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Project	**Leases**		
Paper topic	Summary of Feedback on the 2013 ED		
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Purpose of this paper

1. This paper summarizes the feedback received in response to the IASB Exposure Draft *Leases* and proposed FASB Accounting Standards Update, *Leases (Topic 842)* (collectively referred to as "the 2013 ED"), which were published for public comment in May 2013.

2. After the publication of the 2013 ED, both IASB and FASB staff and Board members (collectively referred to as "the staff" and "the Boards") met with numerous organizations and professionals to explain the proposals and to obtain feedback. These activities included the following:

    (a) Approximately 45 meetings with more than 260 investors and analysts to discuss the lessee accounting proposals, and nine meetings with approximately 25 investors and analysts to discuss the lessor accounting proposals. These meetings included equity and credit analysts from both the buy side and the sell side. Many of these investors and analysts focus on particular industry sectors that engage in significant leasing activities, while others cover the markets more generally, and a few are accounting analysts. The investors and analysts that participated in the staff and the Boards'

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outreach are based in the U.K., Sweden, Switzerland, Belgium, the Netherlands, France, Australia, New Zealand, Hong Kong, Japan, Canada, and the U.S. Collectively, these investors and analysts and other users of financial statements that provided feedback on the 2013 ED are referred to as "users" in this agenda paper.

(b) Approximately 25 fieldwork meetings with preparers from various industries including consumer goods, retail, aviation, oil and gas, telecommunications, and automotive. The meetings were held in Germany, France, Spain, the U.K., the U.S., Japan, and Brazil between August and October 2013. These meetings were held with individual lessees and lessors to discuss, in detail, the costs of implementation for those companies. Almost all fieldwork meetings:

   (i) Were held at the preparer's premises and lasted from a half day to a full day.

   (ii) Involved meeting with preparer personnel from various departments within the organization, including the accounting, operations, legal, investor relations, and IT departments.

(c) Eight roundtables were held in London, Norwalk, Los Angeles, Singapore, and Sao Paulo during September and October 2013. These were attended by approximately 100 representatives and included one roundtable focused on non-public entities ("NPEs").

(d) Outreach meetings with various other individual preparers and groups of preparers (including NPEs), standard setters, and regulators. These meetings included presentations during accounting conferences, keynote presentations at industry forums, and meetings with individual organizations or groups.

(e) Project webcasts that attracted over 2,000 participants.

3. The summary of feedback included in this paper is based on the staff's preliminary analysis of respondents' comment letters, as well as on feedback received during these outreach activities.

4. A detailed analysis of feedback received on specific proposals in the 2013 ED will be presented to the Boards when they redeliberate those proposals. This paper does not include any staff recommendations, and the Boards will not be asked to make any technical decisions at this meeting.

Overview of the comment letters

5. The four-month comment period ended on September 13, 2013. As of November 7, 2013, the Boards have received 638 comment letters. Appendix A provides a summary by type of respondent and geographical region.

6. The response rate to the 2013 ED is high, mainly because most entities are lessees. Consequently, it is not surprising that almost all industries are well represented in the responses. Some of the concerns raised by those respondents are specific to their industry (for example, interpreting whether a specific contract is a lease or a service contract), but many concerns expressed are shared by respondents from a range of different industries.

7. The relevance of the proposals, in terms of their application across industries and geographical region, is evidenced by the high response rate from preparers, accounting firms, accounting professional bodies, national standard-setters, industry organizations, and other interested parties, including regulators and academics. The relevance of the proposals for users is also evidenced by the receipt of more than 20 comment letters from users.

Structure of the paper

8. The remainder of the paper is structured as follows:

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Overall

9. The majority of constituents commend the Boards for their efforts to change existing lessee accounting. Many constituents support the recognition of a right-of-use (ROU) asset and a lease liability by a lessee for all leases of more than 12 months. These constituents include the majority of users who provided feedback on the proposals, who are of the view that the proposed recognition of assets and liabilities by a lessee would provide them with a better starting point for their analyses. Many other constituents that provided feedback on the 2013 ED did not expressly comment on

this recognition proposal. Others support improving the existing lessee accounting in IAS 17 *Leases* and Topic 840, *Leases* by improving the disclosure requirements, rather than changing the recognition and measurement requirements. Most constituents support the objective of the project to develop a comprehensive and converged lessee accounting model for IFRS and U.S. GAAP.

10. Many constituents also expressed the view that the proposals in the 2013 ED represent a significant improvement over the proposals in the 2010 IASB Exposure Draft *Leases* and the 2010 proposed FASB Accounting Standards Update, *Leases (Topic 840)* (collectively referred to as "the 2010 ED"), especially relating to the following:

    (a) Variable lease payments

    (b) Payments under renewal options and purchase options

    (c) The guidance on the definition of a lease

    (d) Removing the lessor performance obligation approach.

    These constituents commend the Boards for being responsive to the concerns expressed by constituents about the 2010 ED.

11. Many constituents, however, have significant concerns about the proposals in the 2013 ED. Many constituents disagree with the proposed lessee accounting model. Some of these constituents are of the view that the existing lessee accounting model in IAS 17 and Topic 840 should not be changed. Others disagree with one or more specific aspects of the proposed lessee accounting model, such as the proposed dual approach or the requirement to periodically reassess lease assets and lease liabilities. In addition, the majority of constituents disagree with the proposed lessor accounting model. Most of these constituents are of the view that the existing lessor accounting model in IAS 17 and Topic 840 should not be changed.

12. The majority of constituents also have concerns about the costs and complexity of the proposals in the 2013 ED. Specific areas of the proposals that constituents highlight as being particularly costly or complex include the following:

    (a) The dual lessee accounting model

    (b) The Type A lessor accounting model

(c) The reassessment proposals

(d) The disclosure proposals

(e) The scope of the transactions subject to the proposals.

13. Many of these constituents recommend that the Boards undertake a detailed cost-benefit analysis before finalizing any changes to lease accounting.

Lessee

Background

14. The 2013 ED proposed that a lessee would do the following:

(a) Recognize a ROU asset and a lease liability for all leases of more than 12 months, initially measured at the present value of lease payments.

(b) Classify most leases of assets other than property as Type A leases, and:

(i) Subsequently measure the lease liability at amortized cost

(ii) Amortize the ROU asset on a systematic basis that reflects the pattern in which the lessee expects to consume the ROU asset's future economic benefits

(iii) Present interest on the lease liability separately from amortization of the ROU asset.

(c) Classify most leases of property as Type B leases, and:

(i) Subsequently measure the lease liability at amortized cost

(ii) Amortize the ROU asset in each period so that the lessee would recognize the total lease cost on a straight-line basis over the lease term

(iii) Present a single lease expense (cost) combining interest on the lease liability with amortization of the ROU asset.

15. Most of the users that provided feedback already make adjustments to a lessee's reported balance sheet to capitalize operating leases when operating leases are significant to the lessee. Two main techniques are used to adjust the balance sheet:

(a) A multiple of annual operating lease expense

(b) Discounted operating lease commitments

16. Many of those users also adjust a lessee's income statement for operating leases. The most common technique used is to split the operating lease expense for the period into depreciation and interest expense using estimation techniques (for example, two-thirds of the operating lease expense as depreciation expense and one-third as interest expense).

Is there a need to change existing lessee accounting?

17. The majority of constituents agree that there is a need to change or improve the existing lessee accounting model in IAS 17 and Topic 840 because:

    (a) The existing lessee accounting model does not accurately reflect a lessee's financial position in all cases, as evidenced by the adjustments that users often make to operating lessees' financial statements

    (b) There is insufficient information provided in the note disclosures under existing requirements to enable users to make accurate adjustments, which is a view expressed by almost all users who provided feedback

    (c) The existing lessee accounting model gives rise to structuring opportunities because a lessee can account for economically similar transactions very differently.

18. Other constituents stated that they do not think there is a need to change or improve the existing lessee accounting model because:

    (a) The existing lessee accounting model is well understood, has proven to work in practice, and accurately reflects the differing economics of different leases. Although users make adjustments to lessees' reported information under the existing model, the notes to the financial statements provide them with adequate information to make these adjustments.

    (b) Users do not make adjustments in the same way, or for the same purpose. There is no "silver bullet" lessee accounting model that would prevent users from needing to make adjustments in relation to leases.

(c) Although there are benefits to changing the current lessee accounting model, any change to lessee accounting involves costs. The proposals in the 2013 ED would be costly and complex to implement. These constituents think the benefits of changing the lessee accounting model as the 2013 ED proposes would not outweigh the costs.

Lessee accounting—balance sheet

Support

19. Many constituents agree with the proposal to recognize a ROU asset and a lease liability for all leases of more than 12 months, while many others did not explicitly comment on this proposal.

User views

20. The majority of users that provided feedback support the recognition of assets and liabilities for operating leases. Some of these users have specifically stated that a disclosure-only solution would be a suboptimal solution. They are of the view that, although a disclosure-only solution might be acceptable for more sophisticated users, it would not be helpful to the majority of users who require financial statements to provide them with clear information without adjustments being made. This finding is consistent with the findings of surveys conducted by a number of the user associations who submitted comment letters.

21. Almost all credit analysts, including analysts from the credit rating agencies, and users of the financial statements of NPEs in the U.S. (for example, lenders) that participated in outreach activities support the changes proposed to a lessee's balance sheet. Their main focus is assessing the credit risk of a company; thus, they were particularly interested in getting better information about leverage. They are of the view that all leases create assets and debt-like liabilities for a lessee and should be recognized on a lessee's balance sheet.

22. Although the views of equity analysts are more mixed, a majority of equity analysts also support the changes proposed to a lessee's balance sheet. Most equity analysts agree that information about a company's leverage is important for their analyses (that

is, they need to assess credit risk as well as operating performance when analyzing an entity) and they agree that the proposals would provide better information about leverage.

Other views

23. Many other constituents, including regulators, standard setters, accounting firms, and some preparers, also support the Boards' proposal to recognize a ROU asset and a lease liability for all leases of more than 12 months. Arguments given in support include the following:
    (a) The recognition of a ROU asset and a lease liability gives a more accurate representation of a lessee's leverage and the assets used in operations.
    (b) The ROU asset and the lease liability meet the respective definitions of assets and liabilities in the Boards' Conceptual Frameworks. Consequently, recognizing these assets and liabilities would be an improvement to financial reporting.

Concerns

24. Many constituents expressed concerns about the proposal in the 2013 ED for lessees to recognize a ROU asset and a lease liability for all leases of more than 12 months.

User views

25. Some users do not support changing the existing recognition and measurement requirements because they do not think that any one model can provide a complete picture of the economics of leases. Instead, they recommend enhancing the existing disclosure requirements.

26. Additionally, many equity analysts have concerns about the balance sheet proposals. Some are concerned about any change to financial reporting. Others are concerned about the proposed measurement of lease assets and lease liabilities, which focuses on a lessee's contractual commitments. Many of these equity analysts, as well as analysts from two of the credit rating agencies, are interested in obtaining "whole asset" information about leased assets (that is, information about how much would be capitalized if the entity had purchased, rather than leased, the assets). Some are interested in obtaining a measure of the on-going "perpetual" commitments of an

entity (that is, the level of commitments or "debt" needed to continue operating on a basis similar to today).

