IASB Agenda ref	3C
FASB Agenda ref	236

STAFF PAPER

12–14 June 2012

REG FASB | IASB Meeting

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

Project	**Leases**		
Paper topic	Lessor accounting—consequences of lessee decisions		
CONTACT(S)	Aida Vatrenjak	avatrenjak@ifrs.org	+44 207 246 6456
	Patrina Buchanan	pbuchanan@ifrs.org	+44 207 246 6468
	Danielle Zeyher	dtzeyher@fasb.org	+1 203 956 5265

This paper has been prepared by the staff of the IFRS Foundation and the FASB for discussion at a public meeting of the FASB or IASB. It does not purport to represent the views of any individual members of either board. Comments on the application of US GAAP or IFRSs do not purport to set out acceptable or unacceptable application of U.S. GAAP or IFRSs. The FASB and the IASB report their decisions made at public meetings in FASB Action Alert or in IASB Update.

Introduction

1. The recent targeted outreach on lease accounting focused on lessee accounting, and different approaches to the subsequent measurement of the lessee's right-of-use asset.

2. As a part of the outreach we also asked lessors who took part for their views on any consequences of those different approaches for lessor accounting. The feedback received was summarised in agenda paper 3/232 discussed during the May 2012 joint Board meeting.

3. This paper considers the consequences for lessor accounting as a result of the Boards' redeliberations on lessee accounting. It considers two scenarios:

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

   (b) The Boards support an approach that has different lease expense recognition patterns for different leases (Approach 3 in agenda paper 3B/235). Discussion of this scenario should be read in conjunction with agenda paper 3D/237.

The IASB is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRSs. For more information visit www.ifrs.org

The Financial Accounting Standards Board (FASB), is the national standard-setter of the United States, responsible for establishing standards of financial accounting that govern the preparation of financial reports by nongovernmental entities. For more information visit www.fasb.org

4. While this paper discusses the reasons for the Boards' current tentative decisions on lessor accounting, it does not fully reconsider lessor accounting. The paper is written with the view that the Boards have mostly completed redeliberations on lessor accounting and primarily want to address any consequences on those decisions arising from reconsidering lessee accounting.

5. These consequences relate to whether there should be one or two lessor accounting approaches, and if so, how the line between the two approaches should be drawn. The initial and subsequent measurement under both of the lessor accounting approaches is not discussed, but is set out in Appendix A to this paper, reflecting the Boards' current tentative decisions on the two lessor accounting approaches.

6. This paper is structured as follows:

   (a) Staff recommendation (paragraph 7).

   (b) Background to lessor accounting (paragraphs 8-10).

   (c) Discussion of the consequences for lessor accounting if the Boards decide to retain their current tentative decisions regarding lessee accounting (paragraphs 11-37).

   (d) Discussion of the consequences for lessor accounting if the Boards support a lessee accounting approach that has different lease expense recognition patterns for different leases (paragraphs 38-41). This section should be read in conjunction with agenda paper 3D/237.

   (e) Appendix A, which includes the Boards' current tentative decisions on lessor accounting and an example of how the receivable and residual approach works.

   (f) Appendix B, which includes a discussion of accounting for subleases. This discussion is relevant only if the Boards decide to retain their current tentative decisions regarding lessee accounting and have two lessor accounting approaches.

Staff recommendation

7. The staff recommend that:

   (a) If the Boards decide to retain their current tentative decisions regarding lessee accounting, the lessor receivable and residual approach should be applied to some leases and an approach similar to current operating lease accounting should be applied to other leases, with the distinguishing line being based on the lessor's business model (rather than investment property, the boards' current tentative decision).

   The staff notes that the above recommended line for lessors (if Boards retain their current tentative decisions on lessee accounting) is worded differently from the recommended line if the Boards support a lessee accounting approach with different lease expense recognition patterns (the latter being discussed in agenda paper 3D/237). This is because the lessor-only line (ie, business model) is worded solely from the lessor's perspective, considering information that may be available only to the lessor.

   (b) If the Boards support a lessee accounting approach that has different lease expense recognition patterns for different leases, the principle distinguishing between those expense recognition patterns should be consistent for lessees and lessors. This is likely to result in a change to the current tentative decisions on lessor accounting in terms of the population of lease contracts to which the receivable and residual approach would apply. Different ways to 'draw the line' are discussed further in agenda paper 3D/237.

