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STAFF PAPER

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Project	**Leases**		
Paper topic	Interim disclosures		
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Objective

1. The objective of this paper is to discuss whether any of the proposed lessee and lessor disclosure requirements should be required at interim reporting periods.

Staff recommendations

2. The staff recommends the following regarding interim disclosure of lease information:

   (a) For lessees – No amendment to IAS 34 *Interim Financial Reporting*/Topic 270, Interim Reporting.

   (b) For lessors – Amend IAS 34/Topic 270 to require a tabular disclosure of the components of lease income.

Existing guidance and background

3. In the United States and Canada, the capital market regulations require public companies to prepare interim financial statements on a quarterly basis. Many other jurisdictions require public companies to prepare interim financial statements in accordance with IFRSs on a half-yearly basis. An entity may choose

to prepare a complete set of financial statements for the interim reporting period, in which case those financial statements would have to comply with all the requirements in U.S. GAAP or IFRSs, including the requirements on interim financial reporting. More often, an entity will prepare a condensed set of financial statements with selected disclosure as its interim financial statements. The form and content of those interim financial statements is prescribed by Topic 270, SEC Regulation S-X, Rule 10-01, *Interim Financial Statements*[1] (for entities applying U.S. GAAP), and IAS 34 (for entities applying IFRSs).

4. Topic 270 and IAS 34 indicate that the objective of interim financial statements is to provide users of financial statements with timely and reliable information on an entity's financial position and performance. Furthermore, the intention is for interim financial statements to provide an update on the latest complete set of annual financial statements by reporting on changes to an entity's financial position and performance that arise from new activities, events, and circumstances that have occurred since the end of the last annual reporting period. Interim financial statements need not duplicate information previously reported because the reader of interim financial statements is presumed to have access to the entity's most recent set of annual financial statements.

5. Consistent with the objective for interim financial statements, Rule 10-01 and IAS 34 require an entity to disclose information relating to "events subsequent to the end of the most recent fiscal year [that] have occurred which have a material impact on the registrant", or to "include in its interim financial report an explanation of events and transactions that are significant to the understanding of changes in financial position and performance…since the end of the last annual reporting period." U.S. GAAP does not indicate that an entity should provide disclosure at interim periods in those circumstances.

[1] Regulation S-X, Rule 10-01 is shown in the *FASB Accounting Standards Codification*® in Section 270-10-S99. Although it is furnished, it is not authoritative U.S. GAAP.

6. Topic 270 and IAS 34 specify a minimum list of disclosures for interim financial statements. For revenue, those standards specifically require disclosure of the following information:

Standard	**Minimum revenue disclosures for interim financial statements**
Topic 270	• Sales or gross revenue • Seasonal revenue • Revenues from external customers and intersegment revenues for each reportable operating segment.
IAS 34	• Revenues from external customers and intersegment revenues for each segment. (That disclosure is required only if IFRS 8 *Operating Segments*, requires the entity to disclose segment information in its annual financial statements and that revenue information is provided to the chief operating decision maker.)

7. For liabilities that have financing characteristics, those standards specifically require disclosure of the following information:

Standard	**Disclosure requirement**
Topic 715, Compensation—Retirement Benefits	• All of the following information about defined benefit pension plans and other defined benefit postretirement benefit plans, disclosed for all periods presented pursuant to the provisions of Subtopic 715-20, Compensation—Retirement Benefits, Defined Benefit Plans—General: 1. The amount of net periodic benefit cost recognized, for each period for which a statement of income is presented, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the gain or loss component, the prior service cost or credit component, the transition asset or obligation component, and the gain or loss recognized due to a settlement or curtailment 2. The total amount of the employer's contributions paid, and expected to be paid, during the current fiscal year, if significantly different from amounts previously disclosed pursuant to paragraph 715-20-50-1. Estimated contributions may be presented in the aggregate combining all of the following: i. Contributions required by funding regulations or laws ii. Discretionary contributions

	iii. Noncash contributions.
IAS 34	• Issues, repurchases, and repayments of debt and equity securities

8. For the acquisition of property, plant, and equipment, those standards provide the following guidance if the events and transactions are significant to understanding the changes in the financial position and performance of the entity since the last reporting period:

Standard	**Examples of disclosures to be made regarding property, plant, and equipment if significant to the understanding of the financial position or performance of the entity**
Topic 270	• N/A
IAS 34	• Acquisitions or dispositions of property, plant, and equipment • Commitments for the purchase of property, plant, and equipment.

