STAFF PAPER

28/29 February 2012

FASB | IASB Meeting

FASB education session February 15, 2012 /
IASB education session February 27, 2012

Project	**Leases**		
Paper topic	Consequences of lessee accounting discussion and lessor investment property decision		
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Purpose of this paper

1. This paper sets out the staff's initial thinking regarding the following two issues:
   (a) **Issue 1**—Whether there are any consequences for lessor accounting resulting from the outcome of the Boards' lessee accounting discussions (refer to agenda papers 2B/226 and 2C/227).
   (b) **Issue 2**—Whether there are any consequences for lessee accounting resulting from the Boards' tentative decision to exclude leases of investment property (IP) from the scope of the receivable and residual (R&R) approach.
2. The paper does not include a staff recommendation. Instead, it provides information for the Boards to consider when determining whether there are any consequences that arise from either of the issues noted in the paper.

Issue 1—Consequences for lessor accounting of the potential outcome of the Boards' lessee accounting discussions

3. Agenda paper 2C/227 for the February 2012 joint meeting considers three approaches to subsequently measuring the right-of-use (ROU) asset:

(a) Approach A – the Boards' tentative decisions;

(b) Approach B – interest-based amortisation approach; and

(c) Approach C – an underlying asset approach.

4. The following table presents the potential outcomes of the lessee discussion and whether there are any consequences on the Boards' current tentative decisions regarding lessor accounting, assuming that the Boards decide that there is one lessee accounting model:

Outcome	**Approach**	**Line drawn to distinguish between leases**	**Consequence/staff recommendation**
1	A	No line (ie if approach A is applied to all leases, no need to distinguish between leases and purchases).	No consequences on the Boards' tentative lessor decisions.
2A	B	Line drawn to distinguish purchase/sale versus lease using control (if approach B is applied to leases).	No consequences on the Boards' tentative lessor decisions.
2B	B	Line drawn to distinguish purchase/sale versus lease using existing operating/finance lease distinction.	The staff would recommend adding an operating/finance lease distinction to the lessor model.
3	C	No line (ie if approach C is applied to all leases).	No consequences on Boards' tentative lessor decisions.

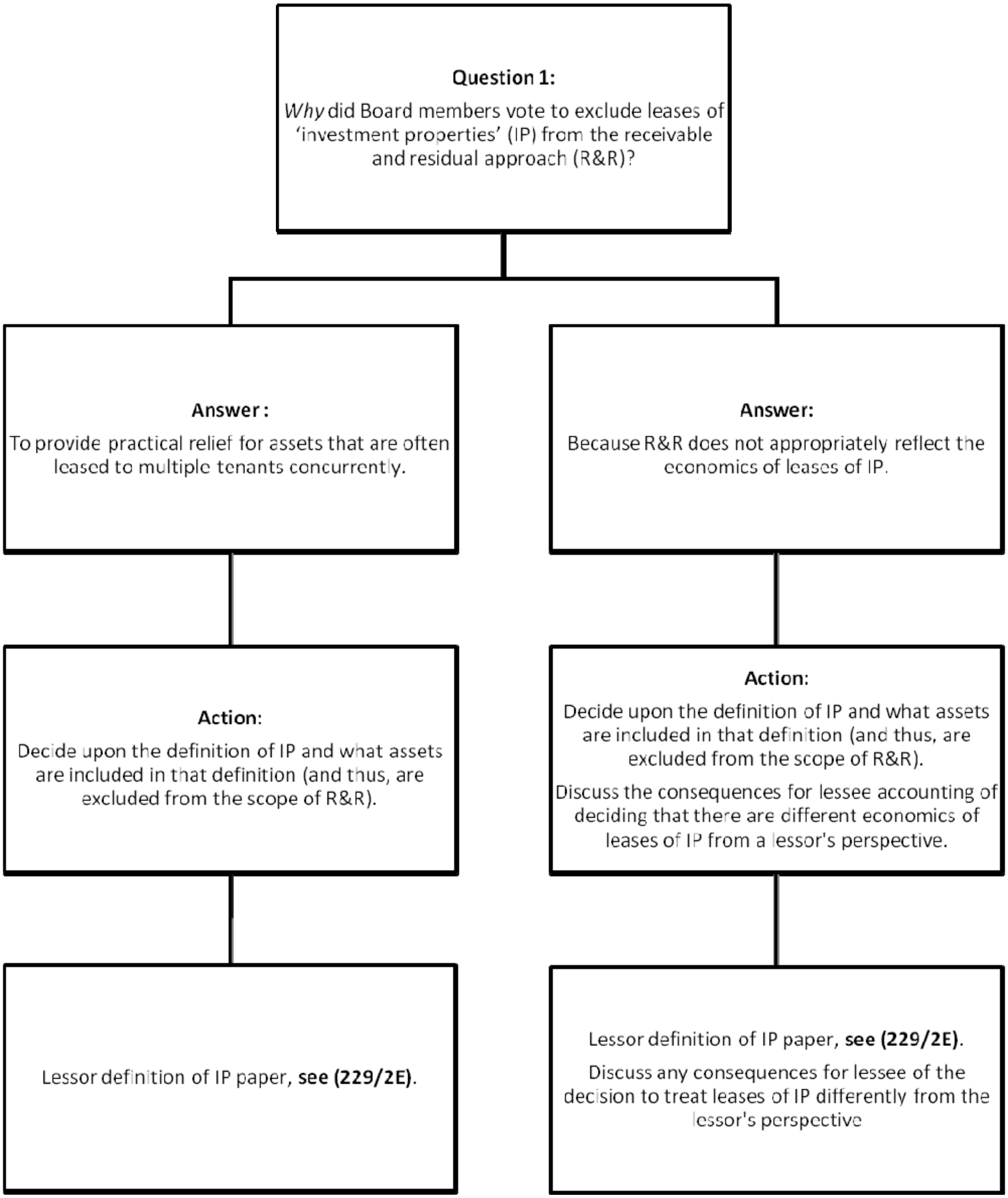
5. If the Boards decide to have one accounting approach for all lessees (whether it is Approach A, B, or C), there would not be any significant consequences on the