Background

8. Lessor accounting was discussed in several Board meetings during the redeliberations of the proposals in the Leases Exposure Draft (2010 ED)[1]. Those papers provide a summary of the proposals in the 2010 ED, further background on lessor accounting and a more comprehensive discussion of the current dual lessor accounting approach. That information has not been repeated in full in this paper.

9. Appendix A of this paper summarises the boards' tentative decisions to date with respect to the lessor accounting model. In short, the Boards' tentatively decided that a lessor would apply:

    (a) An approach similar to current operating lease accounting to leases of investment property; and

    (b) The receivable and residual approach to all other leases (except short-term leases).

10. Appendix A also includes an example of how the receivable and residual approach works.

If the Boards decide to retain the current tentative decisions on lessee accounting

11. When the Boards tentatively decided that an approach similar to operating lease accounting would be applied to investment property leases (whereas the receivable and residual approach would be applied to other leases), the tentative decision on lessee accounting was to have a single model for all leases. Some may therefore think there is no need to further discuss lessor accounting if the Boards reaffirm the current lessee accounting decisions.

---

[1] The papers for these meetings include: IASB agenda papers 1F, 1G, and 1I/FASB memos 160, 161 and 163 (discussed in April 2011), IASB agenda papers 2E and 2F/FASB memos 172 and 173 (discussed in May 2011). IASB agenda paper 2A/FASB memo 180 (discussed in June 2011), IASB agenda paper 5G/FASB memo 193 (discussed in July 2011) and IASB agenda paper 2F/FASB Memo 210 (discussed in October 2011) also address lessor accounting.

12. However, during the Boards' more recent discussions on lessee accounting, the link between lessee and lessor accounting has been raised. Consequently, we think it would be useful to confirm the rationale for the lessor accounting proposals and assess the need for any change, even if the Boards retain their current lessee accounting decisions.

13. This section of the paper considers two questions:

    (a) Is it appropriate to have two approaches for lessor accounting if there is a single model for lessee accounting (discussed in the context of the current decisions)?

    (b) If yes, is the line currently drawn for distinguishing between those two approaches appropriate?

Are two lessor approaches compatible with a single lessee model?

14. If the Boards retain one model for lessee accounting, there is a question as to whether it would be appropriate to have two approaches to lessor accounting. That issue was raised in response to the 2010 ED, which proposed a dual lessor accounting model together with a single lessee accounting model.

15. Under the Boards' current tentative decisions for lessee accounting, the rationale is that the lessee has obtained (and thus the lessor has transferred) the right to use the underlying asset at lease commencement. On this basis, some might argue that a lessor should apply the receivable and residual approach to all lease contracts, reflecting that the lessor has transferred the right-of-use to the lessee and, in exchange, has a lease receivable.

16. However, when the Boards discussed lessor accounting in 2011, they thought that there were good reasons to have two different approaches to lessor accounting. We continue to think that, if the Boards retain the current lessee accounting decisions, it is not necessary to have one lessor accounting model for the reasons noted in the following paragraphs.

17. One particular concern often raised when discussing two lessor approaches with a single lessee model is the accounting for subleases. The staff do not think this would

cause significant issues. Our rationale for that conclusion is included in appendix B to this paper.

18. In the following subsections, we first consider the accounting for investment properties at fair value and then the accounting for investment properties measured at cost. This discussion is relevant because the Boards have tentatively decided to apply a different lessor accounting approach to leases of investment property, rather than the receivable and residual approach which is applied to leases of all other assets.

Investment property measured at fair value

19. Some users of financial statements have informed us that the fair value of an entire investment property gives them more useful information than other measurements, including when the property is leased out to one or multiple tenants. Rental income and changes in fair value are inextricably linked as integral components of the performance of an entity with investment property and measurement at fair value is necessary if that performance is to be reported in a meaningful way. Because of this, the IASB version of 2010 ED proposed that leases of investment property measured at fair value should be excluded from the scope of any new lessor accounting model developed, and rental income should continue to be accounted for similarly to current operating lease accounting. This was supported by almost all respondents to the 2010 ED, and reconfirmed by the Boards when they redeliberated lessor accounting in 2011.

Investment property measured at cost

20. Some may be more concerned with the rationale for applying operating lease accounting to leases of investment property measured at cost when the receivable and residual approach would apply to all other leased assets measured at cost.

