Staff Paper	**IASB/FASB Meeting** **Week commencing October 17, 2011**	IASB Agenda reference	**2D**
	IASB/FASB Education Sessions **Week commencing October 10, 2011**	FASB Agenda reference	**208**

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Project **Leases**

Topic **Lessor Disclosures**

Objective

1. The objective of this paper is to discuss the disclosure requirements for lessors.

Background

2. The 2010 *Leases* Exposure Draft (ED) proposed requiring a number of new disclosures for lessors compared with existing disclosure requirements. Appendix A provides a table of the requirements from the 2010 ED and the corresponding guidance under existing IFRSs and U.S. GAAP.

3. This memo addresses comments received based on the disclosure requirements proposed in the 2010 ED as well as a result of the Boards' redeliberations about lessor recognition and measurement and lessee presentation and disclosure. There are some disclosures that were proposed in the 2010 ED that are not discussed in this paper because those disclosures are either:

   (a) No longer needed because of the Boards' decisions about recognition and measurement; or

   (b) Retained because significant issues were not raised in the comment letters or outreach that followed the issuance of the 2010 ED

(Appendix C contains a listing of those requirements retained but not discussed as part of this paper).

4. This paper will address lessor disclosures in the following sequence:

   (a) Recommendations based on lessee disclosure decisions

   (b) Initial direct costs (proposal in 2010 ED paragraph 73(a)(vii))

   (c) Reconciliation of beginning and ending balances (proposal in 2010 ED paragraph 80)

   (d) Maturity analysis (proposal in 2010 ED paragraph 86)

   (e) Fair value and disclosures of a lessor's exposure to residual asset risk

   (f) Nonpublic entities (FASB only)

   (g) Appendix A – Disclosure requirements of the 2010 ED, IAS 17, and Topic 840

   Appendix B – Summary of decisions reached – Presentation and Disclosure for lessees

   Appendix C – Mark-up of 2010 ED for staff recommendations

   Appendix D – Illustrative disclosure

Recommendations Based on Lessee Disclosure Decisions

5. Appendix B of this paper includes the summary of decisions reached at the July 2011 joint Board meeting on disclosures for lessees. The staff thinks that some of those decisions should be applied to the comparable disclosures for lessors. The staff also thinks that the basis for the decisions made for lessee disclosures would be applied in a similar manner to some lessor disclosures. Therefore, on the basis of the Board's decisions for lessee disclosures, the staff recommends that the following for lessor disclosure requirements:

   (a) A lessor should disclose the total amount of lease income recognized in the financial statements by separately identifying, for example, the following:

(i) Profit, recognized at lease commencement (split into revenue and cost of sales if that is how the lessor has presented the amounts in the statement of comprehensive income)

(ii) Interest income on the lease receivable

(iii) Accretion of the residual asset

(iv) Variable lease income

(v) Short-term lease income

(b) Do not require disclosure of the existence and principal terms of any options for the lessee to purchase the underlying asset

(c) A lessor should disclose the information about variable lease payments and lease term options (as required in paragraphs 73(a)(ii)-73(a)(iii) of the 2010 ED).

Single tabular disclosure of lease income items

6. During the July 2011 joint Board meeting, the Boards decided to require lessees to present or disclose amounts related to variable lease payment expense and short-term lease expense. The Boards decided that these expenses and other lease expenses should be presented together in a tabular format, which would increase the understandability of the information as well as facilitate the analysis of lease expense.

7. The staff discussed such a disclosure of lease income arising from lease contracts with some users. Those users stated that that information would be helpful to understand the total income generated from an entity's leasing activities. The staff thinks that the users of lessors' financial statements would benefit from the disclosure of various lease income items in one place, particularly if those amounts are not presented separately on the statement of comprehensive income. An example of the disclosure can be found in Appendix D of this paper.

Purchase options

8. Paragraph 73(a)(iv) 2010 ED requires an entity to disclose the nature of its arrangements including the existence and principle terms of any options for the lessee to purchase the underlying asset.

9. Similar to lessees, the staff thinks that the inclusion, by a lessor, of an option to purchase the underlying asset upon conclusion of a lease term is not likely to increase or decrease the likelihood of the sale of that asset to the lessee. Additionally, if there is an economic incentive for a purchase option to be exercised by the lessee, the residual asset would be zero and the option price would already be reflected as part of the lease receivable. Therefore, the staff does not think that there is incremental decision useful information provided by this disclosure.

Information about variable lease arrangements and lease term options

10. Paragraphs 73(a)(ii) and 73(a)(iii) requires an entity to disclose the nature of its arrangements including the basis and terms on which contingent rentals are determined and the existence and terms of options, including for renewal and termination.

11. The staff thinks that information about variable lease arrangements and term options are important in understanding the revenues of a lessor in the same way that it is important in understanding the lease expense of lessees. However, similar to comments received for lessees, lessors have concerns about how one would disclose that information for a large number of leases with very different variable lease payment and term option conditions.

