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Project	**Leases**		
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Objective

1. The objective of this paper is to discuss the disclosure requirements for lessees considering the Boards' tentative decisions made at the June 2012 joint Board meeting. Those decisions were that:

   (a) A lessee would recognize a right-of-use (ROU) asset and a liability to make lease payments for all leases (except short-term leases).

   (b) A lessee would recognize amortization on the ROU asset and interest on the liability to make lease payments in its statement of comprehensive income (SCI) when the lease is such that the lessee acquires and consumes a more than insignificant portion of the underlying asset (typically, leases of assets other than property); referred to in this paper as the interest and amortization (I&A) approach.

   (c) A lessee would recognize a straight-line lease expense in its SCI when the lease is such that the lessee does not acquire a more than insignificant portion of the underlying asset (typically, leases of property); referred to in this paper as the single leases expense *(SLE)* approach.

2. The staff has reexamined the previous tentative decisions regarding lessee disclosures to assess whether any changes are required. That is because those tentative decisions regarding disclosure were made at a time when the Boards' tentative decisions were such that a lessee would recognize amortization on the ROU asset and interest on the liability to make lease payments for all leases, other than for short-term leases.

Background

3. The Boards have tentatively decided that a lessee would be required to provide the following disclosures, and the staff is not proposing any changes to those decisions in this paper:

An entity shall disclose:

(a) The nature of its lease contracts, including:

(i) A general description of those lease contracts.

(ii) The basis and terms on which variable lease payments are determined.

(iii) The existence and terms of options to extend or terminate the lease. A lessee shall provide narrative disclosure about the options that were recognized as part of the ROU asset and those that were not.

(iv) The existence and terms of residual value guarantees.

(v) The restrictions imposed by lease contracts, such as those relating to dividends, additional debt, and further leasing.

(b) Information about the principal terms of any lease that has not yet commenced if the lease creates significant rights and obligations for the entity.

(c) Information about significant assumptions and judgments (and changes in significant assumptions and judgments) made in applying the requirements of this standard, which may include (and is not limited to):

(i) The determination of whether the entity has a lease

(ii) The allocation of lease payments between lease and nonlease components

(iii) The determination of whether the lessee has a significant economic incentive

(iv) The determination of the discount rate

(v) Amortization methods.

(IFRS only) An entity shall disclose information relating to risks arising from a lease required by paragraphs 31-42 in IFRS 7, *Financial Instruments: Disclosures.*

4. The aforementioned disclosures are useful to users of the financial statements regardless of the expense recognition profile. That is because they facilitate an understanding of lease transactions entered into by a lessee and the effects that those transactions could have on future cash flows.

5. The Boards also have tentatively decided not to require disclosure of the following:

(a) The discount rate used to calculate the liability to make lease payments

(b) The range of discount rates used to calculate the liability to make lease payments

(c) The fair value of the liability to make lease payments

(d) The existence and principal terms of any options for the lessee to purchase the underlying asset, or initial direct costs incurred on a lease

(e) Information about arrangements that are no longer determined to contain a lease.

6. The staff does not think the change to accounting for some leases should change those decisions.

Disclosures to be reconsidered

7. The Boards also tentatively decided to require the following disclosures. The staff thinks that these disclosures should be reexamined for potential changes resulting from the decision to recognize a single lease expense for some leases:

(a) Maturity analysis

(b) Reconciliation of opening and closing balance of the lease liabilities

(c) Reconciliation of opening and closing balance of the ROU assets

(d) Table of expenses and cash flows related to leases recognized in the reporting period.

Maturity Analysis Disclosure

8. The current tentative decisions would require a lessee to disclose a maturity analysis of the undiscounted cash flows for the liability to make lease payments. The maturity analysis should show, at a minimum, the undiscounted cash flows to be paid in each of the first five years after the reporting date and a total of the amounts for the years thereafter. The lessee should reconcile the maturity analysis to the liability to make lease payments.

9. In agenda paper 3A/ Board memo 239 *Lessee - Statement of Financial Position*, the staff is split on whether a lessee should be allowed to present all lease liabilities together in the statement of financial position (SFP). The answer to that issue may influence the decision about how to disclose the maturity analysis.

10. Regardless of whether the Boards decide to restrict the presentation of lease liabilities, a lessee may present (and if the Boards agree to the restriction, will present) lease liabilities on different lines in the SFP. The staff considered requiring the disclosure of a maturity analysis for liabilities under the I&A approach as well as a maturity analysis for liabilities under the SLE approach because of the possible separate presentation of those amounts in the SFP. Said differently, the staff considered disclosure of the maturities of the two lease liabilities in separate columns.