21. However, we think that there are two different ways in which the Boards can justify retaining operating lease accounting for investment property measured at cost from the lessor's perspective but, at the same time, retaining the current lessee accounting decisions:

(a) The decision regarding investment property measured at cost is taken for practical 'cost-benefit' reasons, and/or

(b) Some leases are economically different from other leases on the basis of how a lessor prices its lease contracts (ie on the basis of a lessor's business model).

Practical reasons

22. Those who view the decision as one taken for practical reasons may not be concerned by any perceived inconsistency with the lessee accounting decisions. To them, this decision was made because (a) investment properties are usually leased many times over their useful lives, and (b) one investment property is often leased out to multiple tenants at the same time. Applying the receivable and residual approach at the beginning of each lease in these situations could be very costly for lessors, without providing sufficient benefit to users of financial statements.[2] Generally, users of financial statements have indicated that the current accounting model (and disclosure) in IAS 40 *Investment Properties* (current operating lease accounting) provides them with useful information.

23. In addition, applying current operating lease accounting to all leases of investment property would provide consistency in the recognition and presentation of revenue (rental income) by lessors who measure investment property at fair value and those who measure it at cost. Comparability of accounting for rental income generated from leases of investment properties is important because there are jurisdictions in which fair value is predominantly used (eg, most of Europe, Hong Kong, Australia) and those in which cost-based measurement is used (eg many parts of Asia, the USA).

24. Under this view, even though the receivable and residual approach might be the conceptually appropriate approach for all leases, the costs of applying this approach to

[2] For example, under the receivable and residual approach, a lessor of a 20-storey building leased out to 20 different lessees would be required to calculate the fair value of each of those floors. This is possible but does not reflect how investment property is currently valued and would be costly. In addition, because the residual asset would be measured on a cost basis, the information about the value of the lessor's investment in the property would not be particularly useful to users of financial statements.

investment properties would exceed the benefits and thus operating lease accounting should apply for practical reasons.

Business model

25. Some would rationalise the investment property decision as being made to better reflect the different business models underpinning leases of, for example, property (ie land or a building or part of a building) and leases of equipment/vehicles. Some of the characteristics of property that make it different from other leased assets include:

    (a) Property is a long-lived asset (often with an appreciating value), rather than a wasting asset.

    (b) Property is often leased numerous times to different lessees over its useful life.

    (c) Property can often be divided into physically-distinct portions, which are often leased as individual units to different lessees.

26. Supporters of this view would argue that lessors of property have a very different business from, for example, a bank lessor of equipment. The bank lessor would typically price its lease contracts based on estimates of the value of the equipment at the beginning and end of the lease contract to obtain a desired return. That lessor would typically have no ongoing involvement with the leased equipment while it is under lease. In contrast, a lessor of property would typically price its lease contracts to obtain a desired return on the whole underlying asset over the entire period that it intends to hold the property (rather than focusing only on the period of the lease). It would often continue to manage the property, providing other services to lessees while the property is under lease. In addition, given the characteristics noted in paragraph 25 above, the value of the property may not deplete over the lease term.

27. Because the lessor often continues to actively manage the underlying asset and its value may not deplete over the lease term, it would appear more appropriate in those situations for the lessor to continue to recognise the entire underlying asset during the lease, instead of accounting for the lease as if the lessor had sold a 'piece' of the property. Users often wish to see the return or 'yield' generated on the entire property, and recognising rental income over the lease term provides this information,

which would not be available under the receivable and residual approach. In addition, because the pricing will often represent a particular yield on the property and not the recovery of any decline in value of the property over the lease term, it would also seem appropriate to recognise rental income on a straight-line basis, akin to earning interest on an interest-only loan.

28. Some proponents of the business model view regard this as being compatible with a single approach to lessee accounting. This is because they view lessee accounting as being solely about accounting for the rights and obligations arising from the lease contract and related cost allocation—all lessees receive a right to use the underlying asset and have an obligation to pay for that right. Accordingly, the Boards may decide to have a single lessee accounting approach. In contrast, lessor accounting is also about accounting for the underlying asset, considering when it is appropriate to recognise income generated from the lease of that underlying asset. From a lessor's perspective, and when thinking about what is useful for users of a lessor's financial statements, supporters of the business model approach think that it is important to consider differing lessor business models when assessing when to recognise revenue generated from a lease contract.

29. Others view the business model approach to lessor accounting as one important reason as to why there should be two lessee accounting models. From a lessee's perspective, and when thinking about what is useful for users of a lessee's financial statements, some supporters of the business model approach for lessors also think that it is important to consider differing business models when assessing the lessee's expense recognition pattern generated from a lease contract; that is, whether interest and amortisation is important rather than a straight-line total lease expense.