27. Because of this, some of these analysts disagree with recognizing assets and liabilities for existing operating leases. Others prefer a different measurement method but think that recognizing assets and liabilities as proposed in the 2013 ED would be an improvement to financial reporting.

Other views

28. Some other constituents, mainly preparers, question whether ROU assets and lease liabilities meet the definition of assets and liabilities for various reasons, including:
    (a) In many cases, lessees do not enter into a lease to finance the purchase of an asset and do not have the option to purchase the assets being leased
    (b) In many cases, there is a possibility for a lessee to renegotiate or terminate a lease early, particularly for property leases
    (c) Many of these constituents view leases as similar to or equivalent to a service or an executory contract and note that assets and liabilities are not recognized for such contracts.

29. Some constituents request that the Boards perform more work to strengthen the ROU model set out in the proposals. Many constituents are concerned about the cost and complexity involved in capitalizing lease assets and lease liabilities. These concerns include the costs involved in tracking and capitalizing all leases and determining appropriate discount rates.

30. Additionally, some constituents are concerned about the broader economic costs and consequences of the proposals, discussed within the "cost-benefit" and "implementation concerns" sections of this paper.

31. Some constituents criticize the accounting for the ROU asset in the Type B lessee accounting model for the following reasons:
    (a) The amortization method proposed:
        (i) Results in an amount recognized on a lessee's balance sheet that is not reflective of how that asset is being consumed by the lessee

(ii) Is dissimilar to any other amortization method allowed for nonfinancial assets, resulting in a lack of comparability between Type B ROU assets and other nonfinancial assets.

(b) The ROU asset would be at increased risk of impairment

(c) A lessee would recognize a ROU asset even though the lessor continues to recognize the entire underlying asset on its balance sheet. Some think that a lessee should not recognize a ROU asset if the rights embedded in that asset are already recognized on a lessor's balance sheet.

Alternative suggestions

32. Constituents provided a number of alternative suggestions regarding the balance sheet requirements for lessees, including:

(a) Recognizing assets and liabilities for some leases, but not for others. Suggestions provided regarding how to determine whether to recognize an asset and a liability for a lease include the following:

(i) An approach focused on the transfer of risks and rewards (similar to the guidance in IAS 17 and Topic 840), the transfer of control, or the in-substance sale of the underlying asset (that is, a lessee would recognize assets and liabilities only when it obtains the significant risks and rewards of ownership or control of the underlying asset, or the lease is an in-substance purchase of the underlying asset)

(ii) Retaining the consumption principle in the 2013 ED, but using that principle to determine lease asset and liability recognition (that is, a lessee would recognize assets and liabilities only when it is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset)

(iii) Recognizing assets and liabilities arising only from material leases or leases of core assets.

(b) Linking the ROU asset and the lease liability in subsequent measurement, as well as in initial measurement

(c) Measuring the ROU asset and the lease liability at an undiscounted amount

(d) Distinguishing between rights of ownership and rights of use, and recognizing different assets and liabilities depending on which types of rights have transferred

(e) Retaining the recognition requirements in IAS 17 and Topic 840, respectively, and only improving lessee disclosure requirements

(f) Taking a "stepped approach" to improving lessee accounting by, first, improving disclosures, and only then reconsidering whether to make changes to the lessee recognition requirements.

Lessee accounting—income statement

Support

33. Many constituents support the Boards' decision to create a dual lessee accounting model for purposes of income statement presentation. They think a dual model appropriately reflects the differing economics of different types of leases. These constituents think that the introduction of a dual model in the 2013 ED is a significant improvement over the 2010 ED.

User views

34. Many users, including most industry-specific users, support the income statement proposals for the following reasons:

(a) Most users that provided feedback agree that there are economic differences between property leases and leases of assets other than property. Therefore, they understand the rationale behind the dual approach proposed for a lessee's income statement.

(b) Almost all airline and transport analysts agree with the proposal to recognize and present amortization expense separately from interest expense for most leases of assets other than property because, in their view, there should be consistency in the treatment of owned and leased assets. Retail, restaurant, and hotel analysts generally support having a single lease expense for property leases, typically presented as an operating expense.

They view the lease expense as an important part of the operating expenses of a retailer, hotelier, or restaurateur.

(c) Some users who are not industry-focused also support the proposed dual model. They are of the view that a lessee's income statement should reflect what a lessee pays for consumption (depreciation) of the underlying asset separately from what it pays for financing (interest). They think the proposed dual model is a practical way to do this. Some of these users would, however, consider the lease expense for Type B leases to be a financing (interest) expense.

Other views

35. Some other constituents, particularly lessees and lessors with property leases, support the proposed accounting for property leases. They think that the income statement requirements in IAS 17 and Topic 840 work well for these leases and accurately reflect the economics of such leases. Consequently, they support a lessee recognizing a single straight-line lease expense in its income statement for most property leases.

Concerns

36. A majority of constituents disagree with the dual accounting model proposed in the 2013 ED, which is based on consumption of the underlying asset.

User views

37. Many users disagree with the income statement proposals in the 2013 ED. Most of those who disagree, including two of the credit rating agencies and most of the other credit analysts that provided feedback, proposed recognizing amortization expense separately from interest expense for all leases (that is, applying Type A accounting to all leases). This reflects their view that leases create assets and debt-like liabilities. Accordingly, they think a lessee should recognize a corresponding interest expense in the income statement for all types of leases.

38. In contrast, some other users who disagree with the income statement proposals suggest that a lessee should recognize a single, straight-line lease expense for all leases currently classified as operating leases. This reflects their view that, for these leases, the benefit to the lessee is received evenly over the lease term.

Other views

39. Some constituents, in particular, standard setters, accounting firms, and some preparers, disagree with having a dual lessee model for conceptual reasons. These constituents think that, if the Boards wish to require capitalization of leases by a lessee, any attempt to differentiate between those leases in the income statement is arbitrary and inconsistent with the recognition of a nonfinancial asset and a financial liability. Some of these constituents are also particularly concerned about an entity potentially having to account for leases of the same type of underlying asset in different ways depending on lease classification.

40. These constituents and others think that any dual model perpetuates the risk of structuring to gain a particular accounting outcome and note that structuring is one of the major criticisms of the existing model in IAS 17 and Topic 840.

41. Other constituents disagree with the classification principle on which the dual accounting model is based. Most of these constituents, mainly preparers and some of the accounting firms, prefer a dual model based on the principle in IAS 17 and Topic 840 (that is, distinguishing between leases that are effectively financed purchases of the underlying asset based on an assessment of the transfer of the significant risks and rewards of ownership, and those that are not) for the following reasons:

    (a) It is readily understood and has worked well in practice, as compared to the consumption principle which is new and untested

    (b) It captures economic differences between leases more accurately than the proposed consumption principle

    (c) It is closely tied to the commercial and bankruptcy laws and income tax systems in some jurisdictions (for example, in the U.S. and the U.K.), unlike the consumption principle.

42. Some constituents criticize the consumption principle generally, noting that a ROU model should not rely on classification guidance that focuses on the underlying asset.

43. Many constituents raised concerns about the costs and complexity of the proposed dual lessee accounting model, stating that:

(a) There would be costs involved in applying any new classification guidance and in setting up the new accounting systems required for Type B accounting

(b) The dual model is complex, particularly the judgments that need to be made in classifying leases

44. Constituents also have specific concerns about the income statement profile of Type A leases. Some constituents criticize the front-loaded expense profile of Type A leases and they also expressed concern about the change from presenting rental expense to presenting interest and amortization for existing operating leases of equipment. Some constituents think that this change could create issues for particular transactions or in particular industries, such as:

(a) In joint arrangements

(b) When rental expense is charged to the cost of another asset

(c) When rental expense is used to recover costs by regulated industries or government contractors.

45. Some constituents raised concerns about the Type B income statement profile. Most of these concerns relate to the inconsistency of recognizing a financial liability without presenting any corresponding interest expense in the income statement. Some preparers are concerned about the effects this would have on ratios used to assess their operations.

Alternative suggestions

46. Many constituents suggest the Boards should adopt a single lessee accounting model. Most of these constituents support applying Type A accounting to all leases, although some, mainly preparers, support applying Type B accounting to all leases.

47. Many other constituents support having a dual accounting model but suggest changing the classification guidance. Most of these constituents suggest using the classification principle that exists in IAS 17 and Topic 840.

48. Other constituents suggest changes to the subsequent measurement of the ROU asset and the lease liability and, thus, the corresponding amounts recognized in the income statement, including the following:

(a) Some suggest amortizing both the ROU asset and the lease liability on a straight-line basis and presenting the amortization as rent expense

(b) Others recommend capitalizing the remaining lease payments on a discounted basis (that is, recognizing the same amount as an asset and liability) and separately recognizing a straight-line rent expense at each reporting date. These constituents suggest various methods and assumptions when measuring the asset and liability (for example, using either a current or lease commencement discount rate).

49. Some constituents suggest that, if the Boards proceed with a dual model, a lessee should be allowed to elect to account for all of its leases in the same way (that is, either all as Type A or all as Type B).

50. Finally, some constituents made the following suggestions for Type B leases:

(a) Presenting interest expense and amortization separately

(b) Presenting the entire rent expense as interest expense

(c) Applying Type A accounting, but combining the interest expense and amortization and presenting them as a single rent expense.

Lessor

Background

51. The 2013 ED proposed that a lessor would do the following:

(a) Classify most leases of assets other than property as a Type A lease, and:

(i) Derecognize the underlying asset and recognize a lease receivable and a residual asset

(ii) Recognize interest income on both the lease receivable and the residual asset

(iii) Recognize any profit relating to the portion of the asset transferred to the lessee at the commencement date.

(b) Classify most leases of property as a Type B lease, and:

(i) Continue to recognize the underlying asset

(ii) Recognize lease income over the lease term, typically on a straight-line basis.

52. Only a few users that provided feedback make adjustments to a lessor's reported information for their analyses. These users estimate a lessor's exposure to residual asset risk for operating leases, typically by estimating the lessor's lease receivable on a discounted basis and subtracting that estimated receivable from the carrying amount of assets that are the subject of an operating lease.

Is there a need to change existing lessor accounting?

53. Some constituents support changing the existing lessor accounting model in IAS 17 and Topic 840 because:

(a) Some users want better information about a lessor's exposure to asset risk and credit risk in equipment leases.

(b) Some lessors do not think the existing lessor accounting model appropriately reflects their leasing activities.

(c) Some constituents support consistency between lessee and lessor accounting. Consequently, these constituents think that the lessor accounting model needs to change if the lessee accounting model changes.

(d) Some constituents note that the Boards have recently developed a new revenue recognition model and support changing lessor accounting to the extent necessary to be consistent with that model.

