STAFF PAPER

12-14 June 2012

FASB | IASB Meeting

FASB Education Session 6 June 2012
IASB Education Session 6 June 2012

Project	**Leases**		
Paper topic	Lease accounting: overview of papers to be discussed at this meeting		
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Purpose of the meeting

1. The purpose of this meeting is for the Boards to decide:
   (a) Whether to reaffirm the current tentative decisions regarding lessee accounting, or to modify them and, if so, how; and
   (b) Whether to reaffirm the current tentative decisions regarding lessor accounting (in the light of the discussions on lessee accounting), or to modify them and, if so, how.
2. This paper sets out:
   (a) Background on the Boards' discussions to date;
   (b) An overview of the papers to be discussed at this meeting and how they interact;
   (c) A summary of the questions for the Boards; and
   (d) A summary of the staff recommendations on the package of papers for discussion at this meeting.

Background

Main objectives of the project

3. The Boards' primary objective in adding a leases project to their respective agendas was to address the criticisms of the existing lease accounting model that has failed to meet the needs of users of financial statements. More specifically, many users consider leases to be financing transactions and they routinely adjust the amounts in the financial statements in an attempt to recognise the assets and liabilities that arise from lease contracts. The Boards also concluded that lease contracts give rise to rights and obligations that meet the definition of assets and liabilities according to their respective frameworks.
4. In addition, the Boards hoped to remove the dividing line between operating and finance leases, which is often applied as a 'bright-line' in practice. The difference in the accounting on either side of that line and, in particular, the off-balance sheet treatment that lessees achieve when a contract is an operating lease, has led to some contracts being written with an objective of achieving a particular accounting outcome.

Summary of previous Board discussions

5. The Boards discussed and reached tentative decisions regarding lessee accounting at their April and May 2011 joint Board meetings. Those decisions were that a lessee would recognise:

    (a) A liability to make lease payments (lease liability), initially measured at the present value of lease payments, and subsequently measured at amortised cost using the effective interest method.

    (b) A right-of-use (ROU) asset, initially measured at an amount equal to the lease liability and subsequently measured at amortised cost.

6. In response to continuing concerns raised by constituents (mainly preparers) about the pattern of lease expense recognition resulting from those lessee accounting decisions and because of the significance of the changes being proposed to the existing lessee accounting model, the Boards decided that it would be appropriate

to re-discuss the lessee accounting proposals before publishing the re-exposure document.

7. Accordingly, the Boards discussed different ways that a lessee could subsequently measure the ROU asset, most recently at its February 2012 joint Board meeting. At that meeting, the Boards decided that it would be helpful to conduct outreach with users, preparers and auditors of financial statements before making any further decisions on the lessee accounting model. The primary objective of the outreach was to assess the potential costs and benefits of the different lessee accounting approaches and the usefulness of the resulting accounting information. We also discussed with lessors any consequences on the lessor accounting proposals of any changes to the lessee accounting model. The Boards and staff conducted the outreach in April and May 2012.

8. A summary of the feedback received from the outreach activities was presented to the Boards at the May 2012 joint meeting. That feedback, and the Board discussions at the May 2012 meeting, formed the basis for the staff's overall recommendations in this paper.

Overview of the papers to be discussed at this meeting

9. Because of the interaction between agenda papers 3B/235, 3C/236 and 3D/237, we recommend that all of the agenda papers should be considered together, as a package, before considering any of the questions summarised in this paper.

Paper 3B/235 Lessee accounting approaches

10. When considering the possible approaches to lessee accounting to include in paper 3B/235, the staff received input and suggestions through the outreach activities and the deliberations at the February 2012 and May 2012 joint Board meetings. On that basis, paper 3B/235 does not address the interest-based amortisation approach and the underlying asset approach. This is because those approaches received very little support, mainly from a practical perspective.

11. Paper 3B/235 discusses the following three approaches to lessee accounting:

(a) Approach 1—the Boards' current tentative decisions on lessee accounting.

(b) Approach 2—an approach that results in a straight-line lease expense recognition pattern for all leases.

(c) Approach 3—an approach that has two different lease expense recognition patterns for different leases. The discussion of how to distinguish between different leases, if the Boards support Approach 3, is discussed in paper 3D/237.

