	IASB/FASB Meeting **Week commencing September 19, 2011**	IASB Agenda reference	**2B**
Staff Paper	**IASB/FASB Education Sessions** **Week commencing September 5, 2011**	FASB Agenda reference	**198**

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Project	**Leases**
Topic	**Presentation: Lessor Statement of Financial Position**

Objective

1. The objective of this paper is to discuss the presentation of a lessor's lease receivable and residual assets in the statement of financial position (SFP).

Background

2. The receivable and residual approach is similar to the derecognition approach as set out in the *Leases* Exposure Draft (ED).

3. The ED requires that, under the derecognition approach, a lessee present the following in the SFP:

   (a) rights to receive lease payments separately from other financial assets, distinguishing those that arise under a sublease

   (b) residual assets, separately within property, plant, and equipment (PP&E), distinguishing those that arise under a sublease

Issues

4. The staff has identified the following issues based on comment letter responses to the ED as well as decisions made during redeliberations following the ED:

(a) Presentation of the residual assets within PP&E

(b) Presentation of the lease receivable and the residual assets together or separately

(c) Disaggregation of the lease receivable and the residual assets.

Presentation of the residual assets within PP&E

Feedback

5. A number of comment letter respondents thought it was inappropriate for an entity to always present the residual assets within PP&E. One comment letter explains:

> The Boards should consider whether presenting residual assets as part of property, plant and equipment is appropriate. A residual asset is considered an investment asset by lessors. If the residual asset is presented as part of property, plant and equipment, this implies that the residual asset is used to support the lessor's business operations. Since the lessor absorbs the risk in the changes in value of the residual asset, the lessor views this asset as an investment that is expected to change in value during the term of a lease as opposed to an asset that will be depredated based on usage or the passage of time. (CL#175)

6. Furthermore, respondents note that often the assets that are the subject of the lease are akin to inventory (that is, goods available for sale). Therefore, to include the residual assets during the lease term within PP&E would be misleading.

Staff Analysis and Recommendation

7. The basis for conclusions in the ED states that the residual assets should be presented separately within PP&E because the residual assets represent the lessor's interest in the underlying assets that are PP&E.

8. In IFRSs, property, plant, and equipment are defined as "tangible items that: (a) are held for the production or supply of goods or services, for the rental to others, or for administrative purposes, (b) are expected to be used during more than one period." Property, plant, and equipment are not defined in U.S. GAAP.

9. The staff agrees that the asset, in the hands of the lessee, functions as PP&E. However, to the lessor, the residual assets represent the rights in the asset that have not been transferred to the lessee. Those rights could be considered an intangible and not PP&E.

10. If a residual asset is being held for the rental to others then, by definition, it could be viewed as appropriate for the residual to be presented within PP&E under IFRSs. However, in the absence of this circumstance, the residual asset does not fit the definition of PP&E.

11. Therefore, the staff is recommending that the ED be revised to not require residual assets to be classified in PP&E.

Question 1
Do the Boards agree that the final leases standard should not require that the residual assets be presented within PP&E?

Presentation of the lease receivable and the residual assets together or separately

Feedback

12. A majority of respondents noted that both the residual assets and the lease receivable under the derecognition approach should be presented separately from one another. Respondents that favored separate presentation did so because they perceived the following differences between the lease receivable and the residual assets:

    (a) the risks associated with each asset

    (b) the nature and substance of each asset

    (c) the liquidity of each asset

    (d) the methods of measurement of each asset.

13. A minority of respondents said they preferred presentation of the lease receivable and the residual assets summing to an investment in lease. One financial institution noted that they would present the lease receivable and the

residual assets together with other financial assets and disaggregate in the notes. They explain:

> We do not agree that a lessor's right to receive lease payments under the derecognition approach should be presented separately from other financial assets as the financial asset in substance, represents a yield earning loan. The split should be documented in the notes. In addition, lessors should be able to present the residual asset … within financial assets, which will be representative of the fact that they are income yielding assets, with separate disclosure in the notes. (CL #166)

14. A respondent suggested that the residual assets should be presented as they would be at the expiry of the lease.

Staff Analysis

15. The staff has identified three approaches for presenting the residual assets and the lease receivable:

    (a) Approach A – Require the presentation of all lease assets under a single caption in the SFP as "investment in leased assets" (with separate presentation or disclosure of the lease receivable and the residual assets; see paragraphs 28-33 of this memo).

    (b) Approach B – Require the residual assets be presented as they would be presented at expiry of the lease.

    (c) Approach C – Do not specify the line items for presentation of the residual assets and the lease receivable.

16. Paragraph 36 of IAS 17 states that "lessors shall recognize assets held under a finance lease in their statements of financial position and present them as a receivable at an amount equal to the total investment in the lease."

17. Paragraph 840-30-30-11 of the Codification states that"the lessor's net investment in a direct financing lease shall consist of the gross investment (as measured in paragraph 840-30-30-6) plus any unamortized initial direct costs minus unearned income."

18. Some staff members favor Approach A because they think that combining assets under a single caption represents a stream of future cash flows that are linked.

