STAFF PAPER

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IASB Meeting

Project	**Leases**		
Paper topic	IFRS 1 – exemption for leases		

CONTACT(S)	Li Li Lian	llian@ifrs.org	+44 20 7246 6486
	Sarah Geisman	sgeisman@ifrs.org	+44 20 7246 6464

Purpose

1. The purpose of this paper is to discuss the transitional requirements for a first-time adopter of IFRSs regarding leases. In particular, this paper asks whether some of the transitional requirements and reliefs the Board has tentatively decided for existing IFRS preparers should also be provided to a first-time adopter of IFRSs.

Background

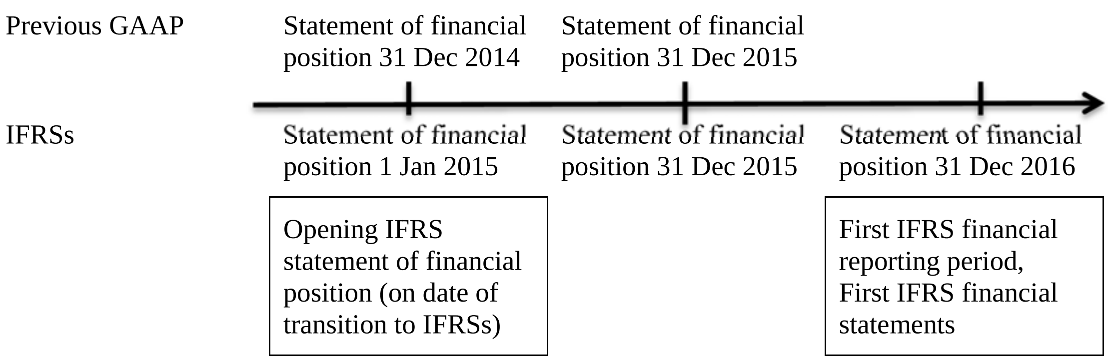
Existing requirements

2. IFRS 1 *First-time adoption of IFRSs* requires that an entity applies the same accounting policies in its opening IFRS statement of financial position and throughout all periods presented in its first IFRS financial statements[1]. Those accounting policies would be based on IFRSs that are effective at the end of the first IFRS reporting period[2], unless otherwise permitted. The new adopter could apply IFRSs that are not yet effective if that IFRS permits early application.

[1] *First IFRS financial statements* are the first annual financial statements in which an entity adopts IFRSs by an explicit and unreserved statement of compliance with IFRSs.

[2] *First IFRS reporting period* is the latest reporting period covered by an entity's first IFRS financial statements.

3. To illustrate, if a first-time adopter were to adopt IFRSs in 1 January 2016, the entity would have to do the following (assuming that the entity chooses to disclose only one year of comparatives):



4. IFRS 1 has an objective to achieve comparability over time (within a first-time adopter's first IFRS financial statements and between different entities adopting IFRSs for the first time at a given date; achieving comparability between first-time adopters and entities that already apply IFRSs is a secondary objective (paragraph BC10).

5. A first-time adopter is not permitted to apply the transitional requirements in other IFRSs unless permitted to do so by IFRS 1. For leasing transactions, IFRS 1 only permits a first-time adopter, as an option, to apply the transitional provisions in IFRIC 4 *Determining whether an Arrangement contains a Lease*.

> D9 … Therefore, a first-time adopter may determine whether an arrangement existing at the date of transition to IFRSs contains a lease on the basis of facts and circumstances existing at that date.
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> D9A If a first-time adopter made the same determination of whether an arrangement contained a lease in accordance with previous GAAP as that required by IFRIC 4 but at a date other than that required by IFRIC 4, the first-time adopter need not reassess that determination when it adopts IFRSs. For an entity to have made the same determination of whether the arrangement contained a lease in accordance with previous GAAP, that

determination would have to be given the same outcome as that resulting from applying IAS 17 *Leases* and IFRIC 4.

6. Other than the above guidance, IFRS 1 does not permit an entity to apply any of the transitional provisions in IAS 17 nor does it contain any other specific exemptions for leases.

7. IFRS 1 also prohibits retrospective application of some aspects of other IFRSs, particularly where retrospective application would require hindsight (judgements by management about past conditions after the outcome of a particular transaction is already known).

ED proposals

8. In the 2010 ED, the Board proposed that paragraphs D9 and D9A of IFRS 1 (quoted above) would be amended so that first-time adopters could apply the same transitional provisions for leases as existing IFRS preparers except that the transitional relief for simple finance leases would not be permitted for first time adopters.

9. There were no comments received specifically on the consequential amendment to IFRS 1. However reading through the comments on transition to the new leases standard, we think that a first-time adopter would face issues similar to those faced by existing IFRS preparers. Consequently, our staff analysis for a first-time adopter is based on the comments raised on the general transitional provisions.

Staff analysis

Should a first-time adopter be permitted to apply the general transitional provisions?

