



Staff Paper FASB Education Session October 14, 2011 FASB Memorandum **215**

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Project **Leases**

Topic **Transition: sale and leaseback**

Purpose

1. This paper addresses transition accounting for sale and leaseback transactions.

Summary of staff recommendation

2. If the Boards decided to permit prospective application of the new leases standard for all finance/capital leases, then the staff recommend a prospective transition approach for sale and leaseback transactions entered into prior to the effective date that resulted in finance/capital leases. Under this approach, an entity would not reevaluate the sale conclusion previously reached and would not remeasure the lease assets and liabilities. In addition, any deferred gain or loss would continue to be amortized over the lease term in accordance with existing standards.
3. For sale and leaseback transactions that resulted in an operating lease or that did not meet the sale recognition criteria under existing standards (or all leases if the Boards do not extend the transition exceptions for all existing finance/capital leases), the staff recommend approach B, which requires retrospective application for the sale piece of the transaction and requires application of the general lease transition principles for the lease portion (that is, retrospective with transition exceptions). Any deferred gain or loss would be recognised in equity when applying the new leases standard.

Background

Existing standards applicable to sale and leaseback transactions

4. Prior to applying the lease accounting standards in IFRSs and U.S. GAAP (as described in paragraphs 5 and 6), an entity must first determine whether the transaction qualifies for sale recognition. There is a difference in the sale recognition criteria between IFRSs and U.S. GAAP. In U.S. GAAP, transactions involving real estate have additional criteria that must be met to conclude sale recognition is appropriate.
5. In IFRSs, the accounting treatment for any gain or loss resulting from the sale portion of a transaction depends on whether or not the lease portion of the transaction is classified as a finance or operating lease. The accounting for each type of lease is as follows:
 - (a) If a finance lease, then any gain on sale is deferred and amortised over the lease term.
 - (b) If an operating lease:
 - (i) and the transaction is at fair value, then any gain or loss is recognised immediately.
 - (ii) otherwise any gain or loss is deferred and amortised over the lease term.
6. In U.S. GAAP, any gain or loss resulting from the sale generally is deferred and amortized over the lease term.

Boards' decisions regarding sale and leaseback transactions consummated subsequent to the effective date of new leases standard

7. The Boards decided that the control criteria in the revenue recognition project should be applied to evaluate whether or not a sale has occurred in a sale and leaseback transaction.
8. The Boards decided that the accounting for any gain or loss resulting from a sale and leaseback transaction should be as follows:
 - (a) If the transaction consideration is at fair value, then any gain or loss resulting from the sale should be recognised when the sale occurs.

- (b) If the transaction consideration is not at fair value, then the assets, liabilities, and any gain or loss should be adjusted to reflect current market rentals.

Summary of feedback received

- 9. Several constituents requested additional transition guidance on accounting for sale and leaseback transactions including (a) the accounting for any deferred gains and losses resulting from sale and leaseback transactions entered into prior to the effective date of the new leases guidance and (b) whether or not reassessment of previous conclusions regarding sale recognition is required.
- 10. Several respondents suggested that any deferred gains or losses at the effective date should continue to be amortized over the lease term, potentially by combining any deferred gains or losses with the corresponding right-of-use assets. They view a deferred gain or loss as representing a benefit or obligation of an entity during the lease term; therefore, they view it would not be appropriate to recognise a deferred gain or loss as an adjustment to equity when applying the new leases standard.
- 11. Some respondents suggested that a previous conclusion regarding sale recognition should not be reassessed.

Staff analysis

Transition for sale and leaseback transactions that result in a finance/capital lease

- 12. A separate paper discusses the general transition requirements and the staff recommended in that paper that for all leases currently classified as finance/capital leases, an entity apply the new leases guidance prospectively. If the Boards agree with that staff recommendation, then the staff recommend a prospective transition approach for sale and leaseback transactions that resulted in a finance/capital lease. Under this approach, an entity would not reevaluate the sale recognition conclusion previously reached and would not remeasure the lease assets and liabilities. In addition, any deferred gain or loss would

continue to be amortized over the lease term in accordance with existing standards.