12. Paragraph 71 of the 2010 ED states:

> An entity shall consider the level of detail necessary to satisfy the disclosure requirements in paragraphs 73−86 and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics.

13. The staff thinks that in the case of a lessor with significant and varied leasing activities, a lessor would read paragraph 71 of the 2010 ED and could be

compelled to provide rather lengthy and detailed disclosures. However, the staff thinks that understanding the sources of revenue of a lessor would certainly be of interest to the users of financial statements.

14. The staff therefore recommends the retention of the requirement to disclose the basis and terms on which contingent rentals are determined (paragraph73(a)(ii)) and existence and terms of options, including renewal and termination (paragraph 73(a)(iii)) of the 2010 ED.

15. A number of comment letters asked for illustrations of the proposed disclosures particularly because of the aggregation and disaggregation criteria provided in paragraph 12 of this memo. The staff thinks that illustrations would be helpful to understand how to apply the aggregation and disaggregation criteria to the required disclosures. Additionally, the staff notes that current U.S. GAAP provides illustrations of lessor disclosures. Therefore, the staff also recommends an illustration of the lessor disclosures be included in the leases guidance. Appendix D of this memo provides what this illustration may look like.

Question 1

Do the Boards agree with the following:

a) require a tabular note of all income items related to leases as outlined in paragraph 7 of this memo?

b) do not require disclosure of the existence and principal terms of any options for the lessee to purchase the underlying asset?

c) retain the requirement to disclose the information about variable lease payments and lease term options as required in paragraphs 73(a)(ii)-73(a)(iii) of the 2010 ED with an illustration of the lessor disclosures included in the leases guidance?

Initial direct costs

16. Paragraph 73(a)(vii) of the 2010 ED requires an entity to disclose the nature of its arrangements including initial direct costs incurred during the reporting period and included in the right to receive lease payments.

Feedback

17. There were few responses regarding a lessor's disclosure of initial direct costs. There was little support for this disclosure noted in the comment letter responses.

18. Comment letter 694 the respondent notes that IFRS 7 does not require the disclosure of capitalized acquisition costs and thus the respondent thinks this disclosure is not necessary. Additionally, the staff notes 310-20-50-3 does not contain a requirement for disclosure regarding initial direst costs but states, "Additional disclosures such as unamortized net fees and costs may be included in the footnotes to the financial statements if the lender believes that such information is useful to the users of financial statements."

19. Another respondent (CL#303) expresses concern over the competitive harm that can be caused by this disclosure.

Staff Analysis

20. The boards decided to eliminate the disclosure of initial direct costs incurred in the period for lessees on the basis of those costs likely being immaterial to the lessee. The staff thinks there will be instances where initial direct costs are significant as compared to the lease receivable and therefore is not suggesting the elimination of this disclosure by the lessor on the basis of immateriality. However, the staff acknowledges that there will be some leases where this cost is not significant as compared to the lease receivable.

21. The staff also notes that the Revenue Recognition project is requiring the disclosure of costs to obtain or fulfill a contract as part of its disclosures.

22. The staff is not convinced that this disclosure would be incrementally useful to the users of the financial statements. Although it will give the user insight into the costs incurred by the lessor in the period, those costs are already reflected in the return generated by the lease over the lease term.

Staff Recommendation

23. Because these costs will be reflected in the return generated by the lessor, there was not strong support for the disclosure and for some lessors the costs capitalized may not be significant compared to the lease receivable, the staff does not think this disclosure should be required.

24. Therefore, the staff recommends the removal of the requirement from the 2010 ED for a lessor to disclose its initial direct costs incurred in the reporting period and included in the right to receive lease payments. Therefore, the staff recommends the removal of the requirement to disclose initial direct costs.

Questions 2
Do the Boards agree that the requirement from the 2010 ED for a lessor to disclose its initial direct costs incurred in the reporting period and included in the right to receive lease payment be removed?

Reconciliation of beginning and ending balances (roll forward disclosures)

25. Paragraph 80 of the 2010 ED states:

> A lessor shall disclose a reconciliation of the opening and closing balances for each of the following:
>
> (a) rights to receive lease payments.
>
> (b) lease liabilities arising from leases to which it applies the performance obligation approach.
>
> (c) residual assets arising from leases to which it applies the derecognition approach.

Feedback

26. Preparers cited cost/benefit concerns about the disclosure of the reconciliations of the rights to receive lease payments and the residual asset. The comments received included concerns over the complexity involved in accumulating that information, the costs involved in doing so and the time needed in light of tight reporting deadlines.

27. Users were strongly in favor of roll-forward disclosures.

28. Roll-forward disclosures are part of existing IFRSs and U.S. GAAP and part of the proposed revenue recognition and insurance contracts projects' disclosure requirements. Roll-forward disclosures were reviewed as part of the cross cutting disclosure work (March 1-2, 2011, joint meeting;- FASB Memo 1/ IASB Agenda Paper 8), and it was determined that because of the differences in each of the projects, the utility of each roll forward disclosure needs to be evaluated in the context of each project separately. If roll-forward disclosures are part of the final leases standard, the cross cutting work indicated that the guidance should provide line items that would appear in the roll-forward disclosures, similar to the Revenue Recognition and Insurance Contracts projects.

