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Project **Leases**

Topic **Transition – Reliefs and Disclosure**

Objective

1. In the papers discussing general transition requirements for lessees and lessors, the staff recommends providing transition reliefs to ease the burden of applying the final standard in the first year of application. The purpose of this paper is to discuss those transition reliefs.

2. This paper also discusses general transition disclosures for lessees and lessors upon implementing the proposed leases requirements.

3. There are some specific transition issues that will need to be addressed for certain transactions that will be discussed in a separate memo. For example, this paper does not discuss transition requirements for sale and leaseback transactions, discount rate, etc.

4. This paper is organized as follows:

   (a) Summary of staff recommendations

   (b) Background

   (c) Staff analysis of transition reliefs for lessees and lessors

   (d) Staff analysis of transition disclosures

(e) Appendix A— Disclosure requirements of Topic 250 and IAS 8.[1]

Summary of staff recommendations

5. To ease the burden of applying the final standard in the first year of application, the staff recommends that the following reliefs should be provided:

   (a) Do not require restatement of contracts that finished before the effective date.

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

   (c) Allow the use of hindsight when preparing comparative information including the determination of whether or not a contract is or contains a lease.

6. Lastly, the staff recommends that the Boards require transition disclosures consistent with IAS 8 and Topic 250. If an entity elects any of the available reliefs in paragraph 5 of this memo, the entity should disclose which reliefs have been elected.

Background

Summary of proposals in the 2010 Leases Exposure Draft (2010 ED)

7. The 2010 ED did not propose any transition reliefs for lessees or lessors upon implementation of the proposed leases requirements.

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[1] Topic 250 and IAS 8 provide guidance for determining whether retrospective application of a change in accounting principle is impracticable and for reporting a change when retrospective application is impracticable. When it is impracticable to determine, the guidance requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment should be made to the opening balance of retained earnings for that period rather than being reported in an income statement. When it is impracticable to determine the cumulative effect of applying a change in accounting principle to all prior periods, the guidance requires that the new accounting principle be applied as if it were adopted prospectively from the earliest date practicable.

Revenue recognition proposals

8. The staff notes that in the revenue recognition project, the Boards have tentatively decided to affirm their decision in the 2010 Exposure Draft on revenue recognition that an entity should apply the proposed standard on a retrospective basis. However, to ease the burden of applying that proposed standard in the first year of application, the Boards tentatively decided to provide reliefs, which are detailed in paragraph 11 of this memo.

9. Additionally, an entity should apply any relief elected consistently to all transactions throughout the comparative periods.

10. The Boards also tentatively decided in the revenue recognition project that if an entity elects any of the available reliefs, the entity should disclose the following information:

    (a) The reliefs that have been elected by the entity

    (b) To the extent reasonably possible, a qualitative assessment of the likely effect of applying those reliefs.

Staff analysis of transition reliefs

11. In the revenue recognition project, the Boards have tentatively decided to provide entities with the following reliefs:

    (a) An entity should not be required to restate contracts that begin and end within the same annual reporting period.

    (b) An entity should be permitted to use hindsight in estimating variable consideration in the comparative reporting periods.

    (c) An entity should be required to perform the onerous test only at the effective date unless an onerous contract liability was recognized previously in a comparative period.

    (d) An entity should not be required to disclose the maturity analyses of remaining performance for prior periods.

12. To ease the burden in the first year of transition, the staff thinks that the Boards also should provide reliefs in the leases project. Possible reliefs are discussed

below. Reliefs that are italicized are reliefs allowed by the Boards in the revenue recognition project.

	Relief	**Comments**	**Recommendation**
1	Do not require restatement of contracts that finished before the effective date.	This relief would avoid an entity having to restate contracts that ended in the comparative periods. Only contracts that are active at the effective date would require restatement. The staff notes that this relief would ease the burden of transition. However, the staff notes that this relief may significantly affect comparability in the comparative periods. Although this relief likely would affect the comparability in comparative periods, the staff thinks it is more important to ensure comparability in periods after the effective date (which would not be affected by this relief). The staff thinks that the reduction in costs for preparers outweighs the benefit of having this	Provide the relief.

		comparative information.	
2	Do not require restatement of contracts that finished within some time period (for example, 12 months) after the effective date.	This relief would avoid an entity having to restate contracts that ended within some time period (for example, 12 months) after the effective date. The staff thinks that this relief may be useful if the period between the issuance of the final standard and the effective date is short. However, assuming there is sufficient time between publication and the effective date, the staff does not think this relief would provide any additional benefit to preparers and that it would just extend the possible lack of comparability for some time after the effective date.	Do not provide the relief.
3	Do not require evaluation of initial direct costs for contracts that began before the effective date.	This relief would avoid an entity having to evaluate initial direct costs of existing contracts under the guidance of the new standard. This may ease the burden of transition on the first year without significantly affecting	Provide the relief.

