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Project	Leases		
Paper topic	Lessee Accounting - Illustrations		
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Contents of this paper

1. This paper sets out the following illustrations to assist the Boards in assessing each of the approaches discussed in Agenda Paper 2C/227:
 - a. Mechanics of the proposed approaches (Illustrations 1 and 2)
 - b. Expense profile summaries (Illustration 3)
 - c. Approach B: interest-based amortisation scenario analysis (Illustration 4)
 - d. Approach C: purchase and finance comparison to the underlying asset approach (Illustration 5).

IASB Agenda ref	2D
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Mechanics of the proposed approaches

2. Illustrations 1 and 2 detail the accounting for:
 - a. a lease of equipment, for which 50% of the equipment's value is expected to be consumed over the lease term, and
 - b. a lease of land, for which 0% of the land's value is expected to be consumed over the lease term (ie the land is not expected to decline in value over the lease term).
3. The accounting for each lease is set out under the following three approaches:
 - a. Approach A: the Boards' current tentative decisions
 - b. Approach B: the 'interest-based amortisation' approach (IBA)
 - c. Approach C: the 'underlying asset' approach (UA).
4. For each of the leases illustrated, the lessee is expected to both consume economic benefits from use of the underlying asset, and make lease payments, on a straight-line basis over the lease term.

*Illustration 1***EQUIPMENT - 50% Consumption****Assumptions:**

Lease term in years	5
Interest rate	6.00%
FV of underlying asset	1,000
Estimated residual value	500
Portion of asset sold	500
Lease payments	149

Periods	0	1	2	3	4	5
Boards' Tentative Decisions (Current)						
Balance Sheet						
Right-of-use asset	626	501	376	251	125	-
Liability to make lease payments	626	515	397	273	140	-
Income Statement						
Interest on lease obligation		38	31	24	16	8
Amortisation expense		125	125	125	125	125
Total Lease Expense		163	156	149	142	134

Interest-Based Amortisation Approach (IBA)						
Balance Sheet						
Right-of-use asset	626	515	397	273	140	-
Liability to make lease payments	626	515	397	273	140	-
Income Statement						
Interest on lease obligation		38	31	24	16	8
Amortisation expense		111	118	125	132	140
Total Lease Expense		149	149	149	149	149

Underlying Asset Approach (UA)						
Balance Sheet						
Right-of-use asset	626	504	380	255	128	-
Liability to make lease payments	626	515	397	273	140	-
Income Statement						
Interest on lease obligation		38	31	24	16	8
Amortisation expense		122	124	125	127	128
Total Lease Expense		160	155	149	143	137

Total Lease Expense by Approach						
Boards' Tentative Decisions		163	156	149	142	134
Interest-Based Amortisation		149	149	149	149	149
Underlying Asset		160	155	149	143	137

Illustration 2

LAND - 0% Consumption

Assumptions:

Lease term in years	5
Interest rate	6.00%
FV of underlying asset	1,000
Estimated residual value	1,000
Portion of asset sold	-
Lease payments	60

Periods	0	1	2	3	4	5
Boards' Tentative Decisions (Current)						
Balance Sheet						
Right-of-use asset	253	202	152	101	51	-
Liability to make lease payments	253	208	160	110	57	-
Income Statement						
Interest on lease obligation		15	12	10	7	3
Amortisation expense		51	51	51	51	51
Total Lease Expense		66	63	60	57	54

