IASB/FASB Meeting - week commencing 18 July 2011

IASB Agenda reference **5G**

FASB Agenda reference **193**

Staff Paper

Project	**Leases**
Topic	**Lessor Accounting—Addendum to Agenda Paper 5G / memo 193**

Introduction

1. On the basis of feedback received on agenda paper 5G / FASB memo 193, the staff have prepared the following addendum. The purpose of this is to summarise the 'receivable and residual' approach set out in that agenda paper / memo and clarify our recommendations, considering whether the model should be applied to all lease contracts.

How the lessor accounting model (the 'receivable and residual' approach) works:

Lessor recognises: (a) a lease receivable and (b) a residual asset.	• If profit on the ROU transferred to the lessee is reasonably assured, the lessor recognises that profit at lease commencement (ie partial profit recognised). The residual asset is measured on an allocated cost basis and, consequently, profit is *not* recognised on the residual asset until the end of the lease term. • If profit is *not* reasonably assured, any profit is recognised over the lease term—in that case, at lease commencement, the residual asset is measured as the difference between the receivable and the previous carrying amount of the underlying. If the lease receivable is greater than the carrying amount of the underlying, the difference between those two amounts is recognised as profit at lease commencement.

In theory, the 'receivable and residual' approach could be applied to all lease contracts (see paragraphs 22, 52-58 and 84-85 of agenda paper 5G / memo 193). However, it may not appropriate in all cases.

When would it be appropriate to apply another model and why?

Possible scope exceptions	Analysis	Staff recommendations
Investment property measured at fair value	If a lessor measures investment property at fair value, that fair value information provides better information than any cost model because investment property is typically an appreciating asset.	Outside the scope of lessor accounting model (see staff recommendation in paragraph 25 of agenda paper 5G / memo 193).
Short-term leases (maximum term less than 12 months)	Because the term of short-term leases is often within one reporting period, the costs of applying the 'receivable and residual' approach would outweigh any benefit (either from a balance sheet or profit or loss perspective).	Use current operating lease accounting—consistent with tentative decisions for lessees and lessors.
Impractical to determine the carrying amount of a leased portion of an asset (eg a multi-tenant leased asset) when the entire asset is measured at cost	Application of 'receivable and residual' model requires information about the carrying amount of the asset that is the subject of the lease (and fair value of that asset if profit is to be recognised at lease commencement). If the lessor has entered into numerous lease contracts for physically-distinct portions of a single larger asset, it might be impractical for the lessor to allocate a portion of the total carrying amount of the asset to each leased portion (in addition, it is likely to be difficult to fair value each leased portion of the larger asset).	Staff recommendation: use current operating lease accounting, with disclosure of lease receivables. The rationale for different accounting for the lessor is on cost/benefit grounds (ie for practical reasons). That conclusion does not affect the decisions about lessee accounting. This is because the ROU is a whole asset for the lessee, regardless of whether it leases a portion of an asset. Consequently, the lessee is able to measure the ROU arising from all lease contracts.

Possible scope exceptions	Analysis	Staff recommendations
Leases > 12 months but for a short period of the total economic life of the asset (eg 2-year lease of a ship with a 30 year life)	Application of the 'receivable and residual' model is *not* impractical for the lessor in this case because the leased asset is a whole asset that the lessor accounts for separately—ie the lessor has information about the carrying amount of the leased asset. The accounting (assuming profit would not be reasonably assured) would be very similar to current operating lease accounting. However, the staff supporting the 'receivable and residual' approach think that such an approach would provide better information than current operating lease accounting because it more clearly presents the lease receivable. In addition, if such lease contracts were to be accounted for differently by the lessor, the staff have concerns about: (a) defining short-term for these lease contracts, and (b) explaining why a lessor would apply different accounting when the lessee accounts for these contracts in the same way as all other lease contracts.	Staff recommendation: use the 'receivable and residual' approach.