IASB/FASB Meeting
Week commencing 18 July 2011

IASB Agenda reference **5B**

Staff Paper

IASB/FASB Education Sessions
Week commencing 11 July 2011

FASB Agenda reference **188**

Project	**Leases**
Topic	**Lessee Statement of Cash Flows**

Objective

1. The objective of this paper is to discuss the presentation for lessees of cash paid for leases in the statement of cash flows (SCF) and other supplemental cash flow disclosures.

Background

2. Paragraph 27 of the *Leases* Exposure Draft (ED) states:

> 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.

Issues

3. The staff identified four issues with cash flow requirements for lessees:

   (a) Interest - Should the cash paid for leases that is classified as a financing activity include amounts for interest?

   (b) Variable lease payments - Should amounts for variable lease payments be classified as financing activities in the SCF?

   (c) Supplemental information - Should there be an explicit statement that a right-of-use (ROU) asset capitalized during the period should be reported in supplementary cash flow information as a noncash transaction?

(d) Short-term leases – Should the accounting treatment of short-term leases determine the classification of the associated cash flows?

Staff Recommendations

4. The staff recommends the following:

   (a) Cash paid for the principal component of lease payments should be classified within financing activities and cash paid for the interest component should be classified or disclosed in accordance with applicable cash flow guidance in existing US GAAP and IFRSs.

   (b) Cash paid for variable lease payments excluded from the determination of the liability to make lease payments should be classified within operating cash flows.

   (c) The final standard should include guidance for disclosure of non-cash transactions related to the acquisition of ROU assets.

   (d) Cash paid for short-term lease payments should be classified within operating cash flows.

Interest

5. The ED was originally drafted with the view that the *Financial Statement Presentation* (FSP) project would have required the classification in the SCF of interest paid based on the classification of the underlying liability. However, the change in timing of FSP necessitates addressing the presentation requirement as outlined in the ED in the context of current IFRSs and US GAAP.

6. A number of comment letters included questions on whether classification in the SCF should be different for the principal and interest components of lease payments. In the comment letters, respondents pointed out that cash payments reported as financing activities in the SCF include principal payments of amounts such as debt.

7. The classification in the SCF and disclosure of interest paid is different between IFRS and US GAAP. Paragraph 31 of IAS 7 requires separate presentation of interest and permits the classification of interest as an operating or a financing activity. ASC 230-10-45-17(d) requires cash paid for interest to be an operating cash outflow. ASC 230-10-50-2 requires the supplemental disclosure of interest paid.

8. The staff thinks that, because interest cash flow classification differs between IFRSs and US GAAP, mandating the classification of the interest paid for leases is outside the scope of the leases project. However, specifying the classification of the principal portion of the liability to make lease payments would be appropriate because similar liabilities are classified in this manner in current practice.

9. Additionally the staff thinks that there is work involved in tracking the payments on the liability separately from the payments of interest, this is done today for other financing liabilities. Thus the staff didn't think this would be overly burdensome.

10. Therefore, the staff recommends that the final leases standard should state that lease payments relating to the principal should be classified within financing activities, which is consistent with the ED.. However, lease payments relating to interest should be classified or disclosed in accordance with the applicable SCF requirements under either current US GAAP or IFRSs.

Question 1
Do the Boards agree that as it relates to the SCF cash paid for lease payments relating to the principal should be classified within financing activities and that cash paid for lease payments relating to interest should be classified or disclosed in accordance with the applicable IFRS or US GAAP SCF requirements?

Variable lease payments

11. The Boards have tentatively decided that the value of the ROU asset and the liability to make lease payments should only include amounts for variable lease payments that are index based and that are, in substance, fixed lease payments.

12. Since the liability to make lease payments does not include other variable lease payments (for example, variable lease payments that depend on future sales), the staff thinks there is no settlement of a financing liability by the lessee when those variable lease payments are made. If there is no financing liability, the staff thinks it would be inappropriate to include those cash flows in the financing section of the SCF.

13. However, the staff also thinks users want information about variable lease payments that are excluded from the determination of the value of the ROU asset and corresponding liability to make lease payments.