11. The rationale for requiring such disclosure of the maturities in separate columns is based on the fact that it provides information about future cash flows related to different line items in the SFP. Such disclosure may be more effective if it relates to or explains the line items on the primary financial statements, rather than if it relates to a particular type of transaction.

12. In addition, the staff does not think that the cost of disclosing separate maturity analyses would be substantially more than disclosing a single maturity analysis for lease liabilities.

13. However, the staff acknowledges that separating the maturity analysis based primarily on the possible presentation in the SFP may not be viewed as an adequate reason for requiring additional disclosure. The main objective of providing a maturity analysis disclosure is to provide additional information about the lessee's commitments at the reporting date, and the timing of future cash flows associated with those commitments. Because of this, requiring separate maturity analyses would appear less relevant given that all lease liabilities are measured in the same way and future cash flows remain the same regardless of the accounting.

14. Consequently, on balance, the staff did not think the separate maturity analyses would be incrementally useful. Therefore, the staff recommends that a lessee should disclose one maturity analysis that sets out the undiscounted cash flows relating to all lease liabilities, and that analysis reconcile to the total lease liability.

15. The FASB had tentatively decided that a lessee should disclose the maturities of contractual commitments related to lease agreements for services and other nonlease components that are not recorded as part of the lease liability. The IASB has tentatively decided to not require this disclosure.

16. The staff thinks that it is informative to have the maturity of those commitments disclosed but does not think there is any incremental benefit in bifurcating between the two types of leases. Accordingly, the staff does not recommend any change to this tentative decision.

Questions 1 & 2

Do the Boards agree with the staff's recommendation to require the disclosure of a single maturity analysis that sets out the future undiscounted cash flows relating to all lease liabilities, and that analysis should reconcile to the total lease liability?

Does the FASB agree to not bifurcate the disclosure of the maturity of contractual commitments associated with services and other nonlease components between the two lease types?

Reconciliation of opening and closing balance of the liability

17. The current tentative decisions require a lessee to disclose a reconciliation of opening and closing balances of liabilities to make lease payments. The reconciliation should disclose items that are useful in understanding the movement in liabilities to make lease payments, which may include but is not limited to:

    (a) Liabilities created due to leases commencing

    (b) Liabilities cancelled due to leases terminating

    (c) Cash paid

    (d) Foreign currency translation adjustments

    (e) Effects of business combinations.

18. The decision on the presentation of the liability (discussed in agenda paper 3A/239) may influence the decision on the disclosure of the rollforward of the lease liabilities.

19. The staff recommendations in agenda paper 3A/239 (both Option A and Option B) permit a lessee to present lease liabilities under the I&A approach separately from lease liabilities under the SLE approach in the SFP. Because of this, those two lease liabilities could be presented within different line items. When a rollforward is specific to a line item (or part of a line item), it helps to explain the change in that line item. The staff thinks that the information provided by a rollforward would lose much of its value if only one rollforward were disclosed that relates to two line items in the SFP.

Accordingly, the staff sees benefit in requiring a lessee to disclose rollforward information relating to both lease liabilities under the I&A approach and lease liabilities under the SLE approach.

20. In addition, if an entity presents lease liabilities within different line items in the SFP, it is likely that the costs of preparing separate rollforward information for those two lease liabilities will not be substantially more than preparing combined roll forward information. That is because the preparer would have to analyze the changes in two different liability balances, regardless of whether the rollforward is disclosed separately.

21. Consequently, the staff recommends that a lessee should provide a reconciliation of opening and closing balances of both lease liabilities under the I&A approach and lease liabilities under the SLE approach.

Disclosure of interest / unwinding of discount as part of the roll forward

22. In the 2010 ED, the proposals for a lessee to disclose a reconciliation of opening and closing balances of lease liabilities included a requirement for the lessee to disclose the total cash lease payments paid during the period. A consequence of this requirement was that the reconciliation would also need to include interest or the unwinding of discount on the lease liability.

23. The staff think that the roll forward proposals included in the re-exposure document should also include a requirement for the lessee to disclose interest/unwinding of discount on the lease liability, for liabilities under both the I&A approach and the SLE approach.

24. The main reason for this recommendation relates to information received from users during the outreach conducted during April and May 2012. Many of the users that we spoke to informed us that obtaining interest/unwinding of discount information relating to all lease liabilities would be useful, regardless of whether that interest is presented as such in the lessee's SCI. Some users consider all leases to be a form of financing and such disclosure would facilitate their analysis on this basis.

25. However, requiring that the rollforward include the interest or unwinding of the discount makes it necessary to require that a lessee presents and discloses

any accrued interest or accretion on the lease liability together with the liability balance itself.