54. The majority of constituents, however, do not support changing the existing lessor accounting model because:

(a) The existing lessor accounting model in IAS 17 and Topic 840 is well understood and accurately reflects the different economics of different lease transactions

(b) Most users do not currently adjust lessors' financial statements

(c) Although there is a clear need to change lessee accounting, lessor accounting is not fundamentally flawed and should not be changed solely because lessee accounting is changing. These constituents do not think that

consistency between the lessee and the lessor accounting models is necessary.

(d) Changes to lessee accounting should not be delayed because of difficulties in determining the appropriate lessor accounting model

(e) Although there would be some benefits from the proposed changes to lessor accounting, the costs involved in the proposals would outweigh the benefits

The dual lessor accounting model

Support

User views

55. All users that commented on the accounting for property leases support the proposals, which generally preserve existing operating lease accounting for property leases. Although some think that recognizing a lease receivable and a residual asset for all leases would be more correct from a conceptual perspective, they are of the view that the proposals for property leases provides information that is most useful for users.

56. Most users agree that better information about a lessor's exposure to credit risk and asset risk would be beneficial for most leases of assets other than property. In particular, those who already adjust a lessor's reported financial information to estimate the lessor's exposure to those risks support changes that would provide this information. However, some of these users were indifferent as to whether they receive that information in note disclosures or on the balance sheet, while others would prefer it within the note disclosures.

57. Some users support the changes proposed to leases of assets other than property because, in their view, the accounting proposed (that is, accounting for a lease as a financing transaction) more closely aligns the accounting with the underlying economics of most of those leases. In particular, some who follow captive lessors support the proposed change that would align lease accounting more closely with sale accounting.

Other views

58. Most other constituents support a dual lessor accounting model, stating that Type A accounting, although consistent with the ROU model, should not be applied by lessors

in all cases. These constituents think that there are economic differences between different types of leases and that different lessors have different business models. In their view, these differences should be reflected in a dual lessor accounting model.

59. Some constituents, including some lessors, stated that the dual lessor accounting model in the 2013 ED better reflects these differences than the existing dual lessor accounting model. For example, many of these constituents think that the proposed Type A model better reflects the operations of a lessor that is a financial institution or operates similarly to a financial institution (for example, some captive manufacturer lessors). In their view, a Type A model provides an accurate representation of the asset risk and credit risk retained by such lessors.

60. Most constituents, especially property lessors, support the proposal to require Type B accounting for most property leases. These constituents stated that Type B accounting reflects the business model of property lessors. They cautioned against requiring Type A accounting for property leases, stating that it would be costly to apply with little to no benefit. User feedback was also consistent with this sentiment.

61. Some constituents commented that the dual model proposed in the 2013 ED represents a significant improvement over the dual model proposed in the 2010 ED, noting that:

    (a) The Type B accounting proposed in the 2013 ED is preferable to the performance obligation approach proposed in the 2010 ED

    (b) There are specific improvements made to the Type A accounting proposed in the 2013 ED compared to the derecognition approach proposed in the 2010 ED (for example, the accretion of the residual asset over the lease term).

Concerns

62. The majority of constituents had various concerns about the proposed dual lessor accounting model.

User views

63. Many users disagree with the proposed changes to lessor accounting and, in particular, the effects that the proposed accounting would have on a lessor's income

statement. Those who follow lessors of long-lived assets (for example, aircraft, drilling rigs, rail cars) do not support the proposed changes, preferring to receive revenue information that is relatively predictable and that often reflects actual cash inflows, as this is what they receive for operating leases under existing requirements. They are concerned about the potential volatility in amounts recognized in a lessor's income statement under the proposals, particularly when the second-hand market for leased assets is volatile. They are of the view that the proposed accounting would reduce transparency for some lessors, such as drilling rig lessors.

Other views

64. A majority of other constituents do not support the proposed dual model. This is because, in their view, it does not result in improved financial reporting for many lessors of equipment, including:

    (a) Lessors of long-lived assets (for example, drilling rigs, aircraft, or rail cars)

    (b) Lessors of multi-tenanted equipment (for example, telecommunications towers or fiber cables)

    (c) Lessors who provide substantial services with their leases

    (d) Lessors who release assets.

65. These constituents disagree with such lessors applying Type A accounting because, in their view:

    (a) Derecognizing the underlying asset and recognizing a lease receivable and a residual asset does not appropriately reflect those lessors' business models. They consider those lessors to be in the business of managing assets over the entire economic lives of those assets, rather than over any individual lease term.

    (b) It is inappropriate for those lessors to derecognize underlying assets when the lessor retains an interest in the "whole" underlying asset and can borrow money using that underlying asset as collateral.

    (c) The proposed effects on the income statement do not appropriately reflect the economics of leases entered into by those lessors. In particular, they disagree with the characterization of lease income as interest income and

the front-loaded pattern of income recognition, particularly when the secondhand market for leased assets is volatile.

(d) Those lessors' leases are priced similarly to property leases and are not priced on a cost-plus-return basis that is typical of many equipment leases.

66. Some constituents are particularly concerned about the costs and complexity of the proposed dual lessor accounting model, stating that:

(a) There would be costs involved in applying any new classification guidance and in setting up the accounting systems required for Type A accounting

(b) The dual model is complex, particularly the judgments that need to be made in classifying leases and in applying the Type A model (for example, estimating future residual values)

67. Some constituents also disagree with the lessor model because they think that the focus on the lessee's consumption of economic benefits in determining when and in what way profit is recognized is inconsistent with the Boards' new revenue recognition model.

68. Finally, some constituents disagree with the lessor model because they think that the dual model, especially Type B accounting, is inconsistent with the ROU model and the lessee accounting model.

69. For these reasons, many constituents do not think that the proposed dual model would result in an improvement in financial reporting when compared to the existing lessor model in IAS 17 and Topic 840.

Alternative suggestions

70. The majority of constituents support a dual lessor accounting model but recommend that the classification guidance be changed in various ways:

(a) Most recommend that the Boards should not change the existing lessor accounting model in IAS 17 and Topic 840 in any significant way. They suggest that classification should be based on the transfer of risks and rewards, transfer of control, or sale of the underlying asset, in a manner similar to or identical to the classification guidance in IAS 17 or Topic 840.

Many of these constituents also recommend that the current disclosure requirements in IAS 17 and Topic 840 be improved to give more information about a lessor's exposure to asset risk and credit risk.

(b) Some recommend that classification depend on a lessor's business model (for example, whether the lessor is primarily involved in providing finance to lessees or whether the lessor is more focused on managing underlying assets over the economic lives of those assets).

(c) Some recommend that classification depend on various other aspects, including, for example:

  (i) The amount of residual asset risk retained by the lessor

  (ii) Whether the rent a lessor could charge for subsequent leases varies depending on the age of the underlying asset.

(d) Some recommend that the dual model include a scope exception for leases of underlying assets that are measured at fair value through profit or loss.

71. Some constituents suggest a single lessor accounting model rather than the proposed dual model. Almost all of these constituents support an accounting model similar to the Type A approach proposed in the 2013 ED. Some of these constituents suggest that this single lessor model could include an exception for underlying assets that are measured at fair value through profit or loss. In addition, some suggest that an exception could also apply to leases of portions of assets that are otherwise used by the lessor (for example, a lease of surplus space in a building used by the lessor for its operations).

72. A few constituents support the performance obligation approach in the 2010 ED and recommend that the Boards reintroduce that approach.

Type A lessor accounting—how the approach works

Support

73. Some constituents support specific aspects of Type A accounting, such as the accretion of the residual asset and the recognition of profit on the lease. Many of these constituents commend the Boards for making improvements to the derecognition model proposed in the 2010 ED.

Concerns

74. Constituents have various questions or concerns about the measurement of the residual asset, including the following:

    (a) Many constituents are concerned about the judgment required in determining the expected value of the underlying asset at the end of each lease, especially for underlying assets for which the secondhand market is volatile (for example, aircraft or ships).

    (b) Constituents note that the determination of the expected value of the residual asset would have a significant effect on the amount and timing of income recognition. Some constituents are concerned that the requirements provide opportunities for lessors to manage the timing of income recognition.

    (c) Some constituents are concerned that the carrying amount of the gross residual asset provides less useful information because:

        (i) It is comprised of disparate parts including variable lease payments and any unrealized profit on the underlying asset

        (ii) It is subsequently measured (or accreted) in a way that is inconsistent with the treatment of other nonfinancial assets.

    (d) Some constituents have specific concerns about the proposal to include variable lease payments in the measurement of the residual asset if the lessor reflects an expectation of variable lease payments in the rate the lessor charges the lessee. These constituents said that the proposal:

        (i) Is too complex

        (ii) Would lead to inconsistent accounting between different lessors

        (iii) Inappropriately relies on subjective estimates

        (iv) Inappropriately includes cash flows received as part of the lease in the measurement of the residual asset.

75. Some constituents disagree with the proposed recognition of profit on a lease at lease commencement because they think that it would be inappropriate for a lessor to

recognize any profit before the lessor has sold the whole underlying asset. Some of these constituents also note the possibility for profit reversal if the lease is terminated early.

76. However, others think that a lessor should recognize the entire difference between the fair value of the underlying asset and its carrying amount as profit at lease commencement. These constituents think that it is complex and counterintuitive to split the profit into a realized portion and an unrealized portion and include the unrealized portion as part of the residual asset.

77. Some constituents also disagree with the impairment requirements. They are concerned that splitting the cash flows assessed for impairment purposes into those related to the receivable and those related to the residual would be complex and arbitrary.

Alternative suggestions

78. Many constituents suggest that the Boards should not change existing U.S. GAAP and IFRS lessor accounting for leases that would receive Type A accounting (that is, a lessor should apply current sales-type/finance lease accounting to leases that are effectively financings rather than the receivable and residual approach).

79. Other constituents suggest changing particular aspects of the proposed Type A lessor accounting. Those suggestions include:

(a) Not recognizing the residual asset separately from the lease receivable

(b) Providing more guidance on determining the estimated value of the residual asset

(c) Measuring the residual asset at fair value, or the present value of the expected residual value at the end of the lease

(d) Not recognizing any profit on the lease at lease commencement, or recognizing the full difference between the underlying asset's fair value and its carrying amount

(e) "Freezing" the carrying amount of the residual asset without any accretion, or allowing reassessment of the carrying amount of the residual asset

(f) Removing the requirement to include variable lease payments as part of the residual asset, or introducing a requirement to include variable lease payments as part of the lease receivable

(g) Treating the lease receivable and the residual asset as one asset for purposes of impairment.

Type B lessor accounting—how the approach works

80. Few comments were received on the details of Type B accounting. A few constituents are concerned about the requirement to recognize rental income on a straight-line basis or another systematic basis, if that basis is more representative of the pattern in which income is earned from the underlying asset. Some of these constituents would prefer a lessor to recognize rental income when it receives cash payments.

Classification

Background

81. The 2013 ED proposed that lease classification would largely depend on the nature of the underlying asset. An entity would classify most leases of property as Type B leases and most leases of assets other than property as Type A leases. However, an entity would classify a lease of property as a Type A lease (and a lease of an asset other than property as a Type B lease) if that lease met one of two specific classification tests, based on comparing the lease payments to the fair value of the underlying asset and comparing the lease term to the economic life of the underlying asset.