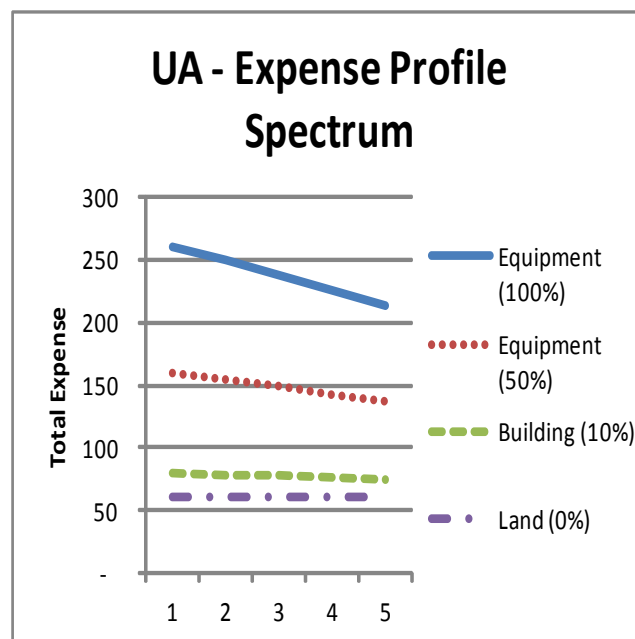
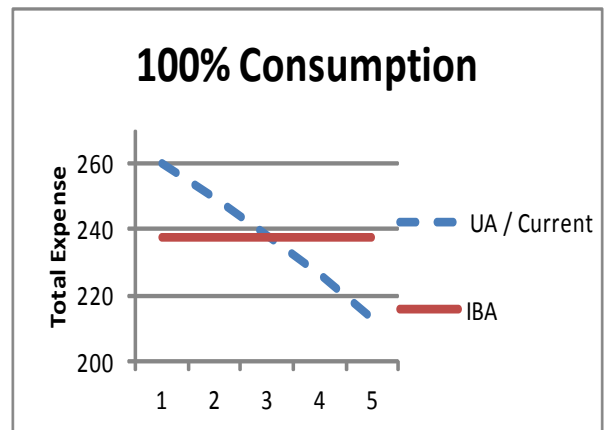
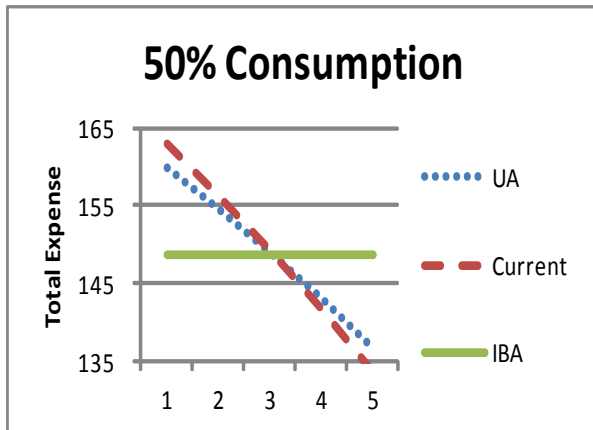
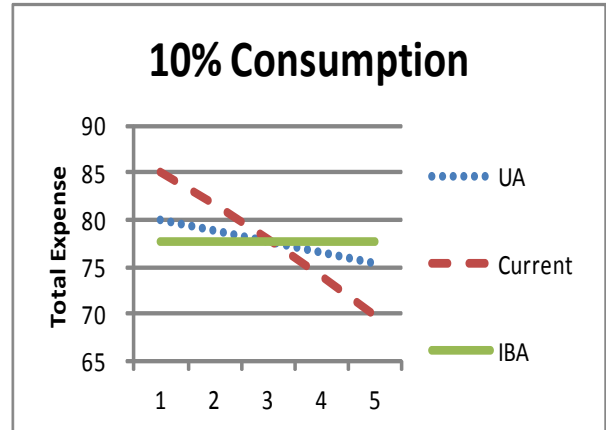
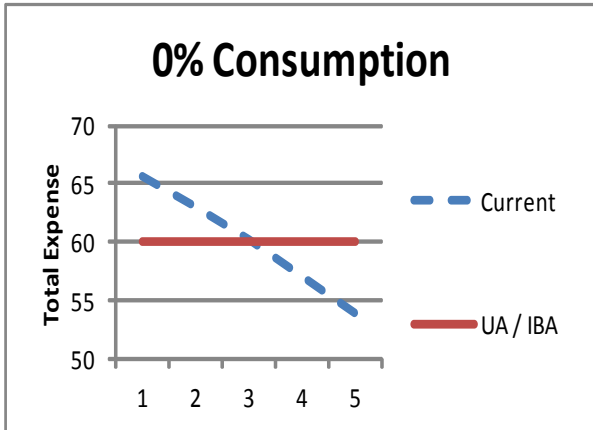
Interest-Based Amortisation Approach (IBA)						
Balance Sheet						
Right-of-use asset	253	208	160	110	57	-
Liability to make lease payments	253	208	160	110	57	-
Income Statement						
Interest on lease obligation		15	12	10	7	3
Amortisation expense		45	48	50	53	57
Total Lease Expense		60	60	60	60	60

Underlying Asset Approach (UA)						
Balance Sheet						
Right-of-use asset	253	208	160	110	57	-
Liability to make lease payments	253	208	160	110	57	-
Income Statement						
Interest on lease obligation		15	12	10	7	3
Amortisation expense		45	48	50	53	57
Total Lease Expense		60	60	60	60	60

Total Lease Expense by Approach						
Boards' Tentative Decisions		66	63	60	57	54
Interest-Based Amortisation		60	60	60	60	60
Underlying Asset		60	60	60	60	60

Expense profile summaries

5. Illustration 3 details the lease expense profiles for a single lease under the Boards' tentative decisions (current), the 'interest-based amortisation' approach (IBA), and the 'underlying asset' approach (UA). Each of the leases below is for an asset with a fair value of CU1,000 at lease commencement, over a lease term of 5 years, and the interest rate implicit in the lease is 6%. Again, for each lease illustrated, the lessee is expected to both consume economic benefits from use of the underlying asset, and make lease payments, on a straight-line basis over the lease term.
6. The graphs are labeled with respect to the expected consumption of the underlying asset over the lease term. If the lease has 0% consumption, the asset is not expected to decrease in value. If the lease has 100% consumption, the asset is expected to have no value at the end of the lease.
7. For each of the given leases, the Boards' tentative decisions produce a reducing lease expense recognition profile, the 'interest-based amortisation' approach produces a straight-line expense profile, and the 'underlying asset' approach produces a variety of results that are summarised in the 'UA - Expense Profile Spectrum.' The 'underlying asset' approach lease expense profile shifts from straight line (akin to IBA) to a reducing expense profile (akin to the Boards' tentative decisions) as the percentage consumption increases.