Is the investment property line the right one?

30. Those who view the lessor accounting decision as being made for practical reasons would probably agree with a relatively bright line being drawn to identify those leases that are accounted for differently. For some, the investment property line works because it reduces the costs of accounting for leases of property and also increases

comparability of revenue recognition with investment properties measured at fair value.

31. However, we are not recommending retaining the current tentative decisions to differentiate between investment property and other leases for a number of reasons:

    (a) The definition of investment property in US GAAP and IFRS is not the same and, thus, we would need to develop a converged definition.

    (b) The current definitions would often exclude leases of a portion of a building. For example, if an entity leased out one floor of its 10 floor head office, that floor would not be investment property.

    (c) There are leases of other assets that are priced in a similar way to investment property, for which we think lessors should also apply operating lease accounting (see paragraphs 35-37).

32. Nonetheless, if the Boards wish to retain the current lessor decisions, a paper was prepared (but not discussed by the Boards) regarding the definition of investment property (ie agenda paper 2E/229 from the February 2012 joint meeting), which we can bring back to the July 2012 joint meeting.

Business model view

33. Even if the Boards' retain the current lessee accounting decisions, we recommend changing the lessor accounting tentative decisions to distinguish between different lessor business models.

34. As discussed previously in paragraphs 25-28 of this paper, we think that there are broadly two different lessor business models:

    (a) Those lessors who price lease contracts based on estimates of the value of the asset at the beginning and end of the lease contract to obtain a desired return. The following are possible indicators of such a business model:

        (i) The lease contract includes an implicit rate of return that takes into account the expected change in the value of the underlying asset between the beginning and end of the lease term.

(ii) The lessor typically leases the underlying asset relatively few times (typically once or twice) before disposing of the asset.

(iii) The pricing of any services associated with the lease is clearly separated.

(b) Those lessors who price lease contracts to obtain a desired return on the whole underlying asset over the entire period that they intend to hold the asset, which is much longer than the period of any individual lease contract.

(i) The lease contract assumes an implicit rate of return or yield on the underlying asset, valued as of the beginning of the lease.

(ii) The lessor leases the underlying asset numerous times over its economic life, with relatively insignificant depletion in value of the underlying asset over any individual lease term.

(iii) The underlying asset is a long-lived asset, and may be a portion of a larger physical asset.

(iv) The lessor provides services associated with the underlying asset to the lessee, with the pricing often not clearly separated.

35. Those who support the lessor business model distinction think that there are some non-property lessors who have similar business models to investment property lessors (eg rail cars, which are leased numerous times over the asset's economic life (with pricing reflecting current rental market conditions)).

36. They also note that some leases of property would be more appropriately accounted for under the receivable and residual approach, for example a lease of a property that would today be classified as a finance lease.

37. Consequently, they would conclude that there are different lessor business models that justify having differing accounting treatments.

If the Boards decide to change the current tentative decisions on lessee accounting

38. If the Boards support an approach that has different lease expense recognition patterns for different leases, reflecting the different economics that are inherent in lease contracts, then we think that reflecting those differences in lessor accounting would also be appropriate. It would appear difficult to justify how the lease is economically different for the lessee but not for the lessor.

39. In paragraphs 33-37 of this paper, we discuss and recommend distinguishing between leases from a lessor's perspective based on the lessor's business model, if the Boards decide to retain their current tentative decisions on lessee accounting. Given that discussion, some may think that this would lead to the conclusion that there should be a similar distinction from a lessee's perspective, if the Boards support a lessee accounting approach with different lease expense recognition patterns. Put another way, on the basis that the lessor originates the lease, it could be argued that the *lessor* should determine the economics of the lease and, thus the lessor's business model would drive any distinction in accounting from the lessee's perspective. However, we do not think this would be operational. A lessee would not necessarily have sufficient information to be able to assess how the lessor has priced the lease contract. Consequently, the lessee might look to its business purpose for entering into the lease to distinguish between different leases. In doing that, and because lessees could enter into similar lease transactions for different business purposes, we think that such an approach (a) could result in a different classification of leases by the lessee and the lessor for the same contract, and (b) a lack of comparability in accounting for similar leases by different lessees (this is also discussed in agenda paper 3D/237). For these reasons, we are not recommending a distinguishing line based on a lessor's business model if the Boards support a lessee accounting approach with different lease expense recognition patterns for different leases.