29. Users thought the roll-forward disclosures would be of great importance, particularly for the residual assets. They note that the roll-forward disclosures would allow them to understand the changes in the residual asset as well as provide information that is important to their analysis that is unavailable elsewhere.

Staff Analysis

30. Currently, many systems are not configured to compile information that would be disclosed in the roll-forward of the lease receivable and residual asset. Furthermore, the staff sees merit in preparers' concerns that tight reporting deadlines and rigor around controls for audit purposes further complicates the reporting of roll-forward disclosures.

31. However, when analyzing the lease assets of a lessor, the roll-forwards provide the user with (a) information not available otherwise and (b) that information in one place.

32. During our outreach, users have demonstrated how information that is useful in understanding the leasing activity of an entity is often difficult to identify. The information in the roll-forward disclosures not only provides the user with information but also signals the user to look for more information or ask questions.

33. Finally, the staff notes that, for most lessors, their leasing activity is a fundamental part of the overall operating activities of the lessor. Accordingly, the information required by roll-forward disclosures should be both available and relevant for an understanding of the lessor's business.

Staff recommendation

34. The staff thinks that the decision to retain the roll-forward disclosures for the lessor would be useful in the same way as and is consistent with the disclosures required for lessees and those required by the revenue recognition project.

35. Therefore the staff recommends the reconciliation of the beginning and ending balances for the lease receivable and the residual asset.

36. Furthermore, if the Boards agree to retain the roll-forward disclosures, the requirement's wording should include the line items that a lessor might be expected to include in the roll-forwards, which would be consistent with the wording in revenue recognition and insurance. Appendix C includes a preliminary mark-up of the 2010 ED for the changes proposed by this paper, including the additional line items that might be included in the roll-forward disclosures.

Questions 3
Do the Boards agree that a lessor should be required to reconcile the beginning and ending balances of the lease receivable and the residual asset?

Maturity analysis

37. Paragraph 86 of the 2010 ED states:

> A lessor shall disclose a maturity analysis of the right to receive lease payments showing the undiscounted cash flows on an annual basis for the first five years and a total of the amounts for the remaining years. The maturity analysis shall distinguish the cash flows attributable to the minimum amounts receivable specified in the lease (ie excluding contingent rentals and expected payments from the lessee under term option penalties and residual value

> guarantees) and the amounts recognized in the statement of financial position.

38. Respondents commented on the following three issues relating to these proposals:
    (a) Which amounts should be included in the maturity analysis?
    (b) Which time bands should be used in the maturity analysis?
    (c) Should disclosures of the discounts rates used to measure the right to receive lease payments be required?

Amounts included in the maturity analysis

Feedback

39. There were a number of respondents who did not favor the disclosure of the maturity analysis of the receivable. One respondent stated:

> We … believe that the requirement to provide a maturity analysis of the right to receive lease payments on an annual basis for the first five years and a total for the remaining lease term is unnecessary. The requirement is inconsistent with the disclosure requirements related to loans and other financial assets, and we believe of limited value to financial statement users. (CL# 503)

40. Some respondents expressed concerns about the separation of minimum amounts and amounts such as contingent rentals, penalties and residual value guarantees. Respondents stated that this separation would be burdensome to preparers.

Staff Analysis

41. The Boards have decided to limit the inputs that are included in the initial measurement of the lease receivable compared to what was proposed in the 2010 ED. The staff has observed that because of those changes, amounts such as variable lease payments (contingent rentals) will no longer be included in the receivable and therefore would not need to be separated in the maturity analysis.

42. Furthermore, the staff considered the utility of separating amounts in the maturity analysis for residual value guarantees or penalties. Because those

amounts are not likely to be recognized until known and they are likely to be unknown until paid (or shortly before they are paid), separate presentation in the maturity analysis does not therefore appear to offer a significant benefit compared to the cost of accumulating that data separately from the remainder of the receivable.

43. The staff notes that during the July 2011 joint Board meeting, the FASB decided to include in the maturity analysis the contractual obligations of the lessee for the service components of it lease agreements. The IASB did not agree to this disclosure. This paper does not address a similar disclosure for lessors as the service portions of lease contracts are covered by the Revenue Recognition project.

Staff Recommendation

44. The staff recommends that the final standard require the disclosure of a maturity analysis of undiscounted amounts included in the lease receivable. Furthermore, to be consistent with decisions the Boards have made on lessee disclosures, the staff recommends requiring that amount to be reconciled to the amount recognized in the statement of financial position.

Time bands

Staff recommendation

45. Although some respondents noted the inconsistency between the time bands used in IFRS 7 and the 2010 ED, most respondents did not object to the utility of the disclosure of the five annual periods.

46. At the July 2011 joint Board meeting, the Boards decided that the maturity schedule for lessees could be useful if extended out beyond five years and therefore they decided to retain the five years as a minimum for the time bands presented.