*Illustration 3***Summary of P&L Effects**

Approach B: Interest-based amortisation scenario analysis

8. Illustration 4 details the accounting under the ‘interest-based amortisation’ approach when the lessee:
 - a. pays over a shorter term than the period of use,
 - b. has a rent-free period at the beginning of the lease, and
 - c. expects higher consumption of benefits in the early years of the lease.
9. The right-of-use asset and lease liability are accounted for separately.
 - a. The right-of-use asset is calculated as the present value of the remaining economic benefits at the end of each period, and the amortisation expense represents the consumption of benefits.
 - b. The lease liability is accounted for using the effective interest method.
10. The ‘interest-based amortisation’ approach does not always produce a straight-line total lease expense profile. The three scenarios illustrate the various expense profiles that can occur under the ‘interest-based amortisation’ approach when lease payments and expected benefit consumption are not even over the lease term.

*Illustration 4***IBA Approach (Approach B) - Scenario Analysis****Assumptions:**

Lease term in years	5
Interest rate	6.00%
FV of underlying asset	1,000
Estimated residual value	500

Periods	0	1	2	3	4	5
Lessee pays over a shorter term than period of use						
<i>Pattern of benefits</i>		149	149	149	149	149
Cash payment	500	36	36	36	36	-
Balance Sheet						
Right-of-use asset	626	515	397	273	140	-
Liability to make lease payments	126	97	67	34	-	-
Income Statement						
Interest on lease obligation		8	6	4	2	-
Amortisation expense		111	118	125	132	140
Total Lease Expense		119	124	129	134	140

Lessee has rent-free period at beginning of lease						
<i>Pattern of benefits</i>		149	149	149	149	149
Cash payment		-	192	192	192	192
Balance Sheet						
Right-of-use asset	626	515	397	273	140	-
Liability to make lease payments	626	664	512	351	181	-
Income Statement						
Interest on lease obligation		38	40	31	21	11
Amortisation expense		111	118	125	132	140
Total Lease Expense		149	158	156	153	151

Lessee expects higher consumption of benefits in early years						
<i>Pattern of benefits</i>		180	170	150	130	102
Cash payment		149	149	149	149	149
Balance Sheet						
Right-of-use asset	626	484	343	214	96	-
Liability to make lease payments	626	515	397	273	140	-
Income Statement						
Interest on lease obligation		38	31	24	16	8
Amortisation expense		142	141	129	117	96
Total Lease Expense		180	172	153	134	105

Approach C: Purchase and finance comparison to the UA approach

11. Illustration 5 compares leasing an asset under the ‘underlying asset’ approach to purchasing that asset, and separately obtaining a loan to finance the purchase for a five-year period equal to the lease term. This example illustrates that the total expense profiles are identical under both of these scenarios.
12. Rather than leasing an asset, a lessee could often choose to purchase that asset (and finance that purchase), use it for a given period and then sell the asset. Approach C accounts for those two sets of transactions (ie a lease and a purchase of the asset with financing) on a comparable basis. In this example, the underlying asset has a fair value of CU1,000 and an expected residual value of CU500 at the end of 5 years. The lessee can either lease this asset for five annual payments of CU149, or finance the purchase of the entire asset for CU1,000 with annual payments of CU149 and a CU500 balloon payment at the end of year 5 (the proceeds from the sale of the asset is used to satisfy the CU500 note payable balance at the end of year 5).
13. The staff recognizes that lessees may not always be in a lease vs. buy scenario for various reasons (type of asset, access to capital, etc.), but thinks that the underlying rationale is still valid for all lease contracts.

*Illustration 5***UA Approach (Approach C) - Purchase and Finance Comparison****Assumptions:**

Lease term in years	5
Interest rate	6.00%
FV of underlying asset	1,000
Estimated residual value	500
Portion of asset sold	500
Lease payments	149

Periods	0	1	2	3	4	5
Fixed Asset Accounting						
Balance Sheet						
PPE, net	1,000	900	800	700	600	-
Note payable	1,000	911	817	718	612	-
Income Statement						
Interest expense		60	55	49	43	37
Depreciation expense		100	100	100	100	100
Total Expense		160	155	149	143	137

Underlying Asset Approach (UA)						
Balance Sheet						
Right-of-use asset	626	504	380	255	128	-
Liability to make lease payments	626	515	397	273	140	-
Income Statement						
Interest on lease obligation		38	31	24	16	8
Amortisation expense		122	124	125	127	128
Total Lease Expense		160	155	149	143	137