13. The primary benefits of this approach are that
 - (a) the accounting for existing finance/capital leases would be consistent regardless of whether or not the lease results from a sale and leaseback transaction, and
 - (b) transition would require no incremental effort by preparers for these transactions.
14. The primary disadvantages of this approach are that
 - (a) the accounting for any gain or loss resulting from a sale and leaseback transactions that existed prior and subsequent to applying the new leases standard would not be comparable and
 - (b) such inconsistency may continue for many years depending on the lease term.
15. If the Boards do not prefer this approach for sale and leaseback transactions resulting in finance/capital leases, then the Boards could select one of the transitions approaches addressed below.

Transition for other sale and leaseback transactions

16. This section addresses transition accounting for the following sale and leaseback transactions:
 - (a) sale and leaseback transactions that resulted in operating leases or that did not meet the sale recognition criteria under existing standards.
 - (b) all sale and leaseback transactions if the Boards do not allow prospective accounting for all finance/capital leases.
17. The staff identified the following three approaches for transition of sale and leaseback transactions.
 - (a) Approach A requires prospective application for sale and leaseback transactions. The sale conclusion previously reached would not be reevaluated and no liability to make lease payments and no right-of-

use asset would be recorded on the statement of financial position, except for finance/capital leases where lease assets and liabilities would be recorded under existing IFRSs and U.S. GAAP. In addition, any deferred gain or loss would be amortized over the lease term in accordance with existing guidance.

- (b) Approach B requires retrospective application for the sale piece of the transaction and the lessee would apply the general principles on lease transition for the lease portion (that is, retrospective with transition exceptions). Some transactions that previously did not meet the criteria for sale recognition may meet the criteria under the new model in the revenue project and vice versa. Any deferred gain or loss would be recognised in equity when first applying the new leases standard.
- (c) Approach C requires the following:
 - (i) If the sale and leaseback transaction did not meet the sale recognition criteria under existing standards, then follow approach B (that is, reevaluate the sale and apply other transition requirements to the lease). Any deferred gain or loss would be recognised in equity when the leases standard is first applied.
 - (ii) If the sale and leaseback transaction met the sale recognition criteria under existing standards, then do not reevaluate the sale conclusion and apply the general leases transition requirements. Any deferred gain or loss would be recognised in equity when transitioning to the leases standard.

18. The following table compares and contrasts the aforementioned approaches for some significant transition considerations. Following the table is additional staff analysis regarding the approaches.

	Approach A	Approach B	Approach C
Comparability	<p>Least comparable:</p> <ul style="list-style-type: none"> a) The accounting for the lease portion would be different for sale and leaseback transactions that existed prior and subsequent to implementation and all other leases because no right-of-use asset would be recognised. b) Transactions that do not meet sale recognition criteria under existing standards may meet sale criteria under revenue project model and vice versa. c) Differences in accounting under exiting IFRSs and U.S. GAAP would continue. d) The differences, which could be significant, may extend for a long period of time depending on the length of the lease portion of the transaction. 	<p>Most comparable:</p> <ul style="list-style-type: none"> a) The accounting for both the sale portion and the lease portion would be consistent across time. b) Existing differences between IFRSs and U.S. GAAP for accounting for sale and leaseback transactions would be eliminated. c) All types of leases (apart from those that qualify for transition exceptions otherwise granted by the Boards) would be accounted for the same regardless of whether or not the lease was part of a sale and leaseback transaction. d) A retrospective approach for the sale portion of the transaction is consistent with the Boards' decision in the revenue recognition project. 	<p>The accounting for the sale portion of a transaction would not be comparable prior and subsequent to applying the new standard when a different sale recognition conclusion is reached under existing standards and the new model in the revenue project.</p> <p>The accounting for the lease portion of a transaction would be consistent as addressed for approach B.</p>