82. This section of the paper discusses comments received on specific aspects of the proposed classification guidance, assuming the final leases standard retains classification guidance that is similar to the 2013 ED proposal. It does not discuss more fundamental comments received on the lessee and lessor accounting models, such as suggestions to either use a single lessee or lessor accounting model or to change the classification principle (for example, to one more aligned with the existing lease classification principle in IAS 17 and Topic 840). These suggestions were discussed in the lessee and lessor sections of this paper.

Support

83. Some constituents support the classification guidance as proposed in the 2013 ED. These constituents think that the classification guidance appropriately offers a core principle (that is, classification on the basis of consumption of the underlying asset) and an operational way to apply that principle (that is, classification based principally on the nature of the underlying asset, with exception tests designed to more closely align application with the underlying principle).

Concerns

84. Most constituents are concerned about various aspects of the proposed classification guidance.

85. Most constituents are concerned about the use of subjective phrases that would impact lease classification, including the terms “insignificant,” “major part,” and “substantially all.” These constituents think that these phrases, without any additional guidance on their meaning, would lead to inconsistent application of the classification guidance.

86. Constituents are also concerned about aspects of the two-tiered classification test in the 2013 ED, including:

    (a) The application of the consumption principle on the basis of the underlying asset. Some constituents think that it is inappropriate for lease classification in a ROU model to depend on the nature of the underlying asset.

    (b) The application of the consumption principle on the basis of comparing the present value of lease payments to the fair value of the underlying asset and/or comparing the lease term to the economic life of the underlying asset. These constituents are concerned that the tests would lead to similar leases of the same underlying asset being classified differently. For example, some constituents are concerned about an entity classifying property leases as Type A leases, especially land-only leases.

87. Some constituents have concerns about the definition of property in the classification guidance. Most of these constituents think that the definition of property in the 2013 ED is too narrow.

88. Some constituents have concerns about specific aspects of the classification guidance, including the guidance relating to:

(a) Leases of land and buildings. Some constituents would prefer to separate the land and building elements of these leases, while others disagree with using the remaining economic life of the building to classify the combined lease.

(b) Lease components with the right to use more than one asset. Some constituents request more guidance on how to determine the "primary asset," while others disagree with the primary asset concept, particularly for leases with property and nonproperty elements.

(c) Economic life. Some constituents disagree with the proposal to use the remaining economic life of the underlying asset for classification of property leases and the total economic life of the underlying asset for leases of assets other than property. Most of these constituents prefer to use the total economic life for all underlying assets for the proposed classification test. They do not think that the classification of leases of the same underlying asset should change from Type B to Type A as the asset ages, which could be the case if classification depends on the remaining life of the underlying asset.

(d) Fair value. Some constituents disagree with the proposal to base the classification test on the fair value of the underlying asset because, for some assets, fair value is difficult to determine.

(e) Reassessment of lease classification. Some constituents disagree with the prohibition against reassessing lease classification. In their view, this could lead to structuring by, for example, including extension options to achieve Type B rather than Type A classification.

Alternative suggestions

89. Constituents suggest the following various modifications to the classification guidance, if the Boards decide to retain classification guidance similar to that proposed in the 2013 ED:

    (a) Classification based solely on the underlying asset for leases of both property and assets other than property. These constituents would prefer an entity to apply the consumption principle strictly on the basis of the nature of the underlying asset (that is, classify all property leases as Type B leases and all leases of assets other than property as Type A leases).

    (b) Classification based solely on the consumption principle (that is, whether the lessee consumes more than an insignificant amount of the economic benefits embedded in the underlying asset).

    (c) Changing the classification test in a way that would reduce, but not eliminate, Type A property leases and Type B leases of assets other than property.

    (d) Expanding the definition of property to incorporate the concept of “integral equipment” under existing Topic 840 or the recent IFRS Interpretations Committee’s deliberations on the definition of property. These constituents think that such an expanded definition should incorporate assets such as telecommunications towers, fiber-optic cables, and pipelines.

    (e) Improving the guidance with regard to terms such as “economic life,” “insignificant,” “major,” and “substantially all”.

    (f) Using numerical tests rather than terms such as “insignificant” or “major”.

    (g) Including more application guidance and illustrative examples.

Definition of a Lease

Background

90. The 2013 ED defines a lease as "a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration." An entity would determine whether a contract contains a lease by assessing whether:

    (a) Fulfillment of the contract depends on the use of an identified asset

    (b) The contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

91. In providing feedback on the proposed definition of a lease, many constituents stressed the increased importance of, and pressure on, that definition. That is because the distinction between a lease and a service contract is the new "line" in determining whether a transaction is recognized on a lessee's balance sheet. Under the 2013 ED, the accounting for leases would be significantly different from services because a lessee would recognize all leases (other than short-term leases) on its balance sheet, while the accounting for services would remain unchanged. Under existing requirements, the accounting for an operating lease is similar to the accounting for a service, from a recognition and revenue/expense attribution standpoint. Consequently, the existing dividing line between a lease and a service is not subject to the same level of scrutiny.

Support

92. Most constituents stated that the proposed definition of a lease is an improvement compared to that in the 2010 ED and existing accounting. Many constituents find the additional guidance in the 2013 ED, both within the proposed requirements and illustrations, to be beneficial. Some constituents commented that they would be able to apply the guidance in practice without significant issues or difficulties.

93. Some constituents think that the outcome from the assessment of whether a contract contains a lease would be consistent with the economics of the transaction.

94. Many constituents support the proposal to more closely align the control concept in identifying a lease with the control concepts in other standards (for example, the Boards' forthcoming revenue recognition standard and existing consolidation guidance).

95. Some constituents agree that a capacity portion of an asset should not be an identified asset.

Concerns

96. Although most constituents support the overall direction of the proposed definition of a lease, the majority of constituents do not think the Boards have provided adequate guidance to consistently apply that definition. Most of the concerns relate to the following:

    (a) Determining when a lessee *directs the use of* the underlying asset

    (b) Assessing whether substitution rights regarding an otherwise identified asset are *substantive*.

97. Many constituents stated that additional guidance is required for entities to appropriately and consistently determine whether a lessee *directs the use* of an identified asset. A number of constituents commented that particular types of contracts or transactions, including charter arrangements in the shipping and oil and gas industries, power purchase agreements, and subcontracted manufacturing service arrangements, may be extremely difficult to assess in that respect. In their view, the examples provided in the 2013 ED are not as helpful as they could be because:

    (a) They do not address more complicated scenarios.

    (b) The analysis in the examples is not sufficiently linked to the proposed guidance to explain how that guidance should be applied.

98. Constituents raised the following specific concerns about directing the use of an asset:

    (a) Which decisions constitute "decisions about the use of the asset that most significantly affect the economic benefits to be derived from use of the asset"?

(b) What level of customer involvement in the design of the asset is enough to be considered as having the ability to direct the use of the asset?

(c) How determinative is the physical operation of the underlying asset (for example, in scenarios in which the operation of the asset is predetermined by its design)?

99. Other constituents commented that the term *incidental*, as it relates to determining whether an asset is *incidental* to the delivery of services, is not clearly defined and may be difficult to interpret and apply consistently in practice.

100. Of those constituents that request additional guidance on determining whether a supplier's substitution rights are substantive:

(a) Some question if those rights should be based on the supplier's *right* to substitute or, instead, should be based on the *occurrence* of that substitution. For example, some constituents suggest that an otherwise identified asset should remain identified until it is substituted by another asset.

(b) Others question the use and definition of *substantive*. Some of these constituents stated that the supplier's right to substitute is substantive even if customer consent is required for substitution. Others added that additional guidance is needed to explain what would constitute "barriers (economic or otherwise) that would prevent the supplier from substituting alternative assets in place of the asset." These constituents principally question how significant those barriers would need to be.

101. Consequently, some constituents question whether the proposed definition of a lease is overly subjective and difficult to apply in practice. Some are concerned about the costs and the level of judgment needed to apply the definition. These constituents think that, in the absence of additional guidance, there would be significant structuring opportunities to avoid concluding that a contract is, or contains, a lease.

102. Some constituents also raised concerns about the treatment of in-substance purchase contracts and whether they are, or should be, within the scope of the proposals. In particular, these constituents request clarity about what would constitute an in-substance sale or purchase to which an entity would apply other guidance.

Alternative suggestions

103. The majority of preparers request additional guidance to clarify all of the following:

    (a) When a contract contains a lease or results solely in the provision of a service

    (b) When substitution rights are substantive

    (c) When the lessee directs the use of the underlying asset.

104. Most of these preparers think it would be helpful if the Boards could either align the language to be more consistent with existing guidance (such as using language in IFRS 10 *Consolidated Financial Statements*) or provide additional examples and implementation guidance to further explain how the Boards intend the definition to be applied.

105. Many constituents recommend that the Boards define what constitutes a service. These constituents stated that providing a definition for both a service as well as a lease would help eliminate confusion between the two transactions.

106. Some preparers and others recommend retaining the definition of a lease in existing guidance with either no change or minimal change. These constituents emphasize that the existing definition of a lease is understood and applied consistently in practice. Some also think that retaining a definition that is familiar to preparers would help reduce implementation costs and complexity, while also ensuring that what most users view as leases are captured by the forthcoming new leases standard.

Separating lease and nonlease components

Background

107. The 2013 ED proposed that both lessees and lessors separate lease components from nonlease components within a contract.

Support

108. The majority of constituents said that they agree, in principle, with separating lease and nonlease components and allocating the contract consideration to those components. They think that the separation of significant components would provide

useful information to users. Many of these constituents, as well as some others, also agree that a lessor should use the guidance in the forthcoming standard on revenue recognition to allocate contract consideration to lease and nonlease components.

Concerns

109. Many constituents, however, note practical application issues with the proposed guidance.

110. The most pervasive concern relates to the requirement for a lessee to combine nonlease components with lease components when the lessee is unable to obtain observable standalone prices for all components of the contract. The majority of constituents said that including nonlease components within a single lease component is not appropriate for the following reasons:

    (a) Including services or other nonlease components in the measurement of the ROU asset and the lease liability would overstate the lessee’s assets and liabilities and inappropriately “gross up” its balance sheet. They assert that a service component does not create an asset at lease commencement because it is not a resource controlled by an entity as a result of past events.

    (b) Including nonlease components in a single lease component introduces inconsistency in accounting between lessees, solely on the basis of the availability of observable standalone prices.

111. Some constituents suggest that the absence of an observable standalone price for a lease component should result in the reassessment of whether that contract includes a lease. In their view, it is counterintuitive to account for the entire contract as a lease if the component for which the lessee cannot obtain an observable standalone price is the lease component. These constituents think that the absence of such a price for the lease component is indicative that the entire contract is a service contract.