		comparability between reporting periods. This relief also prevents previously expensed items from being capitalized upon transition.	
4	Allow entities to apply a discount rate at transition other than the discount rate applicable at lease commencement.	This possible relief will be discussed in the memo on the discount rate for transition.	The staff recommends that the discount rate for measuring liabilities to make lease payments and rights to receive lease payments should be as follows: a. For a lessee, the discount rate at transition should be the incremental borrowing rate on the lessee's entire portfolio of leases. b. For a lessor, the discount rate at transition should be the

			discount rate charged in the lease that is determined at the date of commencement of the lease. Please see IASB Agenda Reference 2J/FASB Agenda Reference 214 for this analysis.
5	*Allow the use of hindsight in estimating the following:* • *Variable lease payments* • *Purchase options and renewal options* • *Residual value guarantees* • *Impairment* • *Revaluation (IFRS only)* • *Bifurcation of nonlease components* • *Contract*	Any retrospective application of the standard would require an entity to determine the estimates it would have made at each reporting date in the comparative periods. If the Boards allow a long period between the issuance of the standard and the effective date, this may not be impracticable; however, it increases complexity and costs of retrospective restatement. The Boards could reduce that complexity by allowing an entity to restate a contract with the benefit of	Provide the relief.

	modifications.	hindsight. For example, if a lessee/lessor knows that an option to extend a lease was exercised, it could reflect that information throughout the comparative periods without assessing whether there was or was not a significant economic incentive to do so during or before the comparative periods. The use of hindsight also would be applicable to variable lease payments, residual value guarantees, impairment, revaluation, and the bifurcation of nonlease components.	
6	Allow the use of hindsight in determining whether a contract is or contains a lease.	This relief would avoid an entity having to determine whether a contract is or contains a lease on the basis of facts and circumstances at the commencement of the contract. Instead, the entity would make that determination based on the facts and circumstances at the effective date. This is similar to the exception currently provided in Topic 840 (originally issued as	Provide the relief.

		EITF Issue No. 01-8, "Determining Whether an Arrangement Contains a Lease").	
7	*Do not require disclosure for prior periods of the maturity analysis of remaining liabilities to make lease payments.*	This relief would avoid an entity having to prepare disclosures at the end of comparative reporting periods. However, the staff notes that because the maturity analysis only discloses undiscounted future cash flows as of the reporting date, there are no prior period amounts to be disclosed. Therefore, this relief is not necessary.	Do not provide the relief.

Summary of staff recommendations

13. To ease the burden of applying the final standard in the first year of application, the staff recommends that the following reliefs should be provided:

    (a) Do not require restatement of contracts that finished before the effective date.

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

    (c) Allow the use of hindsight when preparing comparative information including the determination of whether or not a contract is or contains a lease.

14. An entity would be able to select any, all, or none of the above reliefs.

Question 1 – Transition reliefs
Question 1 – Do the Boards agree with the staff recommendation that, to ease the burden of applying the proposed standard in the first year of application, the following reliefs should be provided: a. Do not require restatement of contracts that finished before the effective date. b. Do not require evaluation of initial direct costs for contracts that began before the effective date. c. Allow the use of hindsight when preparing comparative information including the determination of whether or not a contract is or contains a lease? If not, then which relief options, if any, do the Boards wish to provide?

Staff analysis of transition disclosures

Background

15. The staff notes that paragraph 96 of the IASB 2010 ED states that:

> An entity shall provide the transition disclosures required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, without the disclosure of adjusted basic and diluted earnings per share.

16. The Boards discussed transition disclosures in March 2010 and tentatively decided that transition disclosures should be required in accordance with the guidance in Topic 250 and IAS 8. However, the requirement for U.S. GAAP was not included in the FASB 2010 ED.

Analysis and staff recommendations

17. The staff notes that no specific feedback was received on the transition disclosures. Therefore, the staff recommends that the Boards confirm their tentative decision to require an entity to provide transition disclosures required by IAS 8 for IFRS preparers and also include the decision, for U.S. GAAP preparers, that an entity provide disclosures required by Topic 250. An excerpt of that guidance is included in Appendix A of this memo.

18. Additionally, if the Boards agree with the staff recommendation to provide reliefs for transition, the staff thinks that it would be useful to provide transition disclosures about any of the reliefs elected by an entity. That is consistent with the revenue recognition proposals.