Paper 3C/236 Lessor accounting—consequences of lessee decisions

12. Paper 3C/236 considers the consequences for lessor accounting as a result of the Boards' redeliberations on lessee accounting. It considers two scenarios based on the recommendations in paper 3B/235:

    (a) The Boards decide to retain their current tentative decisions on lessee accounting (Approach 1 in paper 3B/235); and

    (b) The Boards decide on a lessee accounting approach that has different lease expense recognition patterns for different leases (Approach 3 in paper 3B/235).

Paper 3D/237 How to determine the line for different types of leases

13. Paper 3D/237 discusses the application of Approach 3 in paper 3B/235 and, specifically, alternatives for where 'the line' should be drawn that would determine the different lease expense recognition patterns.

14. For each alternative presented, paper 3D/237 also considers what the rationale would be if the line were the same from a lessor's perspective, as well as whether the indicators for determining the line for lessees could be used for lessors.

15. Paper 3D/237 discusses the following approaches for determining 'the line':

    (a) **Option 1:** Determination based on the transfer of substantially all of the risks and rewards of ownership (using the principle in IAS 17 *Leases*).

(b) **Option 2:** Determination based on whether the ROU asset represents the acquisition of a more than an insignificant portion of the underlying asset.

(c) **Option 3:** Determination based on the nature of the underlying asset.

(d) **Option 4:** Determination based on the lessee's business purpose for entering into the lease arrangement.

Staff recommendations—overall recommendations on the package of papers for discussion in June 2012

16. Agenda papers 3B/235, 3C/236 and 3D/237 each include staff recommendations on each of the issues discussed in the respective papers.

17. Regarding lessee accounting (paper 3B/235), the staff have mixed views—a majority of staff support retaining the Boards' current tentative decisions (Approach 1) and others support an approach with different lease expense recognition patterns (Approach 3).

18. If the Boards support Approach 3 in paper 3B/235 (ie a lessee accounting approach with different lease expense recognition patterns), then inconsidering where the line should be to distinguish between leases under Approach 3 (paper 3D/237), again the staff have mixed views—some support an IAS 17 line (Option 1) and others support a line based on the nature of the underlying asset (Option 3).

19. When considering lessor accounting (paper 3C/236), the staff is united in recommending:

    (a) A dual lessor accounting approach, with the dividing line being based on the lessor's business model if the Boards support Approach 1 in paper 3B/235, ie retain the current lessee accounting decisions; or

    (b) A dual lessor accounting approach, with the dividing line the same as for lessees if the Boards support Approach 3 in paper 3B/235, ie decide to support a lessee accounting approach with different lease expense recognition patterns.

Questions for the Boards

20. In light of the diversity of views held by constituents, it is not possible to develop lessee and lessor accounting proposals that would reflect the views of all constituents. For this reason, we think our goal should be to develop lessee and lessor accounting proposals that, in the Boards' view:

    (a) Provide useful and relevant information that faithfully depicts the economics of lease transactions and, thereby, improves the quality and transparency of information provided by lessees and lessors;

    (b) Have a sound rationale that can be readily explained to constituents;

    (c) Are practical; and consequently

    (d) Will be generally accepted by constituents.

21. The following flowchart shows the questions for the Boards relating to agenda papers 3B/235, 3C/236 and 3D/237.

Agenda Paper 3B/235
(Lessee Approaches)
Do Board members wish to change the current tentative decisions on the lessee accounting model so that a different pattern of expense recognition should be applied to some or all leases?

YES

NO

Should a different pattern of expense recognition apply to some OR to all leases?

Some leases

All leases

Agenda paper 3D/237
(The line)
When to apply a different pattern of expense recognition?

- Option 1 – Based on the IAS 17 principle
- Option 2 – Based on consumption of a portion of the underlying asset
- Option 3 – Based on the nature of the underlying asset
- Option 4 – Based on the business purpose for entering into the lease

All leases should get straight-line treatment (Approach 2 in paper 3B/235)

Agenda Paper 3C/236
(Lessor accounting)
Do Board members wish to change the current tentative decisions on the lessor accounting model?

YES

NO

Agenda Paper 3C/236
(Lessor accounting)
Which line do Board members want for lessors to determine when the receivable and residual approach would apply?

- Option 1 – Symmetrical with the line drawn for lessees
- Option 2 – Regardless of any line drawn for lessees, the lessor line should be based one of these:
    - Lessor business model looking at how the lessor prices the lease
    - Based on the IAS 17 principle of in-substance sale

Retain investment property line for lessors