



Project

Leases

Topic

Presentation: Lessee Statement of Financial Position

Objective

1. The objective of this paper is to discuss the presentation of a lessee's right-of-use (ROU) assets and liabilities to make lease payments in the statement of financial position (SFP).

Background

2. The *Leases* Exposure Draft (ED) proposes that a lessee present the following in the SFP:
 - (a) Liabilities to make lease payments, separately from other financial liabilities
 - (b) ROU assets as if they were tangible assets within property, plant and equipment (PP&E), separately from assets that the lessee does not lease.

Issues

3. The staff has identified the following issues based on comment letter responses to the ED as well as decisions made during deliberations following the ED:
 - (a) Disaggregation of ROU assets and liabilities to make lease payments

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- (b) Presentation of the ROU asset
- (c) ROU asset: intangible or tangible

Disaggregation of ROU assets and liabilities to make lease payments

Feedback

4. A number of comment letters disagreed with the proposal in the ED to always present ROU assets and liabilities to make lease payments separately in the SFP. Many respondents stated that the disaggregation of ROU assets and liabilities to make lease payments from other assets and liabilities is important. However, they also noted that disaggregation should be permitted in the notes, rather than required in the SFP. One such respondent stated:

We do not believe that a lessee's obligation to pay rentals should always be presented separately on the face of the balance sheet. Disclosure in the notes is sufficient in most cases. We believe there is sufficient guidance in IAS 1 Presentation of Financial Statements as to what should be disclosed on the face of the primary statements...(CL#683)

5. Another respondent addressed the presentation of the ROU asset:

We believe that there are merits to making a distinction between owned assets and leased assets in the financial statements of the lessee. However, this may well give way to an overly complicated balance sheet. The board should consider permitting management to consider how best to present this information to users. (CL#736)

6. A few respondents noted that liabilities to make lease payments should be disaggregated from other liabilities because lease liabilities have unique measurement attributes and are viewed differently depending on the circumstances (for example, bankruptcy).
7. Consistent with the feedback received on other joint projects, ED respondents expressed concern about clutter in the financial statements. Many contend that the financial statements should be summarized with disaggregation of amounts in those statements more appropriately disclosed in the notes.

8. Some users expressed concern that they may not receive disaggregated information at the time of an earnings release if amounts are disaggregated in the notes to the financial statements.

Staff Analysis

9. The staff thinks the final leases standard should allow ROU assets and liabilities to make lease payments to be presented either in the SFP *or* disclosed in the notes. That requirement will provide users with the disaggregated information while allowing the entity to determine the appropriate presentation either in the SFP or in the notes.
10. US GAAP does not provide guidance on the disaggregation of amounts included in the financial statements. The staff believes that this issue is more appropriately addressed in a separate project such as the financial statement presentation project rather than part of a standard on leases.
11. In contrast, paragraphs 57 (a) and 58 of IAS 1 provide guidance on determining whether to present additional items separately in the statement of financial position, as follows:
 - 57(a) line items are included when the size, nature or function of an item or aggregation of similar items is such that separate presentation is relevant to an understanding of the entity's financial position
 - 58 An entity makes the judgement about whether to present additional items separately on the basis of an assessment of:
 - (a) the nature and liquidity of the assets
 - (b) the function of the assets within the entity
 - (c) the amounts, nature and timing of liabilities.
12. Some respondents said they would view lease assets and liabilities differently from other assets and liabilities. Consequently, the staff thinks it is important that the required disclosure also state which line items in the SFP that the ROU asset and liability to make lease payments are included in if they are not disaggregated in the SFP. That would allow for identification of amounts in those circumstances in which a user views ROU assets and liabilities to make lease payments differently from assets and liabilities that have a similar nature and/or function.

Staff recommendation

13. The staff recommends that the final leases standard require that ROU assets and liabilities to make lease payments either be separately presented in the SFP or disclosed in the notes to the financial statements.
14. The staff also recommends that, if ROU assets and liabilities to make lease payments are not separately presented in the SFP, the amounts disclosed should indicate which line item in the SFP the ROU assets and liabilities to make lease payments are included in.