47. Therefore, consistent with decisions made at the July, 2011 joint Board meeting for lessees, the staff recommends retaining the requirement to disclose the maturity analysis for each of the first five annual periods noting that this requirement is the minimum number of time bands to be disclosed.

Discount rate

Staff recommendation

48. Consistent with decisions made at the July 2011 joint Board meeting for lessees, the staff recommends that neither the disclosure of the weighted average nor range of discount rates used to determine the lease receivable be required by lessors. That is because with both the discounted and undiscounted amounts provided, the staff sees little incremental value in disclosing the rate and thinks that a user could discern an approximate rate if it wishes. In addition, lessors will not want to disclose the rate they are charging the lessee.

Question 4
Do the Boards agree with the following staff recommendations: i) Include the requirement to disclose a maturity analysis of undiscounted cash flows that are included in the lease receivable reconciled to the amount reported in the SFP for the lease receivable? ii) The time bands required for the maturity analysis of the lease receivable should be, at a minimum, each of the first five years following the reporting date and the total of the remaining years? iii) Consistent with the decisions made for lessees, do not require disclosures of the range or the weighted average of discount rates used to calculate the lease receivable?

Fair value and disclosures of a lessor's exposure to residual asset risk

49. During the July 2011 joint Board meeting, the Boards discussed fair value disclosures of the liability to make lease payments by a lessee. The Boards decided not to require a fair value disclosure of the liability to make lease payments as part of lessee disclosures.

50. The staff thinks that fair value information about a lessor's lease assets would be useful. Users have expressed a desire to have disclosures of the fair value of both the lease receivable and the residual asset. Furthermore, many of those

users have said that they also would benefit from a fair value disclosure that incorporates term options and variable lease payments.

51. The staff thinks that the disclosure of such amounts would be costly and complex. Furthermore, disclosing the fair value of lease assets would presumably incorporate amounts to be received for variable lease payments and term options that the Boards have decided are difficult to estimate and, thus, have chosen not to include in the lease receivable. Reincorporating those amounts into the computation of the fair value of the asset would contradict the basis on which the Boards have made their prior recognition and measurement decisions.

52. Some argue that since the lease receivable is a financial asset (and the liability for the lessee is a financial liability) the fair value disclosures required by IFRS 7 should be required by the final standard. In addition, some users think that the fair value of the residual asset should be disclosed. One respondent states:

> We note that the fair value disclosure provisions of IFRS 7 have not been included in the disclosure requirements for leases. As these are financial instruments, we do not believe they should be excluded from such disclosures. We would encourage the inclusion of disclosures related to the fair value of the right to receive lease payments if they are not remeasured at fair value. We would also like the fair value of the residual asset to be provided as such information is useful to investors. Fair value can convey whether an entity has market advantage in lease negotiations or intrinsic value from above market lease arrangements. (CL# 780)

Staff analysis

53. Similar to the thoughts provided in the September 2011 joint Board meeting Board Memo 200 / Agenda Paper 2D *Leases: Applicability of Financial Asset Guidance to the Right to Receive Lease Payments* the staff thinks that fair value disclosures of the lease receivable would be costly and complex for the preparers of the financial statements.

54. The staff thinks that disclosing the fair value of the residual asset would also be costly and complex to disclose. This is due to many different factors such as how to allocate fair value to portions of larger assets, no observable market prices for some assets and the requirement to frequency with which a lessor would have to update those values, presumably every reporting period.

55. The staff also thinks that a decision to disclose the fair values of lease assets would contradict some of the reasons for the Boards' decisions about recognition and measurement.

56. Therefore, the staff recommends that the Boards do not require disclosure of the fair value of the lease receivable or the residual asset.

57. Nonetheless, some staff members think that users would benefit from more information about a lessor's exposure to residual asset risk as follows:

    (a) Paragraph 81 of the ED requires the disclosure of the nature and amount of each class of residual asset as well as the risks associated with those assets. The staff thinks that this disclosure will give users an understanding of the asset risk associated with the residual asset and thus allow the user to assess the potential changes to the value of the underlying asset in the future.

    (b) Paragraph 73(a)(vi) of the ED requires the lessor disclose the existence and terms of residual value guarantees. This disclosure will also allow the user to assess how an entity manages its exposure to the risks of changes in values of the residual asset by obtaining residual value guarantees.

    (c) In addition to those disclosures, some staff members recommend that a lessor be required to disclose how it manages its exposure to the underlying asset, including

        (i) its risk management strategy in this respect,

        (ii) the carrying amount of the residual asset that is covered by residual value guarantees and the unguaranteed portion of the carrying amount of the residual asset, and

        (iii) whether, for example, the lessor has any other means of reducing its exposure to residual asset risk (e.g. buyback agreements with the manufacturer from whom the lessor purchased the underlying asset, options to put the underlying asset back to the manufacturer, etc.)

58. Some staff members favor the additional disclosure as described in paragraph 57(c). Other staff members do not as they think the requirements as outlined in paragraphs 57(a) and 57(b) are adequate.

