

STAFF PAPER

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Working Group Meeting

Project	Leases
Paper topic	Lessee Accounting - Illustrations

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Mechanics of the proposed approaches

1. 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).
2. The accounting for each lease is set out under the following four approaches:
 - a. Approach A: the Boards' current tentative decisions
 - b. Approach B: the 'interest-based amortisation' approach (IBA)
 - c. Approach C: the 'modified whole asset' approach (MWA)
 - d. Approach D: the 'other comprehensive income' approach (OCI)
3. For each of the leases illustrated in this paper, the lessee is expected to consume economic benefits from use of the leased asset, and make lease payments, on a straight-line basis over the lease term. Therefore, the 'interest-based amortisation' and 'modified interest-based amortisation' approaches discussed in Working Group Paper 2 yield the same results.

Illustration 1

EQUIPMENT - 50% Consumption

Assumptions:

Lease term in years	5
Interest rate	6.00%
FV of leased 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						
<i>Statement of Financial Position (Same for OCI)</i>						
Right-of-use asset	626	501	376	251	125	-
Liability to make lease payments	626	515	397	273	140	-
<i>Statement of Comprehensive Income</i>						
Interest on lease obligation		38	31	24	16	8
Amortisation expense		125	125	125	125	125
Total Lease Expense		163	156	149	142	134

Straight Line - OCI						
<i>Statement of Comprehensive Income</i>						
Interest on lease obligation		38	31	24	16	8
Amortisation expense		111	118	125	132	140
Total Lease Expense		149	149	149	149	149
Other comprehensive income		14	7	0	(7)	(15)
Total Comprehensive Income		163	156	149	142	134

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

Modified Whole Asset Approach						
<i>Statement of Financial Position</i>						
Leased asset	1,000	1,000	1,000	1,000	1,000	1,000
Residual obligation (PV of residual)	(374)	(396)	(420)	(445)	(472)	(500)
Accumulated depreciation	-	(100)	(200)	(300)	(400)	(500)
Net interest in leased asset (ROU Asset)	626	504	380	255	128	-
Liability to make lease payments	626	515	397	273	140	-
<i>Statement of Comprehensive Income</i>						
Interest on lease obligation		38	31	24	16	8
Accretion on residual obligation		22	24	25	27	28
Depreciation on asset		100	100	100	100	100
Total lease expense		160	155	149	143	137

Total Lease Expense by Approach						
Boards' Current Tentative Decisions		163	156	149	142	134
Interest-Based Amortisation/OCI/Operating		149	149	149	149	149
Modified Whole Asset Approach		160	155	149	143	137

Illustration 2

LAND - 0% Consumption

Assumptions:

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

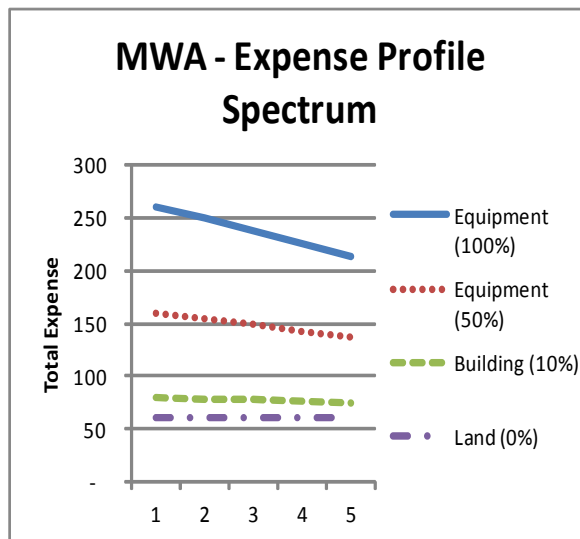
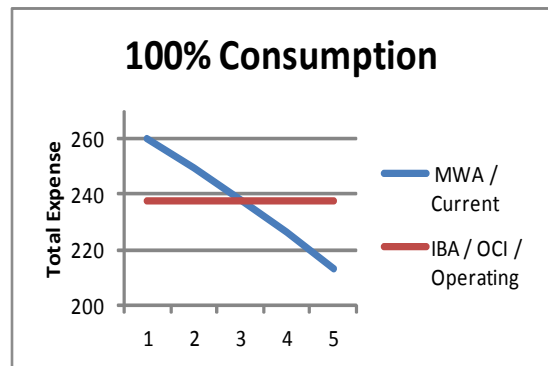
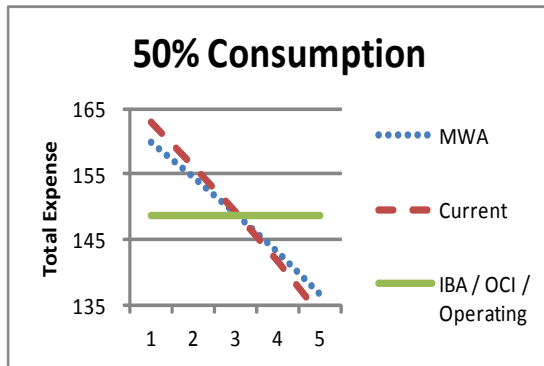
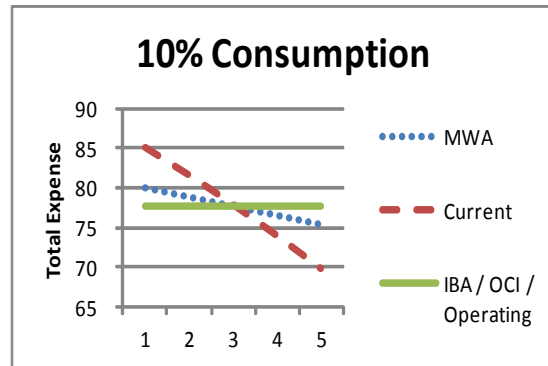
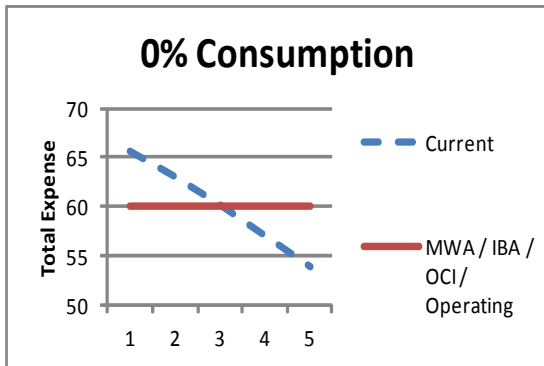
Periods	0	1	2	3	4	5
Boards' Tentative Decisions						
<i>Statement of Financial Position (Same for OCI)</i>						
Right-of-use asset	253	202	152	101	51	-
Liability to make lease payments	253	208	160	110	57	-
<i>Statement of Comprehensive Income</i>						
Interest on lease obligation		15	12	10	7	3
Amortisation expense		51	51	51	51	51
Total Lease Expense		66	63	60	57	54
Straight Line - OCI						
<i>Statement of Comprehensive Income</i>						
Interest on lease obligation		15	12	10	7	3
Amortisation expense		45	48	50	53	57
Total Lease Expense		60	60	60	60	60
Other comprehensive income		6	3	0	(3)	(6)
Total Comprehensive Income		66	63	60	57	54
Interest-Based Amortisation Approach (IBA)						
<i>Statement of Financial Position</i>						
Right-of-use asset	253	208	160	110	57	-
Liability to make lease payments	253	208	160	110	57	-
<i>Statement of Comprehensive Income</i>						
Interest on lease obligation		15	12	10	7	3
Amortisation expense		45	48	50	53	57
Total Lease Expense		60	60	60	60	60
Modified Whole Asset Approach						
<i>Statement of Financial Position</i>						
Leased asset	1,000	1,000	1,000	1,000	1,000	1,000
Residual obligation (PV of residual)	(747)	(792)	(840)	(890)	(943)	(1,000)
Accumulated depreciation	-	-	-	-	-	-
Net interest in leased asset (ROU Asset)	253	208	160	110	57	0
Liability to make lease payments	253	208	160	110	57	-
<i>Statement of Comprehensive Income</i>						
Interest on lease obligation		15	12	10	7	3
Accretion on residual obligation		45	48	50	53	57
Depreciation on asset		-	-	-	-	-
Total lease expense		60	60	60	60	60
Total Lease Expense by Approach						
Boards' Current Tentative Decisions		66	63	60	57	54
Interest-Based Amortisation/OCI/Operating		60	60	60	60	60
Modified Whole Asset Approach		60	60	60	60	60

