	IASB/FASB Meeting **Week commencing 18 July 2011**	IASB Agenda reference	**5C**
Staff Paper	**IASB/FASB Education Sessions** **Week commencing 11 July 2011**	FASB Agenda reference	**189**
Project	**Leases**		
Topic	**Lessee Disclosures – Short Term Leases**		

Objective

1. The objective of this paper is to discuss the disclosure requirements for lessee short-term leases.

Background

2. During the June 15, 2011 joint meeting, the Boards tentatively decided that, for short-term leases, a lessee need not recognize lease assets or lease liabilities. The Boards expressed some support for requiring disclosure of the rental expense recognized 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 requested that the staff provide a memo analyzing the disclosure requirements for lessee short-term lease at a future meeting.

3. Because of the decision to provide the practical expedient, the liability to make lease payments would exclude short-term leases and, therefore, the disclosure of the maturities of the liability to make lease payments would exclude future payments relating to short-term leases.

4. Additionally, the statement of cash flows (SCF) would include an amount for cash paid for liabilities to make lease payments. The cash outflows for short-term leases, because of the practical expedient, would be included in the operating section of the SCF (the treatment of short-term leases in the SCF is discussed in a separate board paper).

5. Under IAS 17, total of future minimum lease payments under non-cancellable operating leases (including short term leases) for periods including not later than one year are required. There is no such requirement in U.S. GAAP.

Approaches

6. The staff has identified the following approaches for addressing disclosures about short-term leases:

   (a) Approach A -Disclose the amounts committed to under contracts for short-term leases in the maturity analysis as of the reporting date.

   (b) Approach B - Disclose the amount of the current year's short-term lease expense and require qualitative disclosure if there are circumstances or expectations present that would indicate that the entity's short-term lease activities would differ significantly from the current reporting period.

   (c) Approach C - Scope short-term leases out of the disclosure requirements for leases.

Approach A –Disclose commitments under short-term leases

7. The staff thinks that Approach A is consistent with current IFRS, but would create an additional disclosure requirement under U.S. GAAP. However, Approach A is inconsistent with the disclosure the staff is recommending in the memo on lessee disclosures. This is because, due to the practical expedient, the short-term lease will not be part of the liability to make lease payments.

8. The Boards have tentatively decided to exclude short-term leases from the liability to make lease payments. As a result, the staff thinks that an entity might not track those commitments separately in the general ledger or respective sub-ledgers. Therefore, if the boards were to require Approach A, the practical expedient provided to an entity to exclude short-term leases from the recognition requirements of the proposed lease standard might, in some part, be negated by the effort needed to accumulate those commitments manually for the purposes of disclosure.

Approach B – Disclose the current year's short-term lease expense

9. The staff thinks that the current period expense for short-term lease contracts is often a good indicator for what the next year's cash outflows would be under short-term lease contracts.

10. The staff thinks that there would be some level of cost incurred to accumulate a by-nature expense such as short-term lease expense. That is because some entities have a vertically integrated structure in which costs are often pooled and allocated across various departments or segments and, therefore, are not currently available at the highest level of consolidation. That becomes less of an issue for (a) entities who report expenses by nature, (b) entities that are not as vertically integrated, and (c) smaller companies. Although that information currently may not exist at the highest levels of consolidation, most entities have explained that a system modification to accumulate the information is possible with moderate effort and cost.

11. The staff thinks there may be circumstances in which an entity's expense will not be indicative of next year's cash flows because of commitments made or plans that an entity has regarding short-term leases. Therefore, the staff also would recommend qualitative disclosure if there are circumstances or expectations present for a change in activity under short-term leases.

Approach C – Do not require disclosure about short-term leases

12. Approach C would provide preparers the most relief from the cost of the disclosure requirements. Some preparers believe that a practical expedient on the recognition of short-term leases should extend to the related short-term lease disclosures for the same reason it was originally supported as recognition exclusion. Counter to that however, is that users who would find information about all leases useful will not have transparent information about short-term lease amounts unless those amounts were of such a magnitude as to warrant separate presentation on either the SFP or Statement of Comprehensive Income.

Staff Analysis

13. The staff notes the Boards' strong preference to support a practical expedient to lessees of short-term leases if there are some compensating disclosure requirements. Additionally, the staff thinks users would want information about the effects of all leases, including those that meet the short-term definition. Therefore, the majority of staff members do not recommend Approach C (although a minority of the staff support it for cost-benefit reasons).

14. During the June 2011 joint meeting, concerns were expressed that the removal of commitments for short-term leases from the commitments disclosure would reduce the quality of IFRSs.

15. However, the staff notes that the commitments under contracts for short-term leases as of a point in time would be a different amount than the expense in the following period. That is because the expense in the following period includes both short-term leases that existed at the end of the previous reporting date (the future commitments) as well as short-term contracts entered into in that following period.

16. Additionally, the staff notes that the current IFRS disclosure of amounts due within the year under operating leases not only include amounts for short-term leases but amounts for all operating leases due within the year. The commitments disclosure would still have amounts due within one year for all leases that are not initially 12 months or less.

17. The staff thinks that liabilities to make lease payments due within one year plus the short-term lease expense (which would include both lease and non-lease expenses such as service components embedded into the contractual payments) from the current year would be a better proxy for the next year's cash flows under lease contracts than the amount provided as due within one year under current IFRSs.

18. The staff also reached out to preparers regarding Approaches A and B. From a cost perspective, all of the preparers who responded stated that reporting the expense (Approach B) would be the less costly of the two options.

Staff recommendation

19. The majority of the staff recommend Approach B. The staff thinks that, in many cases, the amount of current-year short-term lease expense is more indicative of the next year's cash flows (and, thus, working capital requirements) than amounts committed to under short-term lease agreements as of the reporting date. Furthermore, the staff's outreach indicates that Approach B is less costly than Approach A.

20. A minority of staff members recommend Approach C. They note that the reason for the exception for short-term leases is a practical expedient for those leases with a maximum lease term of less than one year. If there is no separate requirement to record assets and liabilities for those leases, those staff also do not think that there should be a requirement to separately track the rental expense for those leases, again, from a cost-benefit perspective.

Question
Do the Boards agree with the staff recommendation to require the disclosure of rental expense incurred under short-term leases during the reporting period, with a qualitative note that indicates if there are circumstances or expectations present that would indicate that the entity's short-term lease practices would result in a material change in the next reporting period (Approach B)?