112. Other constituents disagree with the requirement to separate components for the following reasons:

    (a) Lessors expressed concern about the lessee separation proposals because they think the proposals would result in having to communicate proprietary information to customers about how they price their contracts. Additionally,

they think it would be costly for customers to process, analyze, and reclassify costs, which may require new or enhanced systems.

(i) Property lessors said that separation would reduce the comparability of their reported rents and tenant reimbursements because the presentation of their rental revenues would be split between lease revenue and tenant reimbursement revenue. These lessors would prefer to account for the entire contract as a lease.

(ii) Drilling rig and shipping lessors said that separation would often be difficult, if not impossible, because their contracts almost always include significant service components. In addition, because their agreements are priced largely based on supply and demand at contract inception, it would be difficult to determine standalone prices for each component. These lessors would prefer their agreements to be accounted for wholly as services.

(b) Lessees expressed concern about the increase in time and cost that would be needed to comply with the separation requirements. In addition, they think that separation would increase the number of leases that they would need to track at an individual asset level, which would increase their systems requirements. They question the benefit that this information would provide to users.

113. Some constituents asked for clarity about whether executory costs would be considered to be nonlease components. These constituents note that executory costs are specifically excluded from the definition of *minimum lease payments* under existing guidance.

Alternative suggestions

114. Most constituents who expressed concern about the recognition of a single lease component in the absence of observable standalone prices suggest that lessees be permitted to use reasonable estimates to separate lease and nonlease components. Many of these constituents note that lessees and lessors use estimates to separate lease and nonlease components according to existing IFRS and U.S. GAAP. Consequently,

such a requirement should not create additional complexity when compared to existing requirements.

115. Other constituents who disagree with the proposed separation of lease and nonlease components suggest, instead, that lessees be required to determine whether the primary component of the contract is a lease or a service component and to account for the entire contract accordingly. To operationalize that suggestion, some constituents suggest providing a threshold below which the separation of components would not be required.

116. Some constituents suggest permitting a lessee to elect not to separate lease and nonlease components for particular classes of underlying assets, and instead to account for those contracts entirely as leases. That would allow lessees to separate nonlease components on material classes of underlying assets, but would not require lessees to incur the costs to do so for less material contracts (for example, contracts that contain leases of smaller office equipment).

Short-term leases

Background

117. The 2013 ED proposed that an entity could make an accounting policy election to not apply the lessee and lessor recognition and measurement requirements to a lease that, at the commencement date, has a maximum possible term under the contract, including any options to extend, of 12 months or less.

Support

118. Many constituents support the recognition and measurement exception for short-term leases. These constituents think the exception is a practical way to help reduce costs while still providing relevant information to users.

Concerns

119. Many constituents disagree with the definition of a short-term lease, which is based on a *maximum possible term*. They said that options to extend the lease should not be

taken into account if the lessee does not have a significant economic incentive to exercise those options.

120. Many constituents said that the proposed short-term exception will not provide sufficient cost relief for preparers. They note that a lease rarely has a maximum possible term of 12 months or less.

121. Other constituents do not agree with creating any short-term lease exception. These constituents said that the costs of providing the short-term lease information do not outweigh the benefits to users. Some also think that the use of a bright line (12 months) in the proposal creates potential structuring opportunities that could result in an understatement of a lessee's assets and liabilities.

Alternative suggestions

122. Many constituents suggest that "short-term" be based on an assessment of the lease term as defined in the proposals (that is, the noncancellable term of the lease plus any optional periods for which the lessee has a significant economic incentive to exercise). These constituents think that it is beneficial to use the same definition when determining the lease term of all leases, including short-term leases.

123. Some constituents suggest extending the recognition and measurement exception for short-term leases. Many think that using two or three years would be a significant improvement and would provide more relief for immaterial leases.

Scope

Background

124. The 2013 ED proposed that an entity would apply the proposed leases guidance to all leases, except for the following:

    (a) Leases of intangible assets (the IASB ED proposed that a lessee need not apply the proposals to leases of intangible assets)

    (b) Leases to explore for or use minerals, oil, natural gas, and similar nonregenerative resources

(c) Leases of biological assets, including timber

(d) Service concession arrangements (IFRS only).

Support

125. Most constituents support the proposed scope of the leases project.

Concerns

126. The majority of constituents, however, are concerned about the time and effort required to apply the proposals to the large volume of "small ticket" leases that many entities have (for example, copiers, printers, and laptop computers). These constituents think that "small ticket" leases are often insignificant to a lessee's overall business. In one meeting, a lessee provided an overview of its leasing portfolio and demonstrated that 98 percent of its total leases (approximately 21,000 leases) make up less than 10 percent of its total remaining lease payments (therefore, approximately $90 million of approximately $900 million). Many constituents also commented that, although they can look to materiality, the burden of proof required by auditors and regulators to demonstrate that leases are not material negates any potential benefit from applying materiality.

127. Some constituents, including some users, disagree with excluding leases of intangible assets from the scope of the proposals. In their view, rights to use intangible assets are economically similar to rights to use tangible assets. Some disagree with the difference in the scope of the proposals for leases of intangible assets within the IASB's and FASB's respective EDs.

Alternative suggestions

128. Many constituents urge the Boards to reconsider excluding leases of noncore assets from the scope of the leases proposals for practical reasons. They think that applying the proposals only to leases of core assets would provide users with relevant and

useful information about an entity's significant leases and, at the same time, considerably ease the burden for preparers, especially during transition.

129. Some constituents request that the Boards include intangible assets in the scope of the leases proposals.

Measurement

Lease term

Background

130. The 2013 ED defines the lease term as the noncancellable period for which the lessee has the right to use an underlying asset, together with both of the following:

(a) Periods covered by an option to extend the lease if the lessee has a significant economic incentive to exercise that option.

(b) Periods covered by an option to terminate the lease if the lessee has a significant economic incentive not to exercise that option.

Support

131. Most constituents (including most users) support the changes to the definition of the lease term from the 2010 ED. Many of these constituents said that the higher threshold proposed in the 2013 ED is preferable to the "more likely than not" threshold proposed in the 2010 ED. That is because, in their view, the higher threshold:

(a) Generally requires less subjective judgment and estimation. Most users said they would not want subjective estimates about renewal options reflected in the measurement of lease assets and lease liabilities.

(b) Avoids recognition of amounts that are not present obligations of the lessee. Some of these constituents added that the substance of the liability recognized under the current proposals is more consistent with the Boards' conceptual framework definition of a liability than the proposals in the 2010 ED.

(c) Avoids excessive volatility from reassessments throughout the lease term.

132. Many constituents agree that there is a need to include some renewal options when determining the lease term to mitigate the risk of lessees inappropriately excluding lease liabilities from the balance sheet (for example, by excluding lease payments in optional periods for which the lessee has a clear economic incentive to exercise).

133. Some constituents said that the implementation guidance relating to "significant economic incentive" provides sufficient guidance for determining the lease term.

134. Some constituents also stated that the lease term reassessment requirements would not be costly or complex to operationalize. That is because, in their view, a change in relevant factors resulting in the lessee having, or no longer having, a significant economic incentive to exercise an option should be infrequent.

Concerns

135. Some constituents think payments to be made during future optional periods do not meet the definition of a liability for the lessee (or a receivable for the lessor) until those options are exercised. That is because, before the exercise date, a lessee can avoid those payments by choosing not to exercise the option.

136. In contrast, a few constituents, mainly a few users, support including lease payments in optional periods in the measurement of lease assets and lease liabilities as was proposed in the 2010 ED. These constituents view estimations as an integral feature of operating a business and added that those estimates provide the most current and relevant information for users. They would prefer lessees to reflect an estimate of expected payments in optional renewal periods in the measurement of ROU assets and lease liabilities.

137. A majority of constituents expressed concern about the interpretation of "significant economic incentive". In their view, application of the concept is unnecessarily subjective. Consequently, consistent interpretation of the concept within and across entities may be difficult in practice. These constituents did not interpret "significant economic incentive" to be a high threshold.

138. Many constituents note that the proposal requires determination of the lease term from the perspective of the lessee. These constituents are concerned about the ability of a

lessor to assess whether the lessee has a significant economic incentive to exercise an option.

139. Most constituents expressed concern about the requirement to reassess the lease term when there is a change in relevant factors resulting in the lessee having (or no longer having) a significant economic incentive to exercise an option. Although many understand the Boards' objective in requiring reassessment of the lease term, they think that the cost of applying the reassessment proposals exceeds any benefit. Specific concerns include the following:

    (a) The effect of management intent

    (b) The significant administrative challenge to track the relevant factors

    (c) The requirement to demonstrate that assumptions have not changed when the entity determines reassessment is not necessary.

    Additionally, these constituents note that reassessment would often have little effect on earnings and, thus, they would prefer to recognize any change to the lease term in the period in which the change actually occurs.

140. Some constituents also are concerned about the determination of the lease term for month-to-month leases, until-further-notice leases, and evergreen leases citing that the guidance is not sufficient to determine the lease term for those leases.

Alternative suggestions

141. Many constituents suggest that the Boards should retain "reasonably assured" or "reasonably certain" if their intent is that "significant economic incentive" would be applied consistently with existing guidance. Some constituents suggest that the Boards perform outreach to understand if there is diversity in the application of "reasonably certain" in IFRS versus "reasonably assured" in U.S. GAAP before deciding which phrase to retain in a converged final standard.

142. Most constituents who expressed concern about the reassessment proposals provided alternative suggestions. The most common suggestions are the following:

(a) To reassess the lease term only when a significant triggering event, such as the exercise of a renewal or termination option, occurs (as opposed to reassessment on a regular basis).

(b) To reassess at a higher level than an individual lease (that is, to reassess at a portfolio level for leases with similar terms and conditions).

143. Some constituents also request additional examples to illustrate how a change in relevant factors results in the lessee having, or no longer having, a significant economic incentive to exercise an option.

Variable lease payments

Background

144. The 2013 ED proposed to include in the measurement of a lessee's lease liability and a lessor's lease receivable fixed payments, in-substance fixed payments, and variable lease payments that are linked to an index or a rate. The lessee (or lessor) would measure, or re-measure, variable lease payments linked to an index or a rate using the index or rate at the end of the reporting period. An entity would recognize all other variable lease payments in profit or loss in the period incurred (or earned).

Support

145. Most constituents (including most users) agree with the changes made to the 2010 ED proposals about the accounting for variable lease payments (the 2010 ED proposed to include an estimate of all variable lease payments, determined using an expected value method, at initial measurement and to continually reassess that estimate). Constituents generally said that variable payments contingent on future events (for example, sales or usage) do not represent a present obligation of the lessee (or a right of the lessor) and, therefore, do not meet the definition of a liability (or asset). In addition, many constituents, including most users, said that they would not want subjective estimates about variable lease payments reflected in the measurement of lease assets and lease liabilities.

146. Many constituents also support the 2013 proposals about variable lease payments linked to an index or a rate and those that are in-substance fixed payments. These

constituents said that it is appropriate to include such payments in the measurement of the lease liability and the lease receivable because the lessee has no ability to avoid in-substance fixed payments and variable payments linked to an index or a rate.