Question 5 & 6
Do the Boards agree that the final standard should not require the disclosure of the fair value of the lease receivable and the residual asset? Do the Boards want to require a lessor to disclose information about its exposure to residual asset risk as described in paragraph 57(c) above?

Nonpublic entities (FASB only)

59. The staff did not identify any significant differences between nonpublic entity preparers, users, and auditors on the topic of lessor disclosures. The staff discussed the issue of roll-forwards, in particular, with users, preparers and auditors of nonpublic entities, including members of the Private Company Financial Reporting Council (PCFRC) and the Technical Issues Committee of the AICPA (TIC). The staff heard from auditors that such roll-forwards would be required in most audits of a lessor since a roll-forward would provide key information about a significant business activity of most lessors and would be necessary to fully understand the yields on a lessor's portfolio as well as the expected future cash flows. As a result, the staff does not recommend any special consideration for nonpublic entities on the topic of disclosures.

Appendix A

Disclosure requirements of the 2010 ED, IAS 17, and Topic 840

<u>Exposure Draft</u>	<u>IAS 17</u>	<u>Topic 840</u>
Information that identifies and explains the amounts in the financial statements 73. An entity shall disclose: (a) the nature of its lease arrangements, including:		
73. (i) a general description of those lease arrangements.	47 Lessors shall, in addition to meeting the requirements in IFRS 7, disclose the following for finance leases: (f) A general description of the lessor's material leasing arrangements. 56 Lessors shall, in addition to meeting the requirements of IFRS 7, disclose the following for operating leases: (c) A general description of the lessor's leasing arrangements.	10-50-4 If leasing, exclusive of leveraged leasing, is a significant part of the lessor's business activities in terms of revenue, net income, or assets, a lessor shall disclose in the financial statements or footnotes thereto a general description of the lessor's leasing arrangements.
73. (ii)the basis and terms on which contingent rentals are determined.	47 (e) Contingent rents recognized as income in the period. 56 (b) Total contingent rents recognized as income in the period.	10-50-5 The lessor shall disclose its accounting policy for contingent rental income.
73. (iii) the existence and terms of options, including for renewal and termination.		
73. (iv) the existence and principal terms of any options for the lessee to purchase the underlying asset.		
73. (vi) the existence and terms of residual value guarantees.		
73. (vii) initial direct costs incurred during the reporting period and included the measurement of the right-of-use asset or right to receive lease payments.		
75. An entity that accounts for		

short-term leases in accordance with paragraphs 64 and 65 shall disclose the fact and, for lessees, the amount recognized in the statement of financial position for such short-term leases.		
78. A lessor shall disclose the information about its exposure to the risks or benefits associated with the underlying asset that it used in determining whether to apply the performance obligation approach or the derecognition approach.		
79. A lessor shall disclose impairment losses arising from leases to which it applies the performance obligation approach separately from those to which it applies the derecognition approach.		
80. A lessor shall disclose a reconciliation of the opening and closing balances for each of the following:		
80.(a) rights to receive lease payments.		
80.(b) lease liabilities arising from leases to which it applies.		
80.(c) residual assets arising from leases to which it applies the derecognition approach.		
81. A lessor shall disclose information about the nature and amount of each class of residual asset arising from leases to which it applies the derecognition approach.	47 (c) The unguaranteed residual values accruing to the benefit of the lessor.	30-50-4(a2) The unguaranteed residual values accruing to the benefit of the lessor.
82. A lessor shall disclose information about the nature of significant service obligations related to its leases.		
Information about the amount, timing and uncertainty of cash flows arising from leases		

83. An entity shall disclose information about significant assumptions and judgements and any changes in assumptions and judgements relating to renewal options, contingent rentals, term option penalties, residual value guarantees and the discount rate used when determining the present value of lease payments.		
84. An entity shall disclose information in accordance with the proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities – Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815).*		
86. A lessor shall disclose a maturity analysis of the right to receive lease payments showing the undiscounted cash flows on an annual basis for the first five years and a total of the amounts for the remaining years. The maturity analysis shall distinguish the cash flows attributable to the minimum amounts receivable specified in the lease (that is, excluding contingent rentals and expected payments from the lessee under term option penalties and residual value guarantees) and the amounts recognized in the statement of financial position.	47 Lessors shall, in addition to meeting the requirements in IFRS 7, disclose the following for finance leases: (a) An entity shall disclose the gross investment in the lease and the present value of minimum lease payments receivable at the end of the reporting period, for each of the following periods: i. Not later than one year; ii. Later than one year and not later than five years; iii. Later than five years. 56 Lessors shall, in addition to meeting the requirements of IFRS 7, disclose the following for operating leases: (a) The figure minimum lease payments under non-cancellable operating leases in the aggregate and for	20-50-4(b) Minimum future rentals on noncancelable leases as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding fiscal years. 30-50-4(b) Future minimum lease payments to be received for each of the five succeeding fiscal y ears as of the date of the latest balance sheet presented.

	each of the following periods: i. Not later than one year; ii. Later than one year and not later than five years; iii. Later than five years.	
	47 (b) Unearned finance income.	30-50-4(a4) Unearned income (see paragraphs 840-30-30-9 and 840-30-30-13).
	47 (d) The accumulated allowance for uncollectible minimum lease payments receivable.	30-50-4(a1ii) The accumulated allowance for uncollectible minimum lease payments receivable.