9. The 2010 *Leases* Exposure Draft did not specifically address whether the proposed disclosures apply to interim financial statements. Instead, an entity would apply Rule 10-01 or IAS 34 to determine the disclosures about leases that a lessee or lessor should include in its interim financial statements.

Staff analysis

10. The staff evaluated the need for interim disclosures based on the following:

    (a) The relative significance of leases to the financial statements of an entity

    (b) The nature of interim reporting as a condensed update to the previous annual financial statements

    (c) The ability to use interim financial statements with annual disclosures to analyze future cash flows

    (d) Current interim reporting requirements for other items.

Lessee

11. Lease expense is one expense among a number of expenses that an entity incurs. Furthermore, many of the individual disclosure requirements for lessees apply to just one aspect of the lease and not the entire lease. For example, the individual requirement to disclose the terms of variable lease payments provides information about a portion of the overall lease expense. Information disclosed in a lessee's annual financial statements would give a user a good basis for understanding the composition of leases, the future cash flows related to leases, and information about the underlying contracts. Because of the way entities utilize leases (that is, generally speaking, leases expire and new leases are initiated to take their place), using the year-end disclosures coupled with the financial statements themselves should provide a user with a reasonable basis for understanding the effects of the current interim period.

12. The staff also thinks that if there is a significant change such that the year-end disclosures are no longer representative of the entity's current leasing activities, the entity would disclose that change in accordance with the requirements in Rule 10-01 and IAS 34.

13. Finally, the staff has not noted prescribed interim disclosure requirements related to items that create operating expenses except in the case of pensions. The staff does not view the lease liability and expense as analogous to pensions for the purpose of evaluating the need for interim disclosures. That is because pensions are subject to a number of factors that can change the net liability, some of which can change significantly during an interim period (for example, movements in the value of plan assets), and those changes could be material to the entity. The staff does not think this is the case for leases.

14. Consequently, the staff recommends to not amend IAS 34/Topic 270 to require lessee disclosures at interim periods.

Question 1
Do the Boards agree with the staff's recommendation to not amend IAS 34/Topic 270 to require lessee disclosures at interim periods?

Lessor

15. Revenue of the lessor related to leases may be significant. In some cases, it may represent substantially all of the revenue of the company. Revenue-related items also are, generally speaking, relevant to all users of the financial statements.

16. Information disclosed in a lessor's annual financial statements about lease revenue may not provide the user with a good basis for understanding what might happen to those revenues in subsequent interim periods. That is because the lessor does not control the decisions of its customers. For example, the lessor generally has no control over the amount of variable lease income it earns if that income is related to the amount of use, or sales derived from use, of the leased asset, and it cannot control whether a lessee extends or terminates a lease. Additionally, market forces may result in customers electing to purchase rather than lease or vice versa period to period. That change in the manner in which an entity generates its revenue (sale versus lease) may be informative.

17. Furthermore, interim disclosures about revenue are specifically required. Segment revenue is required in both IFRSs and U.S. GAAP at interim periods. The 2011 Exposure Draft on revenue recognition proposed a number of disclosures to be made at interim periods.

18. The Boards tentatively decided to require disclosure of the following items related to the disaggregation of lease income:

    A table of all lease-related income items that were recognized in the reporting period, disaggregated into (a) profit, recognized at lease commencement (split into revenue and cost of sales, if that is how the lessor has presented the amounts in the statement of comprehensive income), (b) interest income on the lease receivable, (c) interest income on the residual asset, (d) variable lease income, and (e) short-term lease income.

19. The staff thinks that a breakdown of lease income at interim periods would be informative to users in assessing future cash inflows from revenue-generating activities, regardless of whether there is a change in trends since year end. The staff also understands that, generally speaking, management uses information about the composition of revenue at interim periods and, therefore, the incremental cost to disclose the components of lease income may not be high.