147. Some constituents support the reassessment proposals. Of those supporting reassessment, most are users and a few are preparers.

Concerns

148. Some constituents (mainly some users and some preparers) request that the Boards revert to the proposals for variable lease payments in the 2010 ED. These constituents think that:

(a) It is the *measurement* of future variable lease payments that is uncertain, not the *existence* of the assets or the liability. Some note that the measurement of variable lease payments is no more difficult than, for example, determining the fair value of in-process research and development in a business combination. Excluding those payments could result in the significant understatement of a lessee's liability and a lessor's receivable

(b) Estimates are inherent in lease accounting, such as the proposals for residual value guarantees. Accordingly, an entity should treat variable lease payments not linked to an index or a rate in the same way as other lease payments

(c) Lessees entering into leases with variable payments must have some reliable estimate of their expected lease payments; otherwise, they would not enter into such leases.

149. Many constituents commented on the difficulty of interpreting the meaning of "in-substance fixed" lease payments. These constituents said that the judgment required could lead to inconsistent application. One regulator also said that inconsistent application could lead to issues with enforceability.

150. Some request additional guidance as to whether, and under what circumstances, "in-substance fixed" payments include payments that are contractually variable. A few constituents think that the examples provided in the 2013 ED, without other guidance,

would not be sufficient to explain how the Boards intend an entity to apply the concept of “in-substance fixed” payments..

151. Some constituents think that the proposals might reduce comparability between entities if the terms and conditions of their leases differ, but the economics of those leases are similar. Under the proposals, a lessee with a lease with only variable lease payments (not linked to an index or a rate) would not be required to recognize a lease liability while a lessee with a similar lease with only fixed lease payments would be required to recognize a lease liability.

152. Almost all constituents expressed concern about the reassessment proposals for variable lease payments from a cost and complexity perspective. Many added that they would not expect the impact of such reassessment to affect the income statement in any meaningful way. Consequently, they think that the cost of applying the reassessment proposals would outweigh any benefit.

Alternative suggestions

153. Those constituents who disagreed with the variable lease payments proposals in the 2013 ED (mostly users and standard setters) largely supported reverting to the variable lease payment proposals in the 2010 ED.

154. Many constituents supported aligning the variable lease payment requirements with the variable consideration requirements in the forthcoming revenue recognition standard.

155. Many constituents suggested alternative approaches for the reassessment proposals, including the following:

   (a) Do not reassess variable lease payments linked to an index or a rate but, instead, recognize any difference in profit or loss in each period.

   (b) Reassess only when the change in the relevant index or rate affects the lease payments (that is, when the lessee begins to make lease payments on the basis of the changed index or rate).

   (c) Reassess only in the context of a reassessment for other reasons (for example, a reassessment of the lease term).

Discount rate

Background

156. The 2013 ED proposes that a Type A lessor would discount its lease receivable using the rate it charges the lessee, and a lessee would discount its lease liability using the rate charged by the lessor. If that is not determinable, the lessee would discount its lease liability using its incremental borrowing rate. Lessees and lessors would reassess the discount rate in specified circumstances.

157. The FASB's proposal for NPEs with respect to the discount rate is discussed in the NPE section of this paper.

Support

158. Most constituents did not comment on the discount rate proposals. There was broad support among those constituents that provided feedback on this topic for the lessee to use its incremental borrowing rate in the absence of information about the rate the lessor charges the lessee.

Concerns

159. Concerns among constituents related to the following areas:

    (a) Requests for more guidance on certain aspects, including what is "readily determinable"

    (b) Definition of a lessee's incremental borrowing rate, including whether and how to take account of the collateral in a lease

    (c) Administrative burden

    (d) Periodic reassessment requirements

    (e) Comparability within and across entities

    (f) Issues specific to government contractors.

160. Some constituents expressed concern about the definition of the lessee's incremental borrowing rate, as it is defined in the 2013 ED:

> The rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds

necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

These constituents note that ROU assets do not exist outside of leases. Consequently, it would be difficult to determine an incremental borrowing rate in accordance with this definition.

161. Several constituents said that calculating incremental borrowing rates for individual leases would impose a significant administrative burden on their organizations and increase their system requirements.

162. Some constituents are concerned about the comparability of lease liabilities within and between entities. For example, an entity that operates in multiple jurisdictions is likely to have a different incremental borrowing rate in each jurisdiction. Therefore, an entity could recognize two leases with identical payments and lengths at different amounts. Likewise, some say that comparability across different entities could be affected by differing creditworthiness. They think that entities with a lower credit rating and, thus, higher incremental borrowing rates might recognize lower liabilities than entities with a higher credit rating and lower incremental borrowing rates.

163. Some U.S. constituents note that industry regulations require them to comply with the Cost Accounting Standards (CAS) and the Federal Acquisition Regulation (FAR). These constituents enter into leases exclusively to support various government contracts and are reimbursed using a predetermined rate referred to as the "cost of money". They would prefer to use that rate to discount their liabilities.

Alternative suggestions

164. Some constituents suggest that the Boards permit a portfolio approach in estimating discount rates for lease liabilities with similar terms.

165. Some constituents suggest clarifying the threshold for using the rate the lessor charges the lessee to allow estimation of the rate based on available industry information.

Other lease payments: residual value guarantees

Background

166. The 2013 ED proposed that (a) a lessee should include amounts expected to be payable under residual value guarantees in the initial measurement of the lease liability and (b) the lessor should include lease payments structured as residual value guarantees in the initial measurement of the lease receivable.

Concerns

167. Very few constituents commented on the proposed guidance on residual value guarantees. Although some of these constituents support the proposals, specifically regarding lessees, others expressed concern about one or both of the following:

    (a) The proposals are inconsistent with the treatment of variable lease payments

    (b) The lessee and lessor proposals are not symmetrical.

168. Those constituents who said that the residual value guarantee proposals are inconsistent with the proposals on variable lease payments view residual value guarantees as a form of variable lease payments.

Other lease payments: initial direct costs

Background

169. The 2013 ED proposed that a lessee would include initial direct costs incurred in the initial measurement of the ROU asset and that a lessor would include initial direct costs incurred in the initial measurement of the lease receivable for Type A leases.

Concerns

170. Very few constituents commented on the Boards' proposals on the measurement of initial direct costs. Those constituents who did comment had the following concerns:

    (a) They said that it is difficult to calculate initial direct costs. Consequently, the proposed guidance should apply only to initial direct costs that are material to the lease.

(b) Initial direct costs are incurred to initiate the lease. Accordingly, some constituents said that an entity should not include initial direct costs in the measurement of the ROU asset, but instead should recognize them as an expense in the period in which they are incurred.

Contract modifications

Background

171. The 2013 ED proposed that an entity would account for a modified contract as a new lease if the contractual terms and conditions of a lease are modified resulting in a substantive change to the existing lease. The entity would recognize any difference between the previous lease and the new lease in profit and loss in the period in which the modification occurs.

Concerns

172. Only a handful of constituents commented on the contract modifications proposals, and the majority of these constituents expressed concern about the proposed guidance.

173. Constituents asked for clarification about the following:

(a) The meaning of “the date the modifications become effective”

(b) How to identify a contract modification. They note that the proposed guidance provides a change in the contractual lease term as an example of a substantive change to the existing lease. These constituents question when a change in contractual lease term results in reassessment of the lease term or a contract modification.

174. A few constituents note that most lessees would likely recognize a gain if a contract is modified for Type A leases. That is because the carrying amount of the lease liability would often be larger than the carrying amount of the ROU asset.

175. Almost all of those who commented expressed concerns about the costs and complexity of evaluating all leases for substantive changes that would result in a contract modification.

Sale and leaseback

Background

176. The 2013 ED proposed that an entity would account for a sale and leaseback transaction as a sale of the underlying asset and a leaseback of that asset only if that transaction qualifies as a sale in accordance with the forthcoming revenue recognition standard. If the transaction does not qualify as a sale, an entity would account for the entire transaction as a financing transaction.

Support

177. Most constituents did not comment on the proposed guidance on sale and leaseback transactions.

178. There is broad support among those constituents who provided feedback to align the accounting for the sale with the forthcoming revenue recognition standard. Those constituents, however, note some potential application issues as discussed below.

Concerns

179. Some constituents disagree with the factors included in the 2013 ED that would prevent sale and leaseback accounting (that is, the 2013 ED states that a transfer is not a sale if the lease term of the leaseback is for the major part of the remaining economic life of the underlying asset or the present value of the leaseback payments represents substantially all of the fair value of the underlying asset). These constituents think that it is inappropriate to use those factors to determine when the leaseback represents the transfer of control of the underlying asset to the buyer-lessor.

180. Many constituents note that the inclusion of a purchase option in a sale and leaseback transaction would prevent sale and leaseback accounting. Consequently, an entity would account for such transactions as financing transactions, which these constituents think would not properly reflect the economics in all instances.

181. Some constituents think that recognizing all of the profit associated with the sale of the underlying asset at contract inception would not be reflective of the economics of most sale and leaseback transactions. They suggest that any such profit should instead be spread over the leaseback term.

182. Some constituents disagree with the proposals to account for what is, in effect, a sale and finance leaseback as a financing transaction. They agree that such a transaction should not result in profit recognition for the seller-lessee. Nonetheless, they think that, if the buyer-lessor retains an interest in the residual asset (for example, the transaction is priced assuming an expected residual of 5 percent of the fair value of the asset), it would be more appropriate for the buyer-lessor to account for the transaction in accordance with the lessor proposals, instead of as a financing transaction. That is because the requirements that apply to financing transactions do not specifically address how a lessor would account for its retained interest in the residual asset.

183. Many constituents expressed concern about the transition of existing sale and leaseback transactions. In particular, they mentioned profit previously earned in a sale and operating leaseback that would no longer meet the sale requirements in the 2013 ED. These constituents recommend grandfathering existing sale and leaseback transactions and applying the proposed guidance for sale and leaseback transactions prospectively.

Presentation

Support

184. Some constituents, including users, support the Boards' decision to present ROU assets and lease liabilities separately from other assets and other liabilities. Some constituents also support the Boards' decision to allow flexibility in presenting ROU assets and lease liabilities in either the balance sheet or the note disclosures.

185. Some preparers, mainly from the retail sector, agree with the presentation of cash flows relating to property leases within operating activities, rather than financing activities, in the statement of cash flows.

Concerns

Lessee (Type A & Type B)

User views

186. Not all users expressed views on the proposals related to the statement of cash flows. Of those who did, there were two main views:

    (a) Users from some of the credit rating agencies and some others support applying the proposals for Type A leases (that is, treating cash payments as the repayment of debt) to all leases. This reflects the adjustments they already make for current operating leases and the presentation already required for existing capital (finance) leases.

    (b) Other users would prefer to treat all lease cash outflows as part of operating activities. Even though many of these users view lease liabilities to be debt-like liabilities, they view the actual cash flows to be payments for assets that are used in the operations of the lessee.