	Approach A	Approach B	Approach C
Transition costs	May be the least because an entity would not be required to reevaluate the accounting for a transaction.	<p>May be the highest because an entity would be required to reevaluate the sale and lease portions of a transaction.</p> <p>Although the costs for this approach may be higher than the other approaches, most entities would have only a few (or no) existing sale and leaseback transactions.</p>	The transition costs for this approach are expected to be more than the costs for approach A, but less than the transition costs for approach B. An entity would not be required to reassess a sale conclusion, but would be required to reevaluate the accounting for the lease.
Potential incentives for an entity to consummate transaction prior or subsequent to implementation to achieve a particular accounting outcome	There are potential incentives under each approach depending on the desired outcome, the facts and circumstances of the arrangement, and the entity's reporting framework. Consequently, this is not a significant factor in deciding which approach to select.		

19. The difference between approaches B and C is that approach C does not require reassessment of the sale portion of a transaction if an entity previously concluded that sale recognition was appropriate under existing requirements. This approach was suggested by some respondents. Some staff view that Approach C could reduce transition complexity for some entities, particularly for existing IFRS preparers, because it would not require an entity to reassess the sale conclusion for a transaction that may have occurred many years ago. Other staff note that the proposed revenue recognition standard requires sale reassessment on implementation and question why should transition relief be provided for sale and leaseback transactions. Furthermore, if the Boards decided that a lessee would have to apply the new standard retrospectively ('full' retrospective option), they question how much cost-savings would there be for the seller/lessee.
20. In addition to the three approaches addressed above, the staff considered whether approaches B and C could be modified such that any deferred gain or loss from a sale and leaseback transaction would continue to be amortized over the lease term after implementation. Some respondents viewed a deferred gain or loss as an asset or obligation of the entity during the lease term; therefore, their view is that it would not be appropriate to recognise a deferred gain or loss as an adjustment to equity upon implementation. The staff rejected this approach because it would reduce comparability until the lease term ends, would not reduce transition costs, and would be inconsistent with transition for many other standards that require retrospective application with adjustments recorded in equity.

Staff recommendations

21. If the Boards decided to permit prospective application of the new leases standard for all finance/capital leases, then the staff recommend a prospective transition approach for sale and leaseback transactions entered into prior to the effective date that resulted in finance/capital leases. Under this approach, an entity would not reevaluate the sale conclusion previously reached and would not remeasure the lease assets and liabilities. In addition, any deferred gain or

loss would continue to be amortized over the lease term in accordance with existing standards. The staff's primary reason for recommending this approach is the accounting for existing finance/capital leases would be consistent regardless of whether or not the lease results from a sale and leaseback transaction.

22. For sale and leaseback transactions that resulted in an operating lease or that did not meet the sale recognition criteria under existing standards (or all leases if the Boards do not extend the transition exceptions for all existing finance/capital leases), the staff recommend approach B, which requires retrospective application for the sale piece of the transaction and requires the general principle on transition for the lease portion (that is, retrospective with transition exceptions). Any deferred gain or loss would be recognised in equity when applying the new leases standard.
23. The staff recommend approach B because it provides the highest level of comparability with (a) sale and leaseback transactions consummated prior and subsequent to implementation and (b) leases regardless of whether or not the lease was part of a sale and leaseback transaction. They also note that requiring reassessment of the sale recognition conclusion is consistent with the revenue project, which requires retrospective application.

Question 1

If the Boards decided to permit prospective application of the new leases standard for all finance/capital leases, then the staff recommend a prospective transition approach for sale and leaseback transactions entered into prior to the effective date that resulted in finance/capital leases. Do the Boards agree?

Question 2

For sale and leaseback transactions that resulted in an operating lease or that did not meet the sale recognition criteria under existing standards (or all leases if the Boards do not extend the transition exceptions for all existing finance/capital leases), the staff recommend retrospective application for the sale portion and the general leases transition requirements for the lease portion (approach B). Do the Boards agree?