

IASB Agenda ref Addendum to 2C

FASB Agenda ref

Addendum to 227

STAFF PAPER

28/29 February 2012

FASB | IASB Meeting

Project	Leases		
Paper topic	Lessee accounting-	-approaches (addendum	regarding Approach C)
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Approach C—how a lessee might apply the underlying asset approach in practice

Information required by the lessee to apply Approach C

- 1. In order to apply the underlying asset approach, the lessee is required to have three pieces of information:
 - (a) The lease payments
 - (b) The discount rate (which is also required under Approach A and Approach B also)
 - (c) Any one of the following:
 - (i) The fair value of the underlying asset at lease commencement.
 - (ii) An estimate of the residual value of the underlying asset at the end of the lease term.
 - (iii) An estimate of the percentage consumption (ie estimated decline in value) of the underlying asset during the lease term.
- 2. In practice, for example, when a lessee is making a lease or buy decision, it is likely that the lessee will have information about what it would have cost to purchase the underlying asset at the date of lease commencement. In that case, the lessee could use that fair value information about the underlying asset, together with the discount rate and the lease payments, to work out the amortisation expense for the ROU asset under Approach C.

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3. Alternatively, for example, in the case of a lease of property (and in particular when a lessee leases a portion of a building (eg 2 floors of a building)), the lessee is unlikely to have information about the value of the portion of the building leased. In that case, the lessee would simply need to estimate the percentage consumption of the building over the lease term in order to apply Approach C. For example, the lessee might estimate 10% consumption of the 2 floors of a building over a 10-year lease term. Using that information, the lessee would be able to apply Approach C by inputting that information in, for example, excel and modelling the expected fair value of the underlying asset at the beginning and end of the lease term.

Sensitivity of Approach C to estimation error

- 4. Concerns have been raised about the operationality of Approach C for lessees. We have done some testing of Approach C in terms of its sensitivity to estimation error to assess whether Approach C could be operational.
- 5. Our findings are that Approach C is relatively insensitive to estimation error in calculating the percentage consumption of the asset. To illustrate, the following tables set out an airplane lease and a building lease. In both cases, it is assumed that the lessee does not have information about the fair value of the underlying asset at either the beginning or end of the lease term. Consequently, the lessee estimates the percentage consumption of the underlying asset during the lease term when applying Approach C.

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Airplane - 8 year lease	Less	or		Lessee							
Assumptions:	assu	mptions	s	assumpti	ons						
Lease term in years		. 8		8							
Interest rate		6.0%		6.0%							
FV of underlying asset	15	0,000		0.070							
Estimated residual value		0,000									
Portion of asset consumed (as %)	,	40%		22%	calculate	1 25 8 402	rs of 2E v	oara	cumor	lucoful li	fo
· · ·	4				Calculate	as o yea	15 UI 25 y	ear as	sume	useiui ii	ie
Lease payments		5,062	_	15,062	_		_			_	
Periods		0	1	2	3	4	5	_	6	7	8
Underlying Asset Approach (UA) - assumir	ng the lessee	has into	ormation	about the	e fair valu	e of the u	nderlyin	g asse	t		
Balance Sheet											
Right-of-use asset	9	3,533	82,645	71,554	60,247	48,712	36,934	1 24	4,900	12,594	0
Liability to make lease payments	9:	3,533	84,083	74,066	63,447	52,192	40,261	27	7,615	14,210	-
Income Statement								İ			
Interest on lease obligation			5,612	5,045	4,444	3,807	3,132	2 2	2,416	1,657	853
Amortisation expense			10,888	11,091	11,307	11,535	11,777		2,034	12,306	12,594
Total Lease Expense	_		16,500	16,136	15,751	15,342	14,909	_	4,450	13,963	13,447
Total Lease Expense			10,300	10,130	13,731	13,372	14,503	<u> </u>	1,430	13,303	13,777
Hardard San Assas Assas 1 (118)											
Underlying Asset Approach (UA) - assumir	ng the lessee	estima	tes the %	consump	tion of th	e underly	ing asset			1	
Balance Sheet							_	_			
Right-of-use asset	9	3,532	82,832	71,880	60,663	49,164	37,367	7 25	5,253	12,804	0
Liability to make lease payments	9	3,533	84,083	74,066	63,447	52,192	40,261	2	7,615	14,210	-
Income Statement											
Interest on lease obligation			5,612	5,045	4,444	3,807	3,132	2 2	2,416	1,657	853
Amortisation expense			10,701	10,952	11,217	11,499	11,797		2,114	12,449	12,804
Total Lease Expense			16,313	15,997	15,661	15,306	14,929	_	4,529	14,106	13,657
Total Lease Expense			10,010	13,337	15,001	13,300	1-1,52.		1,323	1-1,100	13,037
Takal Lagas Francis											
Total Lease Expense	C C	• • • •	46 500	46.436	45 354	45.040	44.000		4 450	42.002	40 447
Underlying Asset Approach (assuming per			16,500	16,136	15,751	15,342	14,909		4,450	13,963	13,447
			16,500 16,313	16,136 15,997	15,751 15,661	15,342 15,306	14,909 14,929		4,450 <mark>4,529</mark>	13,963 14,106	13,447 13,657
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