Other views

187. Some other constituents also disagree with the proposals for Type A leases in the statement of cash flows. They think that separating cash flows into interest and principal amounts and presenting them separately could introduce complexity for users and potentially lead to misclassifications in cash flow forecasts. These constituents added that the proposals would create an artificial increase in cash flows from operations.

188. Preparers also expressed concerns, emphasizing that the option for lessees to present owned property, plant, and equipment and ROU assets together, and lease liabilities and secured financing together, would lead to a lack of comparable information for users, despite the requirement for separate disclosure in the notes.

189. In addition, many preparers, particularly those from the banking sector, and some accounting firms are concerned that the proposed presentation requirements would have adverse effects on regulatory capital requirements. They contend that the potential classification of the ROU asset as an intangible asset together with the lease

liability being recognized on the balance sheet would impact key ratios and other metrics, such as leverage ratios and solvency ratios.

Lessor (Type A & Type B)

190. Some constituents, including regulators, preparers, and accounting bodies, question whether a lessor should be allowed to present the lease asset (that is, the sum of the carrying amounts of lease receivables and residual assets) as a single amount in its balance sheet.

191. Some preparers expressed concerns that the cash flow presentation proposal would limit classification to operating activities whereas existing guidance (IASB-only) allows interest received to be included within investing or operating activities.

Alternative suggestions

192. Many constituents, mainly preparers and representatives of the banking sector, suggest that the final standard be clear that the ROU asset is not an intangible asset. These constituents think that classification as a tangible asset better reflects the economics of leases than classification as an intangible asset. Consequently, a potential fix would be to prescribe a separate tangible asset line-item for ROU assets.

193. Some users and other constituents suggest retaining presentation of lease cash flows within operating activities in the statement of cash flows.

194. In addition, some constituents suggest that entities should have flexibility when presenting lease amounts in the income statement and the statement of cash flows (that is, allow lessees flexibility with respect to the presentation of (a) amortization and interest expense and (b) repayments of principal and interest).

195. Other suggestions from constituents include the following:

    (a) Performing further outreach with users to determine whether the disaggregation in presentation on the main financial statements, together with the proposed disclosure requirements, would provide useful information

(b) Clarifying the presentation requirements for short-term lease payments, variable lease payments, and payments for nonlease components

(c) Ensuring that users can clearly identify those income statement expense items relating to leases (for example, by requiring presentation in the income statement of lease-related expenses)

(d) Requiring presentation of ROU assets and lease liabilities on a net basis, which, in their view, would maintain the current depiction of the economic substance and risk profile of operating leases for regulatory purposes

(e) Requiring presentation of ROU assets and lease liabilities as separate line items on the balance sheet, if significant.

Disclosures

Background

196. The 2013 ED proposed qualitative and quantitative disclosure requirements for lessees and lessors to enable users of financial statements to understand the amount, timing, and uncertainty of cash flows arising from leases.

Support

197. The majority of users that expressed views support the proposals, commenting that they would provide useful information relating to the assumptions made by management, the nature of leases, and changes in lease balance sheet amounts from period to period. These users contend that no single amount can provide a complete picture of an entity's leasing activities. Accordingly, a comprehensive disclosure package is important for their analysis.

198. Most users, as well as some academics and regulators, support the proposals for lessees and lessors to provide reconciliations of the ROU asset (IASB-only), the lease liability, the lease receivable, and the residual asset. In their view, these disclosures would provide valuable information when analyzing the changes that occurred during the period in the related accounts.

199. There is also support for the following proposals:

(a) The requirement to disclose an entity's election to not apply the recognition and measurement requirements to short-term leases.

(b) The lessee (and lessor) maturity analysis of the lease liability (lease receivable) showing the undiscounted cash flows on an annual basis for each of the first five years after the reporting date and a total thereafter. Users commented that this information:

  (i) For lessees would aid their analysis of liquidity risk.

  (ii) For lessors would facilitate their forecast of future cash flows.

(c) The qualitative (narrative) disclosures for both lessees and lessors, which provide information about the nature of leases, and significant assumptions and judgments made when applying the proposed requirements.

200. Many constituents, including many preparers, support the requirements for entities to use judgment when determining the level of detail required to satisfy the disclosure requirements. However, several other constituents commented that this judgment could introduce diversity in practice and could create challenges for auditors and regulators.

Concerns

201. Many constituents disagree with the disclosure proposals in the 2013 ED.

202. Preparers generally think that the proposed disclosure requirements for both lessees and lessors are excessive and complex. Some think that it is counterintuitive that entities would be required to provide additional disclosures compared to existing requirements when those entities would also be required to recognize lease assets and liabilities.

(a) Some preparers think that the proposed disclosure requirements would be costly for preparers to implement, particularly as a result of the need to make substantial investments in more robust IT systems. Some indicated that new system capabilities would be required to meet the disclosure requirements that would otherwise not be required to meet the recognition and measurement requirements.

(b) That the proposed asset and liability reconciliations for both lessees and lessors would be especially onerous and create 'information overload'.

203. In addition, some constituents:

(a) Question the relevance of the reconciliation of Type B ROU assets (IASB-only) because the amortization of those assets is a balancing figure.

(b) Commented that the tabular disclosure of lease income by lessors is difficult to prepare. Moreover, they contend that the disclosure of profit or loss for Type A leases seems inconsistent with other guidance.

(c) Assert that the proposed disclosure requirements will not provide decision-useful information for users who will continue to adjust the balance sheet figures using independent techniques, such as multiples of rent expense.

204. Some preparers and other constituents commented that the proposed disclosure requirements did not seem to reconcile with the goals of the broader Disclosure Framework project.

Alternative suggestions

205. Users provided several suggestions to enhance the proposed disclosure requirements for lessees, including:

(a) A single disclosure of the total lease expense (or cost) and a breakdown of the components of that expense (or cost), including information about expenses recognized that are not reflected on the balance sheet.

(b) Disclosure of the interest on the lease liability if that information is not available on the face of the income statement.

(c) Additional disclosures about remaining lease terms by class of underlying asset.

(d) Tabular disclosure of:

(i) The range of possible cash outflows related to all leases (short- and long-term aggregated by major lease type), taking into account management's expectations for renewal options and variable lease payments.

(ii) Historical minimum cash rent payments over the periods presented.

(iii) Historical variable cash rent payments over the periods presented.

(iv) Average and median lease terms.

(v) Disclosure of an average or weighted average discount rate used (and inflation rate assumptions).

206. Many preparers request that the Boards make an explicit statement to the effect that the disclosures listed should not be regarded as mandatory in all situations and that entities should apply materiality judgments in determining the extent to which disclosures are required.

207. Additional requests relating to disclosures include the following:

(a) Accounting firms and other advisors suggest requiring disclosure (if feasible) in the year before adoption of the overall likely effect on the financial statements from implementing the new standard.

(b) Accounting firms and some users suggest requiring disclosure by lessors of the amount of assets reported on the balance sheet as property, plant, and equipment that are subject to Type B leases. This would enable users to clearly see which of the lessor's fixed assets are currently being used by the lessor within its operations and which are not.

(c) Some other users suggest that the Boards require lessors to disclose future cash flow information and expected maturities of all leases.

Transition

Background

208. The 2013 ED allows entities to apply either a modified retrospective ("modified") or full retrospective ("full") transition approach.

Support

209. Most users support the full transition approach.

210. Some constituents broadly support the transition proposals as written. These constituents note that, although the proposals would be costly and complex, the Boards have provided some reliefs for preparers, which would not compromise the information being provided to users.

Concerns

211. Most constituents think the proposals are costly and complex. Some question the cost-benefit analysis of providing comparative period information, noting that the volume of data needed to include comparative information is significant. Others are concerned with the cost of managing dual systems during comparative periods. However, to the extent the Boards have provided the option to apply either a modified or full transition approach, these constituents appreciate the added flexibility.

212. In contrast, many users do not support giving preparers an option in transition method because this would reduce comparability.

213. Many preparers commented that the 2013 ED is unclear as to whether, under the modified approach, entities would classify leases previously accounted for as operating leases using information as of the commencement date or the beginning of the earliest comparative period.

214. Some are concerned about offering multiple approaches (modified and full) because they think that entities would select the approach that results in a more favorable accounting outcome. These constituents think that the two approaches could result in material differences and it would be better to have a single approach.

215. Some are confused about the unit of account at transition and whether an entity should apply either a modified or full transition approach to its entire lease portfolio or by asset class. Some are also confused about applying hindsight. They question whether an entity should apply hindsight to all leases or individual leases.

216. Some constituents request more guidance for existing finance lease residual assets.

217. Some constituents expressed concerns that transition could be burdensome for first time adopters of IFRS. They suggest that providing first time adopters with the same relief as existing IFRS preparers would mitigate these concerns.

Alternative suggestions

218. Some constituents, mainly preparers, support prospective application of the proposed guidance (that is, applying the proposals only to leases entered into on, or after, the effective date). Other constituents recommend allowing preparers to not apply the proposals in the comparative period to leases that end before the effective date.

219. Many constituents recommend a cumulative adjustment to retained earnings at the effective date rather than restating comparative periods. These constituents note that this would be consistent with the Boards' decision on the forthcoming revenue recognition standard. They think that the adjustment would satisfy the needs of users while providing sufficient relief for preparers.

220. Some constituents suggest allowing a lessor to separate the net investment in a finance lease into its receivable and residual components at transition to achieve greater consistency with Type A leases.

221. Some constituents recommend allowing a lessee to apply to all leases the 'simplified' transition approach proposed for Type B leases.

222. Some accounting firms commented that the proposed modified retrospective approach does not address operating leases that were previously considered onerous. In order to avoid losses being recognized twice, they suggest adjusting the ROU asset by the amount of any previously recognized onerous lease provisions.

223. Many users suggest that the Boards allow only one transition method, either modified or full transition, in order to enhance comparability.

Implementation concerns

224. Most constituents have implementation concerns relating to the 2013 ED. Many constituents said that implementing the proposals would be costly, both at the time of first implementing the proposals and on an on-going basis. Most of these constituents said that the most significant costs would be incurred when first implementing the proposals. For discussion purposes, these implementation concerns have been divided into internal concerns (within the entity) and external concerns (outside of the entity).

Internal concerns

225. The principal internal concerns include:

(a) Updating IT systems. Most constituents do not have a central leasing system for existing operating leases. Under the proposals, many preparers would need to invest in new, centralized systems that would house leasing data and compile financial statement information. Some constituents also note that many systems providers have not yet started to develop new leasing systems and currently there are no systems that can account for Type B leases.

(b) Collecting lease data. One of the most commonly raised concerns by constituents relates to the time and resources that would be required to collect the necessary data to apply the proposals. That is principally because of the volume of leases. Entities regularly have hundreds or thousands of leases—some entities have significantly more.

(c) Educating personnel. Once the appropriate information has been compiled, entities would need to educate staff to appropriately assess leases so that the accounting is accurately and consistently applied.

(d) Design and implement new controls. Management would need to design and implement new controls to ensure their financial statement reporting is appropriate.