Appendix B

Summary of decisions reached – presentation and disclosure for lessees

Lessee Presentation and Disclosure (AP 5A/Memo 187, AP 5B/Memo 188, AP 5C/Memo 189, and AP 5D/Memo 190)

At the July 2011 joint meeting, the FASB and IASB discussed the presentation and disclosure requirements for lessees, including presentation in the statement of financial position and on the statement of cash flows.

Lessee presentation and disclosure (AP 5C/Memo 189 and AP 5D/Memo 190)

The Boards discussed lessee disclosures and tentatively decided that a lessee should disclose the following:

1. A reconciliation of the opening and closing balance of right-of-use assets, disaggregated by class of underlying asset.
2. A reconciliation of the opening and closing balance of the liability to make lease payments (unlike the Exposure Draft, a lessee would not be required to disaggregate the reconciliation by class of underlying asset).
3. A maturity analysis of the undiscounted cash flows that are included in the liability to make lease payments. The maturity analysis should show, at a minimum, the undiscounted cash flows to be paid in each of the first five years after the reporting date and a total of the amounts for the years thereafter. The analysis should reconcile to the liability to make lease payments.
4. Information about the principal terms of any lease that has not yet commenced if the lease creates significant rights and obligations for the lessee.
5. Information required in paragraphs 73(a)(ii)-73(a)(iii) of the Exposure Draft (the Boards will provide guidance, illustrations, or both about those requirements).
6. All expenses relating to leases recognized in the reporting period, in a tabular format, disaggregated into (a) amortization expense, (b) interest expense, (c) expense relating to variable lease payments not included in the liability to make lease payments, and (d) expense for those leases for which the short-term practical expedient is elected, to be followed by the principal and interest paid on the liability to make lease payments.
7. Qualitative information to indicate if circumstances or expectations about short-term lease arrangements are present that would result in a material change to the expense in the next reporting period as compared with the current reporting period.

The Boards also tentatively decided that a lessee should:

1. Present or disclose separately interest expense and interest paid relating to leases.

2. ***Not*** combine interest expense and amortization expense and present as lease or rent expense.

Additionally, the Boards tentatively decided that a lessee is ***not*** required to disclose the following:

1. The discount rate used to calculate the liability to make lease payments.
2. The range of discount rates used to calculate the liability to make lease payments.
3. The fair value of the liability to make lease payments.
4. The existence and principal terms of any options for the lessee to purchase the underlying asset, or initial direct costs incurred on a lease.
5. Information about arrangements that are no longer determined to contain a lease.

With regard to future contractual commitments:

1. The IASB tentatively decided that a lessee is not required to disclose the future contractual commitments associated with services and other non-lease components that are separated from a lease contract.
2. The FASB tentatively decided that a lessee should disclose the future contractual commitments associated with services and other non-lease components that are separated from a lease contract.

Presentation: lessee statement of financial position (AP 5A/Memo 187)

The Boards discussed presentation in the lessee statement of financial position and tentatively decided that a lessee should:

1. Separately present in the statement of financial position or disclose in the notes to the financial statements right-of-use assets and liabilities to make lease payments. If right-of-use assets and liabilities to make lease payments are not separately presented in the statement of financial position, the disclosures should indicate in which line item in the statement of financial position the right-of-use assets and liabilities to make lease payments are included.
2. Present the right-of-use asset as if the underlying asset were owned.

The Boards also decided that it is not necessary to clarify whether the right-of-use asset is a tangible or an intangible asset.

Presentation: lessee statement of cash flows (AP 5B/Memo 188)

The Boards discussed the lessee’s statement of cash flows and tentatively decided that a lessee should:

1. Classify cash paid for lease payments relating to the principal within financing activities.
2. Classify or disclose cash paid for lease payments relating to interest in accordance with applicable IFRSs or U.S. GAAP on the statement of cash flows.

3. Classify cash paid for variable lease payments not included in the measurement of the liability to make lease payments as operating activities.
4. Classify cash paid for short-term leases not included in the liability to make lease payments as operating activities.

The Boards tentatively decided that a lessee should disclose:

1. The expense recognized in the reporting period for variable lease payments not included in the liability to make lease payments.
2. The acquisition of a right-of-use asset in exchange for a liability to make lease payments as a supplemental noncash transaction disclosure.

Appendix C

Mark-up of 2010 ED for staff recommendations

The following is the lessor disclosure requirements from the 2010 ED marked up for the recommendations in this paper and the Boards' tentative decisions to date regarding recognition and measurement. This mark-up only reflects the decisions made by the Boards to date and the staff recommendations in this paper. The mark-up below is subject to change.

Information that identifies and explains the amounts in the financial statements

73. An entity shall disclose:

(a) the nature of its lease arrangements, including:

(i) a general description of those lease arrangements.