14. Furthermore, during the April 12-13, 2011, joint Board meeting the staff noted that Board members thought disclosure about those variable lease payments should be robust.

15. Some staff members think a more useful disclosure would be to disclose both cash payments for variable lease payments as well as variable rental expense. Other staff members oppose that requirement because:

    (a) The difference between the cash paid for variable lease payments and the expense will likely be a timing difference and not be material.

    (b) The reporting of cash payments for operating expenses can be costly because cash flow information is not part of the accounting systems as currently configured, whereas reporting an expense is less costly and achievable based on system configurations.

16. The staff also has considered whether the further disaggregation of variable lease payment amounts by type of variable arrangements was warranted. However, the staff determined that a requirement to describe those arrangements (paragraph 73(a)(ii) in the ED) coupled with the total expense would provide the appropriate level of information.

17. Therefore the staff recommends the following:

    (a) Cash paid for variable lease payments excluded from the measurement of the ROU asset and the corresponding liability to make lease payments should be classified as an operating activity.

    (b) Period expenses arising from variable lease payments that were not included in the measurement of the ROU asset and corresponding liability to make lease payments should be either presented separately in profit or loss or disclosed in the notes to the financial statements.

Question 2 & 3
Do the Boards agree that cash paid for variable lease payments excluded from the measurement of the right-of-use asset and the corresponding liability to make lease payments should be classified as an operating cash flow? Do the Boards agree that period expenses for variable lease payments not included in the measurement of the ROU asset and corresponding liability to make lease payments should either be presented in profit or loss or disclosed in the notes to the financial statements?

Noncash Information

18. Both IAS 7 and Topic 230 contain a requirement to disclose information about non-cash financing and investing transactions. For example, if an entity acquires property, plant, and equipment (PP&E) in exchange for assuming a directly related liability, that would be considered a noncash transaction and that amount would be disclosed.

19. If the acquisition of the ROU asset is similar to the acquisition of PP&E, the staff thinks that the disclosure should be made when a ROU asset is acquired in exchange for a liability to make lease payments.

20. The staff thinks that this disclosure would not be made by applying IAS 7 or Topic 230. That is because there would never be a cash investing activity for "cash paid for a right-of-use asset." Therefore, if information about the amounts of ROU assets acquired in the period would be useful, it should be explicitly required as part of the leases standard.

21. Feedback has been received on other projects that states that users will add non-cash information about PP&E acquisitions to the cash paid for PP&E to arrive at a number they view as *real cap-ex* (real cap-ex is the amount of PP&E added during the period in order to operate). A user may include amounts of ROU assets added during the period to that number, because those assets may be viewed as akin to additional PP&E.

22. If the Boards retain the ED requirement to reconcile the change of beginning and ending balances of ROU assets in the notes a user could aggregate the additions to the ROU assets and have the equivalent amount that is being recommended as a non-cash disclosure.

23. However, the staff thinks the disclosure of the amount as a noncash disclosure would be better understood by a user of financial statements as a supplement to understanding the SCF. The staff also notes that the Boards may decide to remove the requirement to provide a roll forward of ROU assets in the notes to the financial statements.

24. Therefore, the staff recommends that the acquisition of a ROU asset in exchange for a liability to make lease payments be required as an additional non-cash disclosure in the SCF.

Question 4
Do the Boards agree that the acquisition of a right-of-use asset in exchange for lease liability should be disclosed in an additional non-cash disclosure in the SCF?

Short-term leases

25. The Boards tentatively decided that for short-term leases, as a practical expedient, a lessee need not recognize lease assets or lease liabilities.

26. Because no liability would be recognized, the cash flows from the payments on short-term leases would be classified within the operating section of the SCF. That would be consistent with the staff recommendation in paragraph 17 of this paper exclude from reporting cash outflows related to leases that are not a settlement of the liability to make lease payments. Therefore, the

staff recommends that cash outflows for short-term leases excluded from the liability to make lease payments be included in the operating section of the SCF.

Question 5
Do the Boards agree that cash outflows for short term leases not included in the liability to make lease payments be included in the operating section of the SCF?