Question 1

Do the Boards agree that:

(a) The final leases standard require that lease assets and lease liabilities should be either separately presented in the SFP *or* disclosed in the notes to the financial statements?

(b) If lease assets and lease liabilities are not separately presented in the SFP, the amounts disclosed should indicate in which line item in the SFP the ROU assets and liabilities to make lease payments are included in?

Presentation of ROU asset

Feedback

15. A few respondents stated that a ROU asset is different from other assets (for example, owned assets) and, therefore, should be presented in its own asset class and not as a part of PP&E in the SFP.
16. IAS 1 states that an entity shall present separately items of a dissimilar nature or function unless they are immaterial. There is no similar requirement in US GAAP.

Staff Analysis

17. The staff thinks it is important that the ROU asset be presented so that the economic benefits arising from both leased and owned assets are shown similarly. For example, the nature of the future economic benefits the entity will

receive from the lease of an asset during the lease term, and the function that asset serves, is similar to the future economic benefits derived from and the function of an equivalent owned asset and, therefore, should be presented in a consistent manner.

18. However, some will argue that the economics, or nature of, leased and owned assets are different. For example, an entity can borrow against owned assets while it cannot do so with a ROU asset. The staff thinks that, although the nature of the assets are not identical, in most cases the assets are not of a dissimilar nature.
19. The staff also thinks that presenting a ROU asset according to the nature or function of the underlying asset provides better information about how the lessee uses the underlying asset. The staff thinks such presentation provides useful information about the productive capacity of a business.

Why not just prescribe the ROU asset be classified as PP&E?

20. As the scope of the ED exempts intangibles and various other mineral and biological rights, the underlying asset being leased is often similar in nature and function to PP&E.
21. In many instances, it would be appropriate for ROU assets and owned assets to be presented together within PP&E (as proposed in the ED) if that classification is made based on the nature and function of the asset. For example, a manufacturing entity has warehouses that it leases and warehouses that it owns. Those warehouses perform the same function and yield similar economic benefits to the entity. The staff thinks this would be a case in which classifying the asset by nature and function would result in amounts being classified together within the caption *PP&E* and that this would provide a useful presentation of the asset.
22. However, the staff thinks that there will be instances in which assets will be disaggregated by an entity because of the particular industry of the entity or the function the asset serves. For example, shipping entity may present *vessels* separately from other PP&E. In that case, ROU assets related to vessels should be classified within vessels, while other ROU assets would be

classified with PP&E. Additionally, if the Boards decide an entity could lease inventory (such as software it resells), classification by function and nature may be more appropriate.

23. Requiring the ROU asset to be classified by the nature of the asset being leased and the function of the asset within the entity would result in an appropriate presentation of owned and leased assets.
24. The staff also thinks requiring amounts to be classified by function and nature would allow a more useful presentation if an entity had other circumstances occurring that made the economics of leased and owned assets significantly different, such as a bankruptcy. At that point, the assets may differ enough by nature that an entity would present those amounts separate from other PP&E. If those assets were required to be presented within PP&E, as per the ED, assets of a dissimilar nature would be forced together.

Staff Recommendation

25. Therefore, the staff recommends the presentation of the ROU asset be determined by the nature and the function of the underlying asset rather than requiring the ROU asset to be always presented within PP&E.

Question 2

Do the Boards agree that the presentation of the ROU asset should be determined by the nature and the function of the underlying asset and should not be required to be presented within PP&E?

ROU asset: intangible or tangible?

26. Some respondents to the ED noted that it was important for the Boards to clarify whether the ROU asset recognized by a lessee is an intangible asset or a tangible asset.