(ii) the basis and terms on which contingent rentals are determined.

(iii) the existence and terms of options, including for renewal and termination.

~~(iv) the existence and principal terms of any options for the lessee to purchase the underlying asset.~~

~~(v) information about assumptions and judgments relating to amortization methods and changes to those assumptions and judgments.~~

(vi) ~~the existence and terms of residual value~~ a discussion of how the lessor manages its exposure to the underlying asset, including

A)its risk management strategy in this respect

B) the carrying amount of the residual asset that is covered by residual value guarantees and the unguaranteed portion of the carrying amount of the residual asset, including the terms of those residual value guarantees,

C) whether the lessor has any other means of reducing its exposure to residual asset risk (eg buyback agreements with the manufacturer from whom the lessor purchased the underlying asset, options to put the underlying asset back to the manufacturer, etc.) *(split recommendation)*

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~~(vii) initial direct costs incurred during the reporting period and included in the measurement of the right to receive lease payments~~

(viii) the restrictions imposed by lease arrangements, such as those relating to dividends, additional debt and further leasing.

(b) information about the principal terms of any lease that has not yet commenced if the lease creates significant rights and obligations for the entity.

(c) A tabular schedule of income related to leases including:

(i)Profit recognized at lease commencement (split into revenue and cost of sales, if that is how the lessor presented this information in the statement of comprehensive income)

(ii) Interest income on lease receivable

(iii) Income from accretion of receivable

(iv) Variable lease payment income

(v) Short term lease income

75. An entity that accounts for short-term leases in accordance with paragraphs xx and xx shall disclose that fact ~~and, for lessees, the amount recognized in the statement of financial position for such short-term leases.~~

~~78. A lessor shall disclose the information about its exposure to the risks or benefits associated with the underlying asset that it used in determining whether to apply the performance obligation approach or the derecognition approach.~~

~~79. A lessor shall disclose impairment losses arising from leases to which it applies the performance obligation approach separately from those to which it applies the derecognition approach~~. (Incorporate into the roll-forward disclosure)

80. A lessor shall disclose a reconciliation of the opening and closing balances for each of the following:

(a) ~~rights to receive lease payments~~ lease receivable. The reconciliation shall show each of the following if applicable

(i) Increase from new or renewed leases

(ii) Increase due to the accretion of the receivable

(iii)Cash received

(iv) Foreign currency translation adjustments;

(v) Effect of business combinations

(vi) Impairments; and

(vii) Any other line items that would be useful in understanding the change in the balance.

~~(b) lease liabilities arising from leases to which it applies the performance obligation approach.~~

(b) residual assets ~~which it applies the derecognition approach.~~ . The reconciliation shall show each of the following if applicable:

(i) Residual asset added from new or renewed leases

(ii) Accretion of the residual asset

(ii) Residual asset reclassified at conclusion of lease

(iii)Residual asset sold

(iv) Foreign currency translation adjustments

(v) Effect of business combinations;

(vi) Impairments; and

(vii) Any other line items that would be useful in understanding the change in the balance.

81. A lessor shall disclose information about the nature and amount of each class of residual asset ~~arising from leases to which it applies the derecognition approach.~~ as well as the risks associated with the residual assets.

82. A lessor shall disclose information about the nature of significant service obligations related to its leases.

Information about the amount, timing and uncertainty of cash flows arising from leases

83. An entity shall disclose information about significant assumptions and judgments and any changes in assumptions and judgments relating to renewal options, ~~contingent rentals~~variable lease payments, term option penalties, residual value guarantees and the discount rate used when determining the present value of lease payments.

84.(FASB) An entity shall disclose information in accordance with the proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)*.

84.(IASB) Except as described in paragraph 86, an entity shall disclose information relating to the risks arising from a lease required by paragraphs 31-42 if IFRS 7 *Financial Instruments: Disclosures*.

86. A lessor shall disclose a maturity analysis of the right to receive lease payments showing the undiscounted cash flows on an annual basis for, at a minimum, the first five years and a total of the amounts for the remaining years. The maturity analysis shall reconcile to ~~distinguish the cash flows~~

~~attributable to the minimum amounts receivable specified in the lease (that is, excluding contingent rentals and expected payments from the lessee under term option penalties and residual value guarantees) and the~~ amounts recognized in the statement of financial position.

Disclosures retained but not addressed by this paper

The following is a list of those requirements contained in the mark-up of the 2010 ED above that were not discussed as part of this paper because significant issues were not raised with these requirements and the staff continue to think they should be retained:

73. An entity shall disclose:

(a) the nature of its lease arrangements, including:

(i) a general description of those lease arrangements.

(viii) the restrictions imposed by lease arrangements, such as those relating to dividends, additional debt and further leasing.

(d) information about the principal terms of any lease that has not yet commenced if the lease creates significant rights and obligations for the entity.

75. An entity that accounts for short-term leases in accordance with paragraphs xx and xx shall disclose that fact

81. A lessor shall disclose information about the nature and amount of each class of residual asset ~~arising from leases to which it applies the derecognition approach.~~ as well as the risks associated with the residual assets.

