 × CU5,747 ÷ CU7,000)
	Cr	revenue		CU5,747	

At the date of commencement of the lease, the lessor recognises profit from the lease of CU1,642 (CU5,747 – CU4,105).

At the end of year 1, the lessor recognises receipt of a rental payment and interest on the lease receivable:

Dr	cash		CU1,000		
	Cr	lease receivable		CU1,000	
Dr	lease receivable		CU460		(CU5,747 × 8%)
	Cr	interest income		CU460	

Following these events, the carrying amount of the residual asset is CU895 (CU5,000 – CU4,105) and the carrying amount of the lease receivable is CU5,207 (CU5,747 – CU1,000 + CU460).

Upon reassessing the lease term, the lessor derecognises an additional portion of the asset transferred to the lessee, recognises additional lease receivable and recognises revenue and cost of sales:

Dr	lease receivable	CU1,040		(CU6,247 – CU5,207)
Dr	cost of sales	CU149		
	Cr residual asset		CU149	(CU895 × CU1,040 ÷ CU6,250)
	Cr revenue		CU1,040	

In profit or loss, the net result of the reassessment of the lease term is income of CU891 (CU1,040 – CU149).

After making this adjustment the carrying amount of the lease receivable is CU6,247 representing the present value of the nine remaining CU1,000 lease payments, and the carrying amount of the residual asset is CU746 (CU895 – CU149).

At the end of year 1, the net amount recognised in profit or loss is income of CU2,993 (initial lease income of CU1,642 plus interest income of CU460 plus CU891 lease income from reassessment).

Sale and leaseback transactions

Determining whether the transferred asset has been purchased or sold (paragraphs 67(a) and 68(a))

B31 An entity considers the effect of the transfer contract and the lease contract together to assess whether the transferred asset has been purchased or sold in accordance with paragraphs B9 and B10. Additionally, such sale and leaseback contracts may have conditions that generally do not arise in other transactions and may result in the transfer not meeting the conditions for a purchase or sale. For example, the following conditions normally preclude the seller/lessee from transferring more than a trivial amount of the risks and benefits associated with the transferred asset at the end of the contract and do not result in a purchase or sale:

(a) The seller/lessee has an obligation or an option to repurchase the asset at an amount that is not fair value at the time of repurchase, or the buyer/lessor can compel the seller/lessee to repurchase the asset.

(b) The seller/lessee guarantees the buyer/lessor's investment or a return on that investment.

(c) The seller/lessee provides the buyer/lessor with a residual value guarantee.

(d) The seller/lessee provides non-recourse financing to the buyer/lessor.

(e) The seller/lessee retains an obligation to service any existing debt related to the asset.

(f) The seller/lessee provides collateral on behalf of the buyer/lessor (other than the transferred asset) or guarantees the buyer/lessor's debt.

(g) The seller/lessee's rental payment is contingent on some predetermined or determinable level of future operations of the buyer/lessor.

(h) The seller/lessee enters into a sale and leaseback

At their 21-22 March 2011 meeting the boards affirmed the decision in the ED that when a sale has occurred, the transaction will be accounted for as a sale and then a leaseback. If a sale has not occurred, the entire transaction will be accounted for as a financing.

The boards tentatively decided that an entity should apply the control criteria described in the revenue recognition project to determine whether a sale has occurred.

The boards affirmed the decision in the ED that in a transaction accounted for as a sale and leaseback:

(a) When the consideration is at fair value, the gains and losses arising from the transaction should be recognised when the sale occurs.

(b) When the consideration is not established at fair value, the assets, liabilities, gains and losses recognised should be adjusted to reflect current market rentals.

The boards affirmed the decision in the ED that the seller/lessee would adopt the 'whole asset' approach in a sale and leaseback transaction. The 'whole asset' approach deems that in a sale and leaseback transaction, the seller/lessee sells the entire underlying asset and leases back a right-of-use asset relating to part of the underlying asset.

The boards tentatively decided that the leases guidance would not prescribe a particular type of lessee accounting model for entities that are accounting for the leaseback part of a sale and leaseback transaction.

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transaction involving asset enhancements without leasing the transferred asset from the buyer/lessor.

(i) The buyer/lessor is obliged to share a significant portion of the appreciation of the asset with the seller/lessee.

(j) Any other provisions or circumstances exist that allow the seller/lessee to participate in any future profits of the buyer/lessor or the appreciation of the transferred asset, eg a situation in which the seller/lessee owns or has an option to acquire a significant interest in the buyer/lessor.