Expense profile summaries

4. Illustration 3 details the lease expense profiles under the Boards' tentative decisions, the 'interest-based amortisation' approach (IBA), the 'modified whole asset' approach (MWA), the 'other comprehensive income' approach (OCI) and operating lease accounting. Each of the leases below are 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%.
5. The graphs are labelled with respect to the expected consumption of the leased 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.
6. For each of the given leases, the Boards' tentative decisions produce a front-loaded expense profile, the 'interest-based amortisation' and operating lease approaches produce a straight-line expense profile, and the 'modified whole asset' approach produces a variety of results that are summarised in the 'MWA - Expense Profile Spectrum.' The 'modified whole asset' approach expense profile shifts from straight-line (akin to operating/IBA/OCI) to front-loaded (akin to the Boards' tentative decisions) as the percentage consumption increases.

Illustration 3

Summary of P&L Effects



Consistency between lessor ‘receivable and residual’ approach and the lessee ‘modified whole asset’ approach

7. Illustration 4 compares the lessor ‘receivable and residual’ approach with the ‘modified whole asset’ approach.
8. The example sets out a 5-year lease of equipment with a fair value (and cost to the lessor) of CU1,000 and an annual fixed lease payment of CU149. The discount rate is 6% and the expected residual value at the end of the lease term is CU500. The lessor does not recognise profit on the lease at lease commencement because the cost of the leased equipment equals the fair value.
9. Under the ‘receivable and residual’ approach, a lessor recognises interest income on the lease receivable (CU117) and accretion income on the gross residual asset (CU126) over the term of the lease.
10. Under the ‘modified whole asset’ approach, the amount recognised by the lessee as interest expense on the lease liability (CU117) and accretion expense on the residual obligation (CU126) mirrors the income recognised by the lessor. In addition, under the ‘modified whole asset’ approach a lessee would recognise depreciation expense equal to the lessor’s decrease in asset value of CU500 (initial fair value of CU1,000 less the expected residual asset of CU500). The total lease-related expense is CU743 (CU117 + CU126 + CU500).

Illustration 4

Lease of equipment - lessee (MWA) and lessor (current) comparison

1,000	Lease asset's FV (and lessor's cost)
500	Expected residual asset
149	Annual payments
6%	Rate implicit
5	Lease term
10	Useful life of asset

Periods	0	1	2	3	4	5
Lessee - modified whole asset approach						
Statement of Financial Position						
Leased asset	1,000	1,000	1,000	1,000	1,000	1,000
Accumulated depreciation		(100)	(200)	(300)	(400)	(500)
Residual obligation	(374)	(396)	(420)	(445)	(472)	(500)
Net leased asset	626	504	380	255	128	-
Liability to make lease payments	626	515	397	273	140	0

							Total
Depreciation expense		100	100	100	100	100	500
Accretion of residual obligation		22	24	25	27	28	126
Interest expense		38	31	24	16	8	117
Total lease expense		160	155	149	143	137	743

Cash out	(743)
Total expense	743

Periods	0	1	2	3	4	5
Lessor - current decisions						
Statement of Financial Position						
Lease receivable	626	515	397	273	140	0
Residual asset	374	396	420	445	472	500
Total assets	1,000	911	817	718	612	500

							Total
Accretion of residual asset		22	24	25	27	28	126
Interest revenue		38	31	24	16	8	117
Total interest / accretion		60	55	49	43	37	243

Cash in	743
Decrease - lease asset	(500)
Net Income	(243)