The nature of the right of use asset should also be clarified. The ED implies that a lessee's asset is an intangible asset, for instance by cross-referencing to IAS 38. Nowhere however does the ED clearly state what the nature of this asset is. This is a crucial issue for lessees in regulated industries such as banks. (CL #735)

However, we find the proposals unclear and conflicting with regard to what the right-of-use asset actually represents for lessees and thus how a lessee should account for the asset. This is because the proposals imply on the one hand that the asset represents an intangible asset (when accounting for the economic benefits arising from using that asset and any revaluation gains/losses recorded, the requirements mandate the use of IAS 38 Intangible Assets), and on the other hand the asset may represent a tangible asset (when presenting and disclosing the asset, the requirements mandate the use of IAS 16 Property, Plant and Equipment). Accordingly, we think that the Board should explicitly state whether a lessee should account for assets arising from an arrangement as tangible assets (in accordance with IAS 16) or intangible assets (in accordance with IAS 38).

We believe that there are arguments for and against the basis for accounting both as intangible and tangible assets. However we understand that this is an issue which has wide-ranging implications (e.g. taxation) and as such would welcome the Board considering this issue in more detail. (CL #721)

Staff Analysis

27. The staff has considered the following approaches for clarifying whether a lessee's ROU asset is a tangible asset or an intangible asset :
 - (a) Do not clarify whether the ROU is a tangible asset or an intangible asset.
 - (b) Clarify that the ROU asset represents a tangible asset.
 - (c) Clarify that the ROU asset represents an intangible asset.
 - (d) Clarify that the ROU asset represents either a tangible asset or an intangible asset based on the nature of the underlying asset.
28. The staff notes that current guidance in Topic 840 and IAS 17 does not state whether a capital/finance lease is tangible or intangible. However, existing US GAAP points to the impairment model for PP&E while IAS 17 points to the impairment model of both PP&E and intangibles..
29. The FASB *Accounting Standards Codification*® Master Glossary defines an intangible asset as follows:

Assets (not including financial assets) that lack physical substance. (The term intangible assets is used to refer to intangible assets other than goodwill.)

30. IAS 38 defines an intangible asset as follows:

An identifiable non-monetary asset without physical substance.

31. Some think that reflecting the ROU asset as an intangible asset better reflects the economics of the right the lessee acquires in a lease arrangement. The actual right does not have physical substance, unlike a tangible asset.
32. However, some respondents were concerned with the economic consequences, specifically for regulatory capital and taxation, of having the ROU asset represented as an intangible asset. For example, regulatory agencies weight the risk of an intangible asset differently than a tangible asset. That is, intangible assets are not typically viewed as being recoverable.

In respect of regulatory capital, there is a possibility that Australian banks may be required to hold regulatory capital in respect of right-of-use assets if they are considered intangible assets, and not viewed in conjunction with the liability to make lease payments by our local regulator. In our most recent annual results we disclosed a \$2.6 billion (undiscounted but not including amounts payable under options to extend not yet exercised) of future minimum lease payments under operating leases. The ramifications of sourcing additional regulatory capital would be significant (potentially an 8% of increased Tier 1 capital), and would have flow on implications to the share prices of banks. (CL #296)

33. Those who think that the ROU asset represents a tangible asset also think that, although the actual ROU asset is not tangible, it represents a right to use an underlying asset that typically is tangible. Therefore, recognizing the ROU as if it were tangible would be reflective of the nature of the underlying asset.
34. Some think that it is not necessary to clarify whether the ROU asset is a tangible asset or an intangible asset. That is because they think that whether a ROU asset is a tangible asset or an intangible asset does not affect the presentation of the ROU asset.

Staff Recommendation

35. The staff does not think it is necessary for the Boards to clarify whether the ROU asset recognized by the lessee represents an intangible asset or a tangible asset. Although the staff thinks that the characteristics of a ROU asset are consistent with the definition of an intangible asset, the staff does not think it is

necessary to clarify for the purposes of presentation and financial reporting. That view is consistent with the staff's recommendation in paragraph 25 of this memo which does not look to what the right itself is, but rather what it is for.

36. Additionally, the staff notes that current guidance in Topic 840 and IAS 17 does not state the nature of capital/finance leases.

Question 3

Do the Boards agree with the staff recommendation that it is not necessary to clarify whether the ROU asset recognized by a lessee is a tangible asset or an intangible asset? If not, why not?