Staff Paper

Project	**Leases**
Topic	**Supplement: presentation of short-term leases**

Objective

1. IASB Agenda Paper (AP) 5A/FASB Memo 140 discusses the accounting for short-term leases.

2. The purpose of this paper is to discuss the presentation of income, expenses, and cash flows from short-term leases. The discussion of the presentation of short-term leases is largely dependent upon the Boards' decisions in AP 5A/Memo 140.

3. This paper is structured as follows:

   (a) Summary of Staff Recommendations

   (b) Summary of Feedback on Proposals in the ED

   (c) Presentation of Profit or Loss from Short-Term Leases

   (d) Presentation of Cash Flows from Short-Term Leases

   (e) Disclosure of Short-Term Leases

   (f) Appendix A: Proposed Amendments to ED.

Summary of Staff Recommendations

4. The staff recommends the following:

   (a) Profit or loss from short-term leases should be presented as lease income/expense in profit or loss, in conformity with current operating lease treatment. The staff views lease income/expense to be synonymous with rent income/expense and rental income/expense, but uses lease income/expense in this paper.

   (b) Cash flows from short-term leases should be presented as operating cash flows on the face of the statement of cash flows for both lessees and lessors.

Summary of Feedback on Proposals in the ED

5. The required presentation of profit or loss and cash flows from short-term leases is not specified in the proposed guidance in the ED. Comment letter respondents found the proposed guidance in paragraphs 64 and 65 (below) on the pattern of profit or loss recognition to be ambiguous:

> Such lessees/lessors shall recognize lease payments in the income statement over the lease term.

6. Several respondents, including users, noted that while this proposed guidance is ambiguous to the *pattern* of profit or loss recognition on the income statement, it also does not address the actual presentation of profit or loss on the income statement.

> In addition, paragraphs 64 and 65 of the ED do not adequately articulate the presentation of short-term lease payments and receipts in the statement of comprehensive income for lessees or lessors. Will short-term lessee amounts be included as a separate rent expense, presented along with amortization of the right-of-use asset, or as interest expense? Similarily, will short-term lessor amounts be included as a separate rental income, along with amortization of the performance obligation in rental income, or as interest income? (CL# 780)

Presentation of Profit or Loss from Short-Term Leases

7. To address the issue of how to present profit or loss from short-term leases, the staff presents the following approaches for lessors and lessees:

    (a) **Approach A:** present the profit or loss from short-term leases as amortization expense (lessee) or lease income (lessor).

    (b) **Approach B:** present the profit or loss from short-term leases as lease income/expense for both lessees and lessors, in conformity with current operating lease treatment.

8. The staff considered a third approach to present the profit or loss from short-term leases as interest income/expense, but rejected this approach due to the following:

    (a) Due to their short-term nature, the time value of money is insignificant to short-term leases and presenting the profit or loss to reflect the time value of money (that is, presenting interest expense/income) would not provide decision-useful information to financial statement users.

(b) The presentation of interest income/expense is inconsistent with the staff recommendation in AP 5A/Memo 140 to permit both lessees and lessors to elect current operating lease accounting for short-term leases in the statement of financial position, as no financing liability is recognized.

(c) The staff received feedback from several comment letter respondents that the presentation of interest income/expense from lease transactions would have a significant effect on cost reimbursement for all leases, including short-term leases, under government contracts:

> Additionally, we want to highlight the fact that the ED will have a significant and negative impact on the actual revenues, profitability, and cash flows of U.S. Government contractors. Although regulatory reporting to government agencies is predicated on U.S . GAAP, government agencies follow the Federal Acquisition Regulation ("FAR") in determining what kinds of expenses may be reimbursed, rather than U.S. GAAP. FAR Part 31.205 states that, "interest on borrowings (however represented) ... are unallowable ... " meaning that the U.S. Government will not reimburse contractors for incurring interest expense in any form.
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> "Rent expense," "depreciation" and "amortization," on the other hand, are "allowable," meaning that the U.S. Government will reimburse contractors for expenses related to renting or leasing so long as they meet the general rules in FAR Part 31.202-2, including reasonableness and allocability. Thus, as a result of the proposed standards as set forth in this ED, any amounts which will fall under the definition of "interest expense" rather than depreciation/amortization or rent expense will now be a non-reimbursable item and will result in a very real and significant decrease in our revenues and cash flows. (CL #389)

Approach A: Lease Income/Amortization Expense

9. Under Approach A, the profit or loss from short-term leases would be presented in the income statement as lease income or amortization expense for lessors or lessees, respectively.

10. Supporters of Approach A think that the income statement presentation should follow the fact that conceptually, a lessee has a right-of-use asset and a lessor has

a right to receive lease payments, even if those assets are not recognized because of cost/benefit considerations under the staff recommendations in AP 5A/Memo 140. Thus, presentation of lessees' expense as amortization expense is appropriate. Supporters also think that this enhances comparability across companies with different kinds of leases; for example, amortization expense for all leases would be excluded from common metrics such as earnings before interest, tax, depreciation, and amortization (EBITDA), regardless of whether or not a lease is accounted for as a short-term lease.