82. A lessor shall disclose information about the nature of significant service obligations related to its leases.

83. An entity shall disclose information about significant assumptions and judgments and any changes in assumptions and judgments relating to renewal options, ~~contingent rentals~~variable lease payments, term option penalties, residual value guarantees and the discount rate used when determining the present value of lease payments.

84.(FASB) An entity shall disclose information in accordance with the proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)*.

84.(IASB) Except as described in paragraph 86, an entity shall disclose information relating to the risks arising from a lease required by paragraphs 31-42 if IFRS 7 *Financial Instruments: Disclosures*.

Appendix D

Illustrative disclosure

Lessor example disclosure – leasing company; significant VLP; 2 classes of residual assets

Background
ABC Ltd (the Company) leases equipment to the global graphics communications industry. The Company has two distinct leasing businesses – printing presses and service trucks. The printing presses are leased to printing shops and the service trucks are leased to business that sell and service printing presses. The Company purchases printing presses and service trucks from manufacturers and simultaneously leases the assets to its customers.

Disclosure

Leases in the Company's printing presses business typically are for a 10 year period, which is a majority of the estimated useful life of the printing presses. Leases in the Company's service trucks business typically are for a 3 year period, which is approximately one-half of the estimated useful life of trucks. The leases in the printing presses business typically involve monthly payments for the duration of the lease. The leases in the service trucks business typically involve both contractual monthly payments and variable lease payments. The variable lease payments are based on distance travelled in the vehicles and are payable in the first quarter of each fiscal year based on usage in the preceding fiscal year. A majority of the lease transactions in the two businesses involve renewal options whereby lessees can renew the leases for a specified period of time at market rates determined at the time of renewal. Those renewal terms for trucks generally allow for annual renewals for three years following the end of the lease. The renewal terms for the printing presses allow for three year renewals generally for 3-15 years following the end of the initial lease. The lease contracts generally are not cancellable and do not involve residual value guarantees. The Company has no service obligations associated with the assets it leases.

73(a)(i)-(vi), 82

The following table is a summary of the significant components of lease income for the year ended December 31, 20X2.

(Amounts in thousands)	
Interest income on lease receivable	27,476
Income from accretion of residual	12,080
Variable lease payments income	14,500
Short-term lease income	980
Lease income for the year ended December 31, 20X2	55,036

73(c)

One significant lease for service trucks was signed, but not commenced, on December 31, 20X2. The terms of the lease are consistent with the terms of the leases that commenced prior to year end as described above. The present value of the right to receive lease payments is approximately CU12,000.

73(b)

The Company has a relatively small number of leases with a maximum term of less than 12 months. The Company's accounting policy is to recognize the revenue associated with these leases ratably over the lease term, but not record a residual asset and receivable for the present value of the lease payments. Revenue recognized associated with these leases was CU980 for the year ended December 31, 20X2.

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The following table is a summary of the significant components of the change in lease receivable between December 31, 20X1 and 20X2. These rights to receive lease payments are included in lease assets on the statement of financial position.

(Amounts in thousands)	
Balance at December 31, 20X1	352,100
Increase from new leases	90,800
Increase from interest	27,476
Cash received	(58,300)
Write offs	(1,790)
Foreign currency translation adjustments	XX
Receivables acquired in business combinations	XX
Balance at December 31, 20X2	410,286

80(a)

The following table is a summary of the significant components of the change in the residual asset between December 31, 20X1 and 20X2. These residual assets are included in lease assets on the statement of financial position.

(Amounts in thousands)	Total
Balance at December 31, 20X1	141,600
Accretion of residual asset	12,080
Increase from new leases	38,052
Residual assets sold to lessee at end of lease	(32,252)
Reclassification of residual assets not sold at end of lease	(11,395)
Impairments	(2,407)
Foreign currency translation adjustments	XX
Receivables acquired in business combinations	XX
Balance at December 31, 20X2	145,678

80(b)

Residual asset balances at December 31, 20X2 consist of CU24,661 of residual asset related to printing presses and CU121,017 of residual assets related to service trucks. The primary risk in the residual assets is market demand for the printing presses. Demand can vary based on global economic conditions, industry factors and the introduction of new printing presses by the Company or other manufacturers. The risk associated with the residual assets is partially mitigated by residual value guarantees from third parties. Approximately CU52,800 of the total residual assets of CU145,678 have residual value guarantees.

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The following table is a summary of undiscounted lease payments to be received that are part of the lease receivable in each of the next five fiscal years and thereafter and a reconciliation of the sum of those payments to the present value of lease payments recorded on the statement of financial position.

(Amounts in thousands)	
Fiscal year ending	
20X3	107,000
20X4	121,302
20X5	136,283
20X6	33,803
20X7	22,550
Thereafter	77,078
Total future lease receipts	498,015
Discount to present value	(89,729)
Capitalized initial direct costs	2,000
Present value of lease receipts	410,286

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