19. Those staff members think it is more meaningful to present the two amounts together. In that way, users are presented with an asset that is representative of :

    (a) Contractual cash flows to be generated from the leased asset (ie the lease receivable) and the value of the leased asset at the end of the lease term (albeit measured on an allocated cost basis).

    (b) the lessor's total interest in an asset to which it has legal title.

20. Furthermore, those staff members view the residual assets as somewhat different from other assets that the lessor either uses in its own business (ie PP&E) or holds to sell (ie inventory). PP&E and inventory are tangible assets readily available to the lessor for use or for sale. In contrast, during the lease term, the lessor typically does not have unrestricted access to the tangible leased asset. By definition, the lessee controls the use of the tangible leased asset during the lease term. Therefore, because of these differences, those staff members would propose presenting the residual assets together with the receivable as an "investment in lease assets."

21. Some other staff members do not favor presenting lease assets together in all circumstances for the following reasons:

    (a) The economics of the initial lease of an asset is a different transaction and has different economic characteristics than any subsequent lease, scrapping, or sale of the residual assets.

    (b) The residual assets and the lease receivable have different risks associated with each asset (asset risk versus credit risk, respectively).

    (c) The nature of the assets are dissimilar enough to, in most cases, warrant separate presentation (a receivable indicates that cash is due to be paid to the lessor; a residual assets represent the rights in the assets that were not transferred as rights of use).

22. The staff members who do not support requiring the presentation of the lease receivable and the residual assets together think that presenting the residual assets as they would be presented following lease expiry is more appropriate.

23. The staff notes that the residual assets represent the rights in the asset that were not transferred to the lessee, and thus may not be viewed as the underlying tangible asset at lease expiry. However, the staff thinks presenting the residual assets as they would be presented at expiry of the lease would be consistent with the Boards' decision that a lessee present the right of use asset as if it owned the underlying asset. That is, although during the lease term the assets (the residual for the lessor and the right of use for the lessee) represent the rights in the underlying, the presentation of those rights would be best done in the context of the underlying asset.

24. Requiring the residual assets to be presented as they would be at lease expiry may result in the following presentation of the residual:

    (a) For an automobile company, as *inventory*

    (b) For a machinery company, as *inventory* or as *scrap*

    (c) For an entity subleasing a portion of its headquarters, as *PP&E*

    (d) For a ship lessor, as *vessels* or *PP&E (IFRS if it is held to be rented)*

    (e) For a real estate lessor, as *investment in real estate.*

25. The staff notes that for a financial services entity, it is unlikely that upon expiry of a lease, the entity would present the residual asset (for example, a car) in "inventory" as banks generally do not have a line for inventory. It is likely that the financial service entity would, upon lease expiry, continue to classify the residual asset as *investment in lease assets* together with other rights to receive lease payments or as an *other asset*.

26. Approach C would not prescribe where an entity would present the lease receivable or the residual assets. However, if Approach C were chosen, the staff would still recommend that those amounts be presented or disclosed separately (see discussion in paragraphs 28-33). However, the staff generally thinks not including guidance will lead to questions and disparity in practice.

27. Therefore, some staff members recommend Approach A and some staff members recommend Approach B.

Question 2
Do the Boards agree with Approach A (require a single SFP caption for lease assets) or Approach B (require the residual assets be presented as it would be upon expiry of the lease)?

Disaggregation

Feedback

28. A majority of respondents thought that the disaggregation of amounts related to leases would be appropriate either presented in the SFP or disclosed in the notes.

29. Respondents would rely on the guidance provided by IAS 1 and SEC regulations, as well as management's judgment as to what should be disaggregated in the SFP.

30. If the Boards choose Approach A in Question 2 of this paper, an entity would either:

    (a) present in the SFP both the residual assets and the lease receivable summing to the investment in leased asset, or

    (b) present a single amount in the SFP for the investment in leased asset and disaggregate the investment into the lease receivable and the residual assets in the notes.

31. If the Boards choose Approach B or C in Question 2, an entity would either:

    (a) present the lease receivable and the residual assets on separate lines on the SFP, or

    (b) an entity would present the lease receivable and the residual assets embedded within other SFP line items and then disclose the amounts in the notes and state which line the assets are embedded in. (For example, under approach B, if the receivable is combined within accounts receivable, the amount specific to the rights to receive lease payments would be disclosed in the notes with a statement that the amount is included within accounts receivable.)

Staff Recommendation

32. Consistent with its recommendation for lessees regarding disaggregation of lease assets and liabilities, the staff recommends that the final leases standard require the residual assets and the lease receivable either be separately presented in the SFP or disclosed in the notes to the financial statements. This would not negate the disaggregation requirements as set forth in IAS 1 or other regulatory requirements. This would merely mean that as part of the leases standard, disaggregation in the SFP is not required.

33. The staff also recommends that, if the residual assets or the lease receivable are not separately presented in the SFP, the amounts disclosed should indicate in which line item in the SFP the residual assets or the lease receivable are included.

Question 3
Do the Boards agree that: (a) The final leases standard should require that the residual assets and the lease receivable should be either separately presented in the SFP or disclosed in the notes to the financial statements? (b) If the residual assets and the lease receivable are not separately presented in the SFP, the amounts disclosed should indicate in which line item in the SFP the residual asset and the lease receivable are included?