20. Consequently, the staff recommends that IAS 34/Topic 270 be amended to require a lessor to provide a table of all lease-related income items in its interim financial statements.

Question 2

Do the Boards agree with the staff's recommendation that IAS 34/Topic 270 be amended to require a lessor to provide a table of all lease-related income items in its interim financial statements?

21. The staff considered other disclosures related to lessors because of the potential significance of lease revenue to an entity. However, the staff thinks the year-end disclosures coupled with the interim financial statements in addition to the disaggregation of lease income would provide a good basis for analysis. Appendix 1 to this paper contains a summary of the Boards' tentative decisions regarding annual disclosure requirements for lessors.

22. In addition, as noted in paragraph 5 of this memo, Rule 10-01 and IAS 34 require an entity to disclose information relating to "significant changes" or to "events subsequent to the end of the most recent fiscal year [that] have occurred which have a material impact on the registrant." Therefore, significant changes to the leasing activity of a lessor during an interim reporting period should result in additional disclosures being made by the lessor. For example, if a lessor identifies

that a large lease receivable is no longer collectible, the lessor is likely to disclose information about the uncollectible amount including any impairment recognized, even though the information may not be explicitly required. Another example might be when an entity signs a significant lease in the interim period with lease terms that differ from the terms disclosed at the year end. In that case, the entity would be likely to disclose the terms of that agreement in the notes to its interim financial statements.

23. Consequently, the staff does not recommend any additional amendments to Topic 270 /IAS 34 for interim disclosures related to lessors.

Question 3

Do the Boards agree with the staff's recommendation that no additional amendments be made to Topic 270/ IAS 34 for interim disclosures related to lessors?

Appendix 1

The following is a summary of the Boards' tentative decisions regarding annual disclosure requirements for lessors:

Information that identifies and explains the amounts in the financial statements

1. 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 right-of-use 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 judgements (and changes in significant assumptions and judgements) 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 fair value of the underlying or residual asset.
      (v) The determination of the discount rate.
      (vi) Amortization methods.
2. An entity shall identify the amount of significant subleases included in the disclosures.

Disclosure (for all leases)

3. A lessor shall disclose qualitative information about the existence, terms, and extent of purchase options in lease contracts.

4. A lessor shall disclose information about how the entity manages its risk associated with the underlying asset, in particular, a lessor shall disclose:
   (a) Its risk management strategy regarding underlying assets
   (b) The carrying amount of residual assets covered by residual value guarantees
   (c) Other means at the lessor's disposal for reducing residual asset risk (for example, buyback agreements with the manufacturer).
5. A lessor shall disclose income recognized in the reporting period relating to leases, in a tabular format disaggregated into:
   (a) Profit recognized at the commencement of the lease (gross or net)
   (b) Interest income on the right to receive lease payments
   (c) Interest income on the residual asset
   (d) Income relating to variable lease payments not included in the right to receive lease payments
   (e) Income relating to short-term leases.

Additional disclosures for interest and amortization approach leases

6. A lessor shall disclose a reconciliation of the opening and closing balances for each of the following:
   (a) Rights to receive lease payments
   (b) Residual assets.
7. In place of the maturity analyses required by paragraph 37(a) of IFRS 7, *Statement of Cash Flows*, a lessor shall disclose a maturity analysis of the right to receive lease payments showing the undiscounted cash flows on an annual basis for the first five years and a total of the amounts for the remaining years. The maturity analysis shall be reconciled to the right to receive lease payments.

Additional disclosures for single lease expense approach leases

8. A lessor shall disclose the following information:
   (a) A maturity analysis of the undiscounted future non-cancellable remaining lease payments. The maturity analysis shall, at a minimum, disclose the undiscounted cash flows to be received in each of the first five years after the reporting date and a total of the amounts to be received in the period from five years after the reporting date to the expiry of the lease. This maturity analysis shall be presented separately from the maturity analysis.
   (b) Lease income within the table of lease income. Lease income shall be split between those amounts that would have been included in the lessors right to receive lease payments, and other variable income that would have not been included in the right to receive lease payments.