Questions 3 & 4
Do the Boards agree with the staff's recommendation to require a lessee to disclose a reconciliation of opening and closing balances of lease liabilities under both the I&A approach and the SLE approach? Furthermore, do the Boards agree that the reconciliation include interest or the unwinding of the discount, thereby requiring that the lessee presents and discloses any accrued interest or accretion on the lease liability together with the liability balance itself?

Reconciliation of opening and closing balance of the ROU assets

26. The current tentative decisions require a lessee to disclose a reconciliation of opening and closing balances of ROU assets disaggregated by class of underlying asset. The reconciliation should disclose items that are useful in understanding the movement in ROU assets, which may include but are not limited to:

(a) Additions from commencement of leases

(b) Disposals from termination of leases

(c) Amortization

(d) Foreign currency translation adjustments

(e) Effects of business combinations

(f) Impairment.

27. That tentative decision to disclose the rollforward of the ROU asset by underlying class of asset did not contemplate that ROU assets relating to different leases might be measured differently. The decision was taken at the time when all ROU assets would be measured on an amortized cost basis.

28. The Boards' decisions in June 2012 result in two lease expense recognition profiles for lessees, which are achieved through different accounting for the subsequent measurement of the ROU asset.

29. For leases under the I&A approach, the ROU asset is measured at amortized cost. Because the measurement of the ROU asset under this approach is akin to how owned assets (usually property, plant, and equipment [PP&E]) are measured, and the disclosure of the rollforward of the ROU asset by underlying class was based on the requirement in IAS 16 *Property, Plant and Equipment* to roll forward PP&E in that manner, the staff would retain this requirement for ROU assets under the I&A approach.

30. Under the SLE approach, the ROU asset is not measured at amortized cost or fair value; it is a balancing figure. As such, some staff members question whether a reconciliation of the ROU asset for those leases would have any meaning and, thus, whether it would provide decision-useful information to users of financial statements.

31. Another reason those staff members think that a rollforward of the ROU asset under the SLE approach is not necessary is because some of the potentially useful information is already otherwise provided. For example, the disclosure of ROU assets acquired under that approach would be required as a supplemental noncash transaction disclosure (see paragraph 15 of agenda paper 3B/Board Memo 240, *Lessee – Statement of Cash Flows*). Some information would not necessarily be provided elsewhere, such as the effect of business combinations and foreign currency translation adjustments. This issue, however, exists for all balances, not just leases.

32. Providing rollforward information is costly for preparers, particularly when the information required is not available centrally within the department producing the group financial statements (which might be the case for leases). Therefore, those staff members recommend that the rollforward of ROU assets under the SLE approach should not be required.

Alternative staff view

33. Other staff members recommend that a rollforward of the ROU asset by underlying type of asset should be required for both ROU assets under the I&A approach and for ROU assets by underlying class of asset under the SLE approach. They think that the change in the Boards' decisions regarding the

measurement of the ROU asset does not lessen the usefulness of the rollforward information. Their view is based on the following:

(a) In the past, users have noted that rollforward information is useful. That was part of the reason the Boards tentatively decided to require such disclosure relating to ROU assets when discussing lessee disclosures in 2011.

(b) Those staff members think that information about additions, disposals, impairment, and the effects of business combinations, are equally useful for all ROU assets, regardless of whether the ROU assets' measurement is at amortized cost or is derived from applying the SLE approach.

(c) All ROU assets will be presented together with items of PP&E. Under IFRSs, rollforward information is disclosed for items of PP&E and, according to the recommendation in this paper, for ROU assets under the I&A approach. Also, under U.S. GAAP, although rollforward information is not disclosed for items of PP&E, deprecation, accumulated depreciation, and closing balance information is required by class of asset. Those staff members see no reason not to present similar information for ROU assets under the SLE approach.

(d) Those staff members acknowledge that some of the information provided in the rollforward may be available elsewhere, e.g., additions of ROU assets are disclosed as part of the supplemental disclosures to the SCF. Nonetheless, those staff members still see benefit in providing the rollforward information for the following two reasons:

    (i) The information in the SCF would not provide that information by class of asset.

    (ii) In the past, users have informed the staff of the benefit of having various pieces of information relating to the same balances or expenses presented in one place.