19. However, the revenue recognition proposals also include a requirement to disclose, to the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those reliefs. The staff has concerns with the application of such a disclosure requirement in the context of lease contracts because of the possible cost of providing that information. That is, although the staff recommends providing reliefs, requiring a qualitative assessment may be costly and may possibly remove much of the transition relief being provided to preparers. Therefore, the staff does not recommend that the Boards require a qualitative assessment of the likely effect of applying reliefs.

Question 2 – Transition disclosures
Question 2 – The staff recommends that the Boards require transition disclosures consistent with IAS 8 and Topic 250. Additionally, the staff recommends that, if an entity elects any of the available reliefs, the entity should disclose which reliefs have been elected. Do the Boards agree with the staff recommendation? If not, why not?

Appendix A – Disclosure Requirements of Topic 250 and IAS 8

IAS 8, paragraphs 28-31

28. When initial application of an IFRS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

(a) the title of the IFRS;

(b) when applicable, that the change in accounting policy is made in accordance with its transitional provisions;

(c) the nature of the change in accounting policy;

(d) when applicable, a description of the transitional provisions;

(e) when applicable, the transitional provisions that might have an effect on future periods;

(f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:

(i) for each financial statement line item affected; and

(ii) if IAS 33 *Earnings per Share* applies to the entity, for basic and diluted earnings per share;

(g) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(h) if retrospective application required by paragraph 19(a) or (b) is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures.

29. When a voluntary change in accounting policy has an effect on the current period or any prior period, would have an effect on that period except that it is

impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

(a) the nature of the change in accounting policy;

(b) the reasons why applying the new accounting policy provides reliable and more relevant information;

(c) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:

(i) for each financial statement line item affected; and

(ii) if IAS 33 applies to the entity, for basic and diluted earnings per share;

(d) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(e) if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures.

30. When an entity has not applied a new IFRS that has been issued but is not yet effective, the entity shall disclose:

(a) this fact; and

(b) known or reasonably estimable information relevant to assessing the possible impact that application of the new IFRS will have on the entity's financial statements in the period of initial application.

31. In complying with paragraph 30, an entity considers disclosing:

(a) the title of the new IFRS;

(b) the nature of the impending change or changes in accounting policy;

(c) the date by which application of the IFRS is required;

(d) the date as at which it plans to apply the IFRS initially; and either:

(i) a discussion of the impact that initial application of the IFRS is expected to have on the entity's financial statements; or

(ii) if that impact is not known or reasonably estimable, a statement to that effect.

Section 250-10-50

[General Note: Section 250-10-50 provides guidance on the disclosure in the notes to financial statements. In some cases, disclosure may relate to disclosure on the face of the financial statements.]

> **Accounting Changes**

> > **Change in Accounting Principle**

250-10-50-1 An entity shall disclose all of the following in the fiscal period in which a **change in accounting principle** is made:

a. The nature of and reason for the change in accounting principle, including an explanation of why the newly adopted accounting principle is preferable.

b. The method of applying the change, including all of the following:

1. A description of the prior-period information that has been retrospectively adjusted, if any.
2. The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for the current period and any prior periods retrospectively adjusted. Presentation of the effect on financial statement subtotals and totals other than income from continuing operations and net income (or other appropriate captions of changes in the applicable net assets or performance indicator) is not required.
3. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented.

4. If **retrospective application** to all prior periods is impracticable, disclosure of the reasons therefore, and a description of the alternative method used to report the change (see paragraphs 250-10-45-5 through 45-7).

c. If indirect effects of a change in accounting principle are recognized both of the following shall be disclosed:

1. A description of the indirect effects of a change in accounting principle, including the amounts that have been recognized in the current period, and the related per-share amounts, if applicable

2. Unless impracticable, the amount of the total recognized indirect effects of the **accounting change** and the related per-share amounts, if applicable, that are attributable to each prior period presented. Compliance with this disclosure requirement is practicable unless an entity cannot comply with it after making every reasonable effort to do so.

Financial statements of subsequent periods need not repeat the disclosures required by this paragraph. If a change in accounting principle has no material effect in the period of change but is reasonably certain to have a material effect in later periods, the disclosures required by (a) shall be provided whenever the financial statements of the period of change are presented.

250-10-50-2 An entity that issues interim financial statements shall provide the required disclosures in the financial statements of both the interim period of the change and the annual period of the change.

250-10-50-3 In the fiscal year in which a new accounting principle is adopted, financial information reported for interim periods after the date of adoption shall disclose the effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), and related per-share amounts, if applicable, for those post-change interim periods.