11. Those that do not support Approach A think that it would be misleading to present amortization expense on the income statement for a right-of-use asset that, if the Boards accept the staff recommendations in AP 5A/Memo 140, is not recognized.

Approach B: Rent Income/Expense

12. Under Approach B, the income/expense from short-term leases would be presented in profit or loss as lease income or lease expense for lessors or lessees, respectively, consistent with current operating lease treatment.

13. Supporters of Approach B acknowledge that, should the Boards accept the staff recommendations in AP 5A/Memo 140, no lease assets or liabilities will be recognized by lessees or lessors for short-term leases. Hence, short-term lease transactions should be presented consistently with other executory contracts and should be clearly disclosed and presented separately from other lease contracts that require the recognition of amortization and interest expense/income. Also, users are familiar with the term *rent income/expense* for lease transactions.

14. Those that do not support Approach B reject this approach because of the comparability concerns discussed in paragraph 10.

Staff Recommendation

15. The staff recommends Approach B, that income/expense from short-term leases be presented as lease income or lease expense for lessors or lessees, respectively. The

staff thinks this approach is consistent with the recommendations in AP 5A/Memo 140 and the cost/benefit considerations in those recommendations. Presenting profit or loss from short-term leases as lease income/expense is consistent with current operating lease accounting. It also reports the effect of lease contracts that are accounted for differently as short-term leases from other lease contracts that are accounted for under the proposed guidance for leases.

Question 1
Do the Boards agree with the staff recommendation that income/expense from short-term leases be presented in profit or loss as lease income or lease expense for lessors or lessees, respectively? Why or why not?

Presentation of Cash Flows from Short-Term Leases

Staff Recommendation

16. The staff recommends that cash flows from short-term leases be presented as operating cash flows in the statement of cash flows.

17. The staff considered an alternative presentation of short-term lease cash flows as financing cash flows, but rejected this for similar arguments as discussed in paragraph 8(b). That is, if the Boards accept the staff recommendations in AP 5A/Memo 140, no financial asset or liability will be recognized in the statement of financial position under the guidance for short-term leases. Consequently, the staff does not think that financing presentation on the statement of cash flows would be appropriate.

18. The staff thinks that presentation of cash flows from short-term leases as operating is consistent with the staff recommendation of Approach B above to present profit or loss from short-term leases as lease income/expense. Presenting cash flows from short-term leases as operating is consistent with current operating lease treatment and appropriately reports the effects of lease contracts that are accounted

for differently as short-term leases than other lease contracts in the statement of cash flows.

Question 2
Do the Boards agree with the staff recommendation to present cash flows from short-term leases as operating cash flows in the statement of cash flows? Why or why not?

Disclosure of Short-Term Leases

19. The staff will continue to evaluate the necessity and extent of disclosures for short-term leases as disclosures for the overall leases project are considered. At a minimum, the staff plans to recommend disclosure of the accounting policy elected by lessees and lessors for short-term leases and amounts recognized in profit or loss for short-term leases. The staff did not think it was appropriate to further consider short-term lease disclosures as a standalone item in this paper, but rather plans to bring an analysis as a component of the overall package of leases disclosures in a future paper.

APPENDIX A

Proposed Amendments to ED

The preliminary draft wording included in this appendix has been prepared by the staff to help the boards in reaching decisions regarding the accounting for short-term leases. The preliminary draft wording starts with the wording used in Appendix A and paragraphs 64 and 65 of the ED and 'marks-up' changes to that wording to reflect the staff recommendations in paragraph 3 of AP 5A/Memo 140 and paragraph 4 of AP 5B/Memo 141.

The Boards have not yet reached decisions about the views expressed under the staff recommendations, and in this appendix, and therefore the wording is subject to change.

Definition of short-term lease (Appendix A to ED)

A1. A **lease** that, at the **date of commencement of the lease**, has a maximum possible ~~**lease term**~~ term, including any options to renew ~~or extend~~, of approximately 12 months or less.

Lessees (paragraph 64)

A2. At the date of inception of a lease, a lessee that has a short-term lease may make ~~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.~~ an accounting policy election for all short-term leases to not recognize a right-of-use asset or a liability to make lease payments in the statement of financial position. Such lessees shall recognize lease payments in the income statement 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. Lease payments shall be presented as lease expense in the income statement and as operating cash flows in the statement of cash flows.

Lessors (paragraph 65)

A3. At the date of inception of a lease, a lessor that has a short-term lease may make ~~elect on a lease-by-lease basis~~ an accounting policy election ~~not to recognize assets or liabilities arising from a short-term lease in the statement of financial position, nor derecognize any portion of the underlying asset.~~ for all short-term leases to not recognize a right to receive lease payments or lease liability (or derecognize any underlying asset) in the statement of financial position. Such lessors shall continue to recognize the underlying asset in accordance with other Topics and shall recognize lease payments in the income statement on a straight-line basis over the lease term, unless another systematic or rational basis is more representative of the time pattern of the benefit provided. Lease payments shall be presented as lease income in the income statement and as operating cash flows in the statement of cash flows.