34. The staff members supporting the alternative view are concerned about costs to preparers and that requiring disclosures that are potentially onerous to prepare may not, in some circumstances, provide benefits that outweigh those costs. However, those staff members suggest that if the Boards think that the cost of

providing the rollforward information would outweigh the potential benefit, then they would recommend that the rollforward information not be required for *all* ROU assets. Those staff members see no reason to require rollforward information by class of asset for ROU assets under the I&A approach and yet require no such information for ROU assets under the SLE approach. That is because, in addition to the points noted in paragraph 33, ROU assets under the SLE approach may often represent a much more significant portion of the value of lease assets on a lessee's SFP than ROU assets under the I&A approach (i.e., property leases may often account for a much more significant proportion of the value of ROU assets than equipment or vehicle leases).

Question 5
Do the Boards wish to require a lessee to provide a reconciliation of opening and closing balances of ROU assets under both the I&A approach and the SLE approach, by class of underlying asset?

Table of expenses related to leases recognized in the reporting period

35. The current tentative decisions require a lessee to disclose expenses and cash payments recognized in the reporting period relating to leases, in a tabular format, disaggregated into the following:

<u>Expenses</u>

(a) Amortization expense

(b) Interest expense

(c) Expenses relating to variable lease payments not included in the liability to make lease payments

(d) Expenses for those leases in which the short-term practical expedient is applied

<u>Cash Flows</u>

(e) Principal and interest paid on the liability to make lease payments

36. One of the reasons for providing this disclosure was to facilitate alternative analysis of the effect of leases because when a lessee recognizes amortization on

a ROU asset and interest on the liability to make lease payments, the total lease expense recognized in each period may not be similar to the cash payments in each period. Many users indicated that, because they need different pieces of information for different analyses that they perform, having information about interest, discount, amortization and cash payments relating to leases would be useful.

37. Under the Boards' current tentative decisions, lease-related expenses will be presented as interest and amortization or as lease expense. The staff thinks the disclosure of the components of lease-related expense continues to be useful to users of financial statements. The staff thinks one of the amounts disclosed should be lease expense recognized under the SLE approach (this was not an element of the initial disclosure requirements because the Boards decided that some leases would follow the SLE approach after they reached tentative decisions on the disclosures). In addition, the staff thinks lessees should be required to disclose cash payments associated with the fixed portion of leases under the SLE approach to provide the full picture of expense and cash payments associated with leases.

38. Paragraph 104 of IAS 1 *Presentation of Financial Statements*, requires an entity that classifies its expenses by function to disclose additional information on the nature of expenses, including depreciation and amortization and employee benefits. However, it is not typical for individual operating expenses to be further disaggregated under U.S. GAAP or IFRSs. For example, a preparer is not explicitly required to disclose payroll expense or rent expense (the expenses typically are presented in account captions such as cost of goods sold or selling expenses). Consequently, one might question whether the Boards should require disclosure of lease-related expenses, particularly those recognized under the SLE approach, since they are presented as operating expenses in the SCI.

39. The staff thinks lease-related expenses are worthy of disclosure, similar to other specific expenses such as share-based payments, pensions, or impairments, because of the following:

    (a) The expenses are the result of estimates

    (b) There are two expense recognition patterns for leases

(c) Many users and some preparers consider all leases to be financing activities (and, therefore, may want to adjust the presentation of the expenses for their analyses).

40. In summary, the revised tabular disclosure of lease expense, followed by cash payments, should be disclosed as follows:

(a) Amortization expense under the I&A approach

(b) Interest expense under the I&A approach

(c) Expenses relating to variable lease payments not included in the liability to make lease payments

(d) Expenses for those leases in which the short-term practical expedient is applied

(e) Lease expense under the SLE approach

(f) Principal and interest paid under the I&A approach

(g) Cash paid on the fixed portion of the leases under the SLE approach.

41. A minority of the staff thinks that the tabular disclosure of disaggregated lease expense followed by cash paid is no longer needed on the basis that it facilitates alternate analysis, as discussed in paragraph 36 of this memo. The minority of the staff thinks because there are now two types of leases with different expense recognition patterns that better reflect the economics of leases, the alternative analysis is not as beneficial. Furthermore, this disclosure may be costly to provide because it involves both the disclosure of 'by nature' expenses, which are often not tracked through accounting systems and cash paid, which also is typically not a figure that is easily extracted from current accounting systems.

42. The minority of the staff continues to think that the expenses relating to variable lease expense and short-term lease expense are worth disclosing because of the following:

(a) These expenses can vary from period to period.

(b) These amounts are not recorded as part of the liabilities (and thus not reflected in any of the disclosures that relate to the liabilities).

(c) The user cannot get a sense for these expenses by looking at the SCF or the supplemental noncash transaction disclosures.

Question 6
Do the Boards agree with the majority staff recommendation that a lessee be required to disclose a table of lease expense followed by cash payments as detailed in paragraph 40 of this memo?