40. Alternatively, some may question why we would not suggest having a business model distinction from a lessor's perspective and perhaps another distinguishing line from the lessee's perspective if we conclude (for the reasons noted in paragraph 39 above)

that the business model line is not the best answer from the lessee's perspective. There are a number of reasons for not doing so:

(a) We think it would be very confusing to have two lessee accounting models as well as two lessor accounting models which would draw the respective distinguishing lines in different places.

(b) We think that Options 2 and 3 discussed in agenda paper 3D/237 would capture a very similar population of lease contracts to the lessor business model view discussed in this paper. Consequently, we do not think it would make sense to have two different distinguishing lines that, on paper, are described differently but, in practice, would capture a similar population of lease contracts.

(c) If the principle and indicators in IAS 17 are retained from a lessee's perspective, thus distinguishing between leases and 'in-substance purchases', we think it would be appropriate to distinguish between leases and 'in-substance sales' from a lessor's perspective. We do not think that the lessor business model view is compatible with an IAS 17 principle.

41. Consequently, we recommend that if any line is drawn for lessee accounting, that the same line should also be applied for lessor accounting. Agenda paper 3D/237, which discusses the line if the Boards support a dual expense recognition approach for lessees, takes into account the lessor perspective. This discussion is therefore not repeated in this paper.

Appendix A

A1. The Boards tentatively decided that for all lease contracts within the scope of the receivable and residual approach, a lessor should:

(a) Initially measure the right to receive lease payments at the present value of the lease payments, discounted using the rate the lessor charges the lessee, and subsequently measure at amortised cost applying an effective interest method.

(b) Initially measure the residual asset as an allocation of the carrying amount of the underlying asset. The initial measurement of the residual asset comprises two amounts: (i) the gross residual asset, measured at the present value of the estimated residual value at the end of the lease term discounted using the rate the lessor charges the lessee and (ii) the unearned income, measured as the difference between the gross residual asset and the allocation of the carrying amount of the underlying asset.

(c) Subsequently measure the gross residual asset by accreting to the estimated residual value at the end of the lease term using the rate the lessor charges the lessee. The lessor would not recognise any of the unearned income in profit or loss until the residual asset is sold or re-leased.

(d) Present the gross residual asset and the unearned income together as a net residual asset.

A2. The Boards tentatively decided that a lessor's lease of investment property would not be within the scope of the receivable and residual approach. Instead, for such leases, the lessor should continue to recognise the underlying asset and recognise lease income over the lease term.
The Boards also tentatively decided that short-term leases should be excluded from the scope of the 'receivable and residual' approach to lessor accounting.

Revenue recognition for lessors with leases of investment property

A3. The IASB tentatively decided that, for leases of investment property, a lessor should recognise rental income on a straight-line basis or on another systematic basis if that

basis is more representative of the pattern in which rentals are earned from the investment property.

A4. The FASB tentatively decided that, for leases of investment property, a lessor that is not an investment property entity or investment company should recognise rental income on a straight-line basis or on another systematic basis if that basis is more representative of the pattern in which rentals are earned from the investment property.

A5. The Boards also tentatively decided that a lessor with leases of investment property not within the scope of the receivable and residual approach should recognise only the underlying investment property in its statement of financial position (as well as any accrued or prepaid rental income).

Example of application 'receivable and residual approach' (equipment lease)

Assumption	
Fair value of leased asset	CU1,000
Carrying amount of leased asset	CU950
Lease term	5 years
Residual (future value)	CU500
Residual (present value)	CU374
Rents (annual in arrears)	CU149
Rate implicit in lease	6%
Initial direct costs	none
PV of lease payments = Lease receivable	CU626

Workings	
Total profit on transaction = FV - carrying amount of leased asset	1,000 - 950 = 50
Profit on ROU = lease rec/FV of leased asset * total profit	626/1,000 * 50 = 31
Unearned income (profit relating to residual) = total profit – profit on ROU	50 – 31 = 19

Periods	**0**	**1**	**2**	**3**	**4**	**5**
Balance sheet						
Receivable	626	515	397	273	140	0
Gross residual asset	374	396	420	445	472	500
Unearned income	(19)	(19)	(19)	(19)	(19)	(19)
Net residual asset	355	377	401	426	453	481
Income statement						
Gain on sale	31	-	-	-	-	-
Interest on receivable	-	38	31	24	16	8
Unwinding interest for residual asset	-	22	24	25	27	28
Total lease income	31	60	55	49	43	37

APPENDIX B: Subleases

B1. The below analysis was prepared as a part of agenda paper 2E/229 posted for (but not discussed at) the February 2012 joint Board meeting. Consequently, the analysis was prepared in the context of leases of investment property being excluded from the receivable and residual approach to lessor accounting. The Boards might decide to change the scope of contracts excluded from the receivable and residual approach, in which case the following discussion should be read in that context.