10. As noted above, when first applying the new leases standard, we think that a first-time adopter would face issues similar to those faced by existing IFRS preparers. This is because we understand that most other GAAPs permit at least some leases to be accounted for as off-balance sheet transactions similar to current operating lease accounting. Consequently, we recommend that a first-time adopter should

be permitted to apply the general leases transitional model at the date of transition to IFRSs:

(a) For lessees:

(i) Recognise liabilities to make lease payments measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of the start of the first IFRS reporting period for each portfolio of leases with reasonably similar characteristics. The incremental borrowing rate for each portfolio of leases should take into consideration the lessee's total leverage, including leases in other portfolios.

(ii) recognise right-of-use assets equal to the proportion of the liability to make lease payments at lease commencement, calculated on the basis of the remaining lease payments.

(iii) in opening retained earnings, recognise any difference between the liabilities to make lease payments and the right-of-use assets.

(b) For lessors:

(i) recognise a right to receive lease payments, measured at the present value of the remaining lease payments, discounted using the rate charged in the lease that was determined at the date of commencement of the lease, subject to any adjustments that are required to reflect impairment.

(ii) recognise a residual asset that is consistent with the initial measurement of the residual asset under the receivable and residual approach, using information available at the date of transition to IFRSs.

Can a first-time adopter use the fair value of the right-of-use asset as its deemed cost?

11. IFRS 1 permits a first-time adopter to measure property, plant and equipment, investment property or intangible assets at fair value in its opening IFRS statement of financial position and use that amount as the deemed cost at that date. This election can be made on an asset-by-asset basis.

12. The major reason that IFRS 1 permits fair value to be used as the deemed cost is that there could be significant cost and effort involved in calculating historical cost; in those cases, calculating fair value could be less costly and result in more relevant and reliable information. We think that this argument, in most cases, does not necessarily apply to right-of-use assets. The boards have decided against requiring fair value measurement of the right-of-use asset for cost-benefit reasons. Calculating the fair value of a right-of-use asset is likely to be *more* costly than calculating historical cost, particularly because much of the work that needs to be performed to calculate historical cost will need to be performed in any event when measuring the liability to make lease payments.

13. Nonetheless, permitting a first-time adopter to initially measure its right-of-use assets at fair value would be consistent with the Board's decision to permit the entity to revalue its right-of-use assets. A right-of-use asset that is revalued is based on the fair value of the asset. If a first-time adopter revalues its right-of-use assets after adoption, it might not make sense to prevent such a first-time adopter from measuring its right-of-use assets at fair value upon adoption of IFRSs.

14. Consequently, we recommend that fair value be permitted to be used as the deemed cost for the right-of-use asset only when the first-time adopter uses the revaluation model to account for the right-of-use asset after adoption. We think this is consistent with the rationale of IFRS 1 (set out in paragraph 4 of this paper) and yet permits fair value to be used as the deemed cost when first-time adopters think that fair value provides more relevant information than cost for right-of-use assets.

Other reliefs considered for a first-time adopter

15. For entities that currently apply IFRSs or US GAAP, the boards tentatively decided to provide the following transitional reliefs:

    (a) Do not require evaluation of initial direct costs for contracts that began before the effective date.

    (b) Permit the use of hindsight in comparative reporting periods, including when determining whether or not a contract is, or contains, a lease.

An entity that elects any of those reliefs should disclose the reliefs elected on transition.

16. The boards also tentatively decided that no adjustments are required to be made to lease assets and liabilities arising from leases currently classified as finance leases.

17. We recommend that a first-time adopter be permitted to apply those transitional reliefs listed in paragraph 15 above and should disclose which reliefs it has elected in its first IFRS financial statements. Although one of the main principles of IFRS 1 is to promote comparability within a first-time adopter's first IFRS financial statements, the Board considered comparability when it decided to permit those transitional reliefs for existing IFRS preparers. The Board decided that the benefit of providing those transitional reliefs outweighed the potential negative effects on comparability in the case of existing IFRS preparers. We think this reasoning also holds true for first-time adopters.

18. Nonetheless, regarding the relief relating to leases currently classified as finance leases in paragraph 16 above, we do not think it is appropriate for IFRS 1 to permit a first-time adopter to carry forward its previous accounting for finance leases accounted for under previous GAAP. We are not in a position to know how a first-time adopter previously accounted for its leases or to consider each previous GAAP separately. We think that carrying forward amounts recognised and measured under previous GAAP could provide misleading information to users. Consequently, we do not recommend that first-time adopters be permitted to retain their previous accounting for finance leases. This is similar to what was proposed in the 2010 ED.

Staff recommendation and questions for the Board

Question 1
We recommend that a first-time adopter of IFRSs should be permitted to: a) apply the general transitional provisions in the leases standard (set out in paragraph 10 of this paper). b) use the fair value of a right-of-use asset as its deemed cost, if that first-time adopter uses the revaluation model to measure right-of-use assets after adoption. c) apply the following reliefs: (i) Do not require evaluation of initial direct costs for contracts that began before the opening IFRS statement of financial position. (ii) Permit the use of hindsight in periods before the first IFRS reporting period, including when determining whether or not a contract is, or contains, a lease. A first-time adopter that elects any of those reliefs should disclose the reliefs elected in its first IFRS financial statements. Does the Board agree with the staff recommendations?