current tentative decisions for lessors, except if the Boards decide to retain an operating/finance lease distinction for lessees. If that is the case, the staff think that such a distinction should also be retained for lessors.

6. If the Boards decide to have more than one accounting approach for lessees, they will have to consider whether that decision for lessees has any impact on their decision to exclude leases of IP from the scope of the R&R approach for lessors, and whether any distinguishing line should be the same for lessees and lessors.

Issue 2—Consequences for lessee accounting of excluding leases of property from the scope of the R&R approach

7. At the October 2011 joint meeting, the Boards tentatively decided that the lessor R&R approach should not be applied to leases of IP, regardless of whether the lessor measures the IP at fair value or on a cost basis.
8. Agenda paper 2E/229 for the February 2012 joint meeting discusses the definition of IP to determine which leases should be excluded from the R&R approach to lessor accounting.
9. The following flow chart asks the Boards to consider whether the rationale to exclude investment properties from the R&R approach was to provide practical relief, or whether it was because the R&R approach did not appropriately reflect the economics of leases of IP.



Question 1:
Why did Board members vote to exclude leases of 'investment properties' (IP) from the receivable and residual approach (R&R)?
Answer:
To provide practical relief for assets that are often leased to multiple tenants concurrently.
Answer:
Because R&R does not appropriately reflect the economics of leases of IP.
Action:
Decide upon the definition of IP and what assets are included in that definition (and thus, are excluded from the scope of R&R).
Action:
Decide upon the definition of IP and what assets are included in that definition (and thus, are excluded from the scope of R&R).
Discuss the consequences for lessee accounting of deciding that there are different economics of leases of IP from a lessor's perspective.
Lessor definition of IP paper, **see (229/2E)**.
Lessor definition of IP paper, **see (229/2E)**.
Discuss any consequences for lessee of the decision to treat leases of IP differently from the lessor's perspective

10. If the Boards' decision was to provide practical relief only, then there are no consequences for the lessee model. Discussions at the October 2011 joint meeting indicated that, for at least some Board members, the decision to exclude leases of IP from the scope of the R&R approach was based on providing a practical expedient to lessors. In particular, when leases relate to a property that has multiple tenants concurrently, the cost of applying the R&R approach could be greater than the benefits of the information provided by that approach because of the need to obtain fair value information for each portion of the property leased. The lessee would not have the same practical issues because it does not need to determine the fair value of the underlying asset that it leases or the fair value of the ROU asset.

11. However, if the Boards' decision on lessor accounting was because the economics of leases of IP are viewed to be different from other leases, then we think there are two ways that this could be viewed:

    (a) No consequence for lessee accounting: The economics of an IP lease are different for a lessor because the nature of IP (ie it is a long-lived asset that often appreciates in value over a typical lease term) means that a property lessor generally has a different business model to other lessors. Many property lessors tend to view their leasing business as one that generates ongoing cash flows from the property (via rents or the provision of services throughout the lease term). The pricing model used by such lessors is often different to the pricing models applied to other leased assets, such as equipment. Many lessors that lease property (1) are charging the lessee interest on the value of the property and (2) are not charging the lessee for depreciation of that asset (because it is often an appreciating asset over the lease term). As such, it could be argued that there is a basis for having two lessor accounting models on the grounds that a property lessor has a different business model to most other lessors, whereas that same argument does not apply from a lessee's perspective. When entering into a lease contract, a lessee is obtaining a ROU asset and paying for it over time so all leases are the same from a lessee perspective.

(b) Consequence for lessee: The Boards may find that their decision on lessor accounting to exclude leases of IP from the scope of the R&R approach could impact their approach for lessee accounting if it is decided that the economics of property leases are different for both lessors and lessees.