Nature of the underlying asset

B2. When a lessee subleases an asset, the underlying asset in respect of that sublease is the right-of-use asset. As a result, lessees that sublease investment property would be required to apply the receivable and residual approach because the nature of the underlying asset is a right of use and not the investment property itself. Consequently, the lessee/sublessor would need to determine the fair value of the right-of-use asset, or a portion of it, when applying the receivable and residual approach, which could be difficult. In the staff's view, these were the types of leases that the Boards were intending to capture when tentatively deciding to provide an exemption from the receivable and residual approach.

B3. Within the context of that tentative decision, the staff intend to clarify in drafting that the lessee/sublessor should be able to apply the exemption (from applying the receivable and residual approach), if the asset being leased meets the definition of investment property, even if the underlying asset is a right-of-use asset.

Mismatch of expense/income recognition

B4. Concerns have been raised that requiring leases of investment property to be excluded from the scope of the receivable and residual approach will result in a 'mismatch' of expense/income recognition for a sublessor, which will not provide useful information to users. Those raising these concerns think that the economics of the lease and the sublease are similar, yet different expense and income recognition patterns occur for the lease and the sublease.

B5. The Boards' tentative decisions treat leases as financing transactions. Consequently, these approaches will result in a lessee who leases investment property recognising a higher interest expense in the early years of a lease. If that lessee subleases the investment property, the lessee/sublessor will recognise a 'straight-line' rental income profile (and will not recognise a corresponding higher interest income profile in the early years of a lease, which it would have recognised if it had applied the 'receivable and residual' approach).

B6. For example, assume a lessee enters into a 10-year lease of investment property. The interest expense recognised using a single lessee accounting model is higher in the earlier years of the lease compared to the later years.

B7. If the lessee was to sublease only 5 years of the 10-year lease, the lessee would apply current operating lease accounting (because it is a lease of investment property) and recognise a straight-line rental income in the income statement, which would not be consistent with the profile of the interest expense.

B8. At the June 2011 joint meeting, the Boards discussed the accounting for subleases under the proposed leases requirements for lessees and lessors and tentatively decided the following:

a. A head lease and a sublease should be accounted for as separate transactions.

b. An intermediate lessor, as a lessee in a head lease arrangement, should account for its assets and liabilities arising from the head lease in accordance with the decisions to date for all lessees.

c. An intermediate lessor, as a lessor in a sublease arrangement, should account for its assets and liabilities arising from the sublease in accordance with the decisions to date for all lessors.

B9. Consequently, the Boards have already tentatively decided that no adjustments should be made to the lessee and lessor model for subleases. The staff thinks that there is no need for the Boards to reconsider these decisions. This issue of a mismatch also occurs in situations other than subleases. For example, a mismatch in expense/income recognition would also occur if a lessor bought property, financed by a loan, which the lessor subsequently leases. This would result in the loan transaction producing a

higher interest expense in the lessor's financial statements in the earlier years of the financing period and the lease producing a 'straight-line' income profile.

B10. The staff also note that a mismatch may not always occur. For example, a lease that is subleased for exactly the same period as the head lease is likely to meet the definition of a sale and, therefore, lessor accounting would not apply. In that case, the sublease would be considered to be a sale of the right-of-use asset and, accordingly, a mismatch of income/expense may not arise.

B11. For example, using the example in paragraph B6 of this paper, if the lessee/sublessor were to sublease the right-of-use asset for the whole 10-year lease period, the lessor would, in fact, have sold the right-of-use asset. Accordingly, the lessee/sublessor would recognise a receivable and derecognise the right-of-use asset. The receivable would generate interest income over the 10-year period, reflecting the fact that the sale occurred with deferred payments. Consequently, the lessee/sublessor would also recognise lease income with an 'interest'-type profile in the income statement, consistently with the profile of interest expense recognised in respect of the lease liability.