(e) Additional personnel. Many constituents said that they would need to hire additional personnel to comply with the 2013 ED. Some think that additional staff would be needed only during the initial implementation, while others think that additional staff would be needed on an on-going basis.

(f) Educating investors. Some constituents are concerned about the costs and effort to educate their investors on the changes. They note that the proposals are a significant change from existing requirements and that some investors do not agree with the changes. These investors may request that management provide supplemental non-GAAP financial information.

External concerns

226. The principal external concerns include:

(a) Regulatory impacts. Banks, principally, have concerns about the impact the proposed accounting would have on regulatory capital requirements and calculations. These constituents note that it would be helpful if the Boards could clarify the nature of the ROU asset, with particular emphases on the similarities between ROU assets and property, plant and equipment. Other types of entities have also expressed concerns about the costs to produce regulatory reporting on a different basis from that proposed in the 2013 ED.

(b) Debt covenants. Many constituents note that the addition of significant lease liabilities to their balance sheet would impact debt covenants. Some think this could result in default. Others are concerned that, at a minimum, they would be forced to renegotiate the terms of their contracts with banks and that this would result in bank and legal fees. These constituents stress the need for the Boards to perform significant outreach and educational efforts with the banking industry before issuing new guidance.

(c) Tax implications. The tax rules in some jurisdictions presently align with existing lease accounting. Constituents in these jurisdictions are concerned that a change in U.S. GAAP/IFRS will require them to maintain two sets of records (one for financial reporting and one for tax purposes) unless the tax rules are amended in a similar way.

(d) Bankruptcy implications. Similar to the tax rules, existing bankruptcy regulations in some jurisdictions are aligned with existing lease accounting. Constituents in these jurisdictions are concerned about the disconnect between financial reporting and bankruptcy regulations that would result from changes in lease accounting.

(e) Professional services fees. Some constituents are concerned about increased costs for auditors and consultants when first implementing the proposals, while others are similarly concerned about on-going, incremental professional services costs resulting from a change in lease accounting (for

example, increased audit fees, increased tax services fees to deal with book-tax reporting differences).

Effective date

227. Many constituents provided comments on the effective date for a final leases standard. The most prevalent of these comments are:

    (a) The need for significant lead time between publication of the final standard and the effective date, with a number of these constituents suggesting an effective date of 3-5 years after publication of a final standard.

    (b) That the earliest comparative period would present the greatest challenge for preparers in terms of collecting and processing the necessary data.

Cost-benefit

Background

228. The 2013 ED included Cost-Benefit Considerations (FASB) and an Effects Analysis (IASB), which discuss whether the benefits of providing better financial information justify the related costs. This section addresses comments on the Boards' respective cost-benefit analyses.

Concerns

229. Most constituents think that the 2013 ED lacked sufficient evidence of a thorough cost-benefit analysis.

230. Some are concerned about the FASB's acknowledgement in paragraph BC323 of the 2013 ED that "the Board's assessment of the costs and benefits likely to result from issuing new requirements is unavoidably more qualitative than quantitative," and that "objective measurement of neither the costs to implement new requirements nor quantification of the value of improved information in financial statements is possible." Although these constituents agree it would be difficult to obtain objective quantitative data, they think it is necessary that the Boards demonstrate a more

thorough understanding of the potential costs of implementation and on-going application of any final standard.

231. Some are concerned that the IASB's Effect Analysis does not describe in sufficient detail the costs that the Board considered when making its cost benefit assessment.

232. Others said that the scope of the Cost-Benefit Considerations and Effects Analysis was not properly defined. These constituents think that the information provided in such assessments is not useful if readers do not understand what the Boards considered in reaching their conclusions.

233. Other constituents think that, although the benefits to financial reporting and the implementation costs were considered, there are other important outcomes that should be taken into consideration, including:

(a) Expected changes in the structure of leases.

(b) The potential for increased borrowing costs for some lessees and decreased costs for others.

(c) The potential increase in the amount of risk-weighted assets and thus the impact on regulatory capital ratios and requirements.

(d) The impact on debt covenants.

Suggestions

234. Many constituents think that the Boards and the staff should perform additional fieldwork testing before issuing a final leases standard.

235. Some constituents recommend that the Boards engage in further user outreach to help understand the specific benefit of the proposed changes.

236. Some constituents recommend that the Boards should have an understanding of the other potential outcomes (such as impacts on regulatory reporting and potential structuring) that may arise if the proposals are finalized.

237. Some constituents think it would be helpful if the Boards describe how the Cost-Benefit and Effects Analysis have been conducted. Recommended clarifications include:

(a) A description of the factors that have been taken into account (for example, are ‘other outcomes’ considered?)

(b) An explanation of how data was gathered

(c) Numerical estimates of effects.

Behavioral Changes

Background

238. Many constituents are concerned that entities may change their leasing behavior if the Boards issue a final standard along the lines of the proposals in the 2013 ED. These constituents think that the requirement for lessees to recognize ROU assets and lease liabilities, as well as the proposed changes to the income statement and cash flow statement for some leases, may encourage entities to make decisions on the basis of achieving a particular accounting outcome.

Concerns

239. The main concerns raised about possible behavioral changes, principally by lessors, include the following:

(a) Lessees would shorten lease terms or structure lease payments to vary on the basis of future use or sales, in order to do any of the following:

(i) Avoid balance sheet recognition (for example, to meet the short-term lease exception)

(ii) Reduce the amount of ROU assets and lease liabilities recognized

(iii) Achieve a desired lease classification.

Some lessors note that they prefer to “lock in” longer lease terms. They expressed concerns that shorter lease terms would increase business risk and the availability of financing.

(b) Entities would add asset substitution clauses to their contracts in an attempt to avoid meeting the definition of a lease.

(c) Lessees would require lessors to provide separately the prices for both the lease and the nonlease components in a contract. That would require additional effort by the lessor and potentially result in disclosing competitive information. Some lessors said that a lessee also could reduce the amount of ROU assets and lease liabilities recognized by allocating a disproportionate amount of the contract consideration to nonlease components of a contract. They note that lessors are incentivized to develop ways to reduce customers' (lessees') obligations to retain business.

(d) Many lessors expressed concerns that lessees would purchase rather than lease assets, especially lessees of high-credit quality.

240. Although there are concerns about behavioral changes, most preparers that participated in outreach meetings indicated that for their property or "large-ticket" equipment leases they would not expect to either discontinue leasing or change contractual terms and conditions as a consequence of the proposed changes to lease accounting. They note that contractual terms and conditions are designed to meet business needs and not achieve a particular accounting outcome. These constituents added that shortening lease terms, or changing fixed to variable lease payments, would increase the risk not only for the lessor, but also for the lessee. Even if a lessor is willing to take on additional risk, the lessor would be expected to charge the lessee for that risk. Consequently, these preparers indicated that it would not make economic sense in many cases to change contractual terms and conditions.

241. Some preparers, however, indicated that the proposals might incentivize them to alter their leasing behavior with respect to 'small-ticket' items, which they might choose to purchase rather than lease. However, most of these preparers also acknowledge that the effort to record and track purchased fixed assets is not substantially different from the expected effort to record and track leases under the proposals.

242. Furthermore, many property lessees note that they often lease property because they cannot, or have no desire to, purchase the property. That can be the case for any of the following reasons:

(a) The property is not available for purchase (for example, a retail space in a shopping mall)

(b) There are regulatory restrictions on purchase

(c) There is a lack of funding

(d) There is a desire to not have residual asset risk

243. These lessees often design a lease to guarantee the availability and use of a desirable location for a longer period and make significant investments in the property. Accordingly, for these lessees shortened lease terms would not align with their business models.

Other Issues

Subleases

Background

244. The 2013 ED proposed that an entity would account for a head lease and a sublease as two separate contracts, accounting for the head lease in accordance with the lessee accounting proposals and the sublease in accordance with the lessor accounting proposals.

245. Only a few constituents provided feedback on the proposals on subleases.

Concerns

246. Those constituents who provided feedback, mainly some preparers and accounting firms, expressed the following concerns:

(a) In their view, the proposals could lead to asymmetry between how an intermediate lessor accounts for a head lease and a sublease relating to the same underlying asset.

(b) The 2013 ED does not clearly state how to account for intercompany sublease transactions.

Alternative suggestions

247. Many of the constituents who provided feedback request that the Boards provide additional guidance about subleases within the body of the standard (rather than in the Basis for Conclusions), specifically about classification and presentation. Some also suggest that subleases should be the subject of illustrative examples.

248. Some suggest linking the presentation of amounts recognized for subleases and head leases in the income statement.

Unit of account

249. Some constituents commented on the unit of account of the 2013 ED, suggesting that the Boards allow an entity to apply the proposals to a portfolio of contracts, similarly to the practical expedient in the Exposure Draft on revenue recognition.

250. These constituents think that applying the proposals at a portfolio level:

(a) Would significantly decrease the cost involved in accounting for large volumes of similar, individually immaterial leases, particularly those attached to master lease arrangements.

(b) Would significantly decrease the costs involved in applying particular aspects of the proposals, including:

(i) Determining the discount rate

(ii) Separating lease and nonlease components

(iii) Reassessment

(c) Would allow lessors to apply the lease proposals to their contracts in the same way as the revenue recognition proposals.

Business combinations

251. Some constituents have concerns about the consequential amendments to IFRS 3 *Business Combinations*, and Topic 805, *Business Combinations*. These concerns include the following:

(a) Some disagree with the proposal that an acquirer would be prohibited from recognizing assets and liabilities for leases with a remaining term of less than 12 months, noting that this is inconsistent with the short-term lease proposals in the 2013 ED and the recognition principle in IFRS 3 and Topic 805. These constituents made various suggestions, including the following:

    (i) Changing the guidance to be consistent with the definition of short-term leases.

    (ii) Providing an option, rather than a requirement, for an acquirer to not recognize assets and liabilities relating to short-term leases.

    (iii) Requiring an acquirer to recognize all assets and liabilities arising from leases held by an acquiree, regardless of lease term.

(b) Some constituents, particularly U.S. preparers, disagree with the proposal that, when the acquiree is a lessor of a Type B lease, the acquirer would recognize the fair value of the underlying asset taking into account any favorable or unfavorable lease terms. These constituents would prefer to recognize separately an intangible asset or liability for favorable or unfavorable lease terms.

(c) Some constituents are concerned about the initial measurement of acquired residual assets in particular situations (for example, when the lessor reflects an expectation of variable lease payments in the rate it charges the lessee or when the fair value of the underlying asset is less than the lease receivable).

(d) Some constituents request further guidance on the subsequent measurement of lease assets and liabilities initially measured at fair value in a business combination.

Interaction with other projects

Revenue Recognition

252. Some constituents suggest that the Boards should stagger the effective dates for the final leases standard and the final revenue recognition standard. These constituents

said that the costs and time necessary to implement each of those standards would be significant and that simultaneously implementing both standards may not be possible or may require the incurrence of significant additional costs.

253. A number of constituents suggest that the approach to accounting for variable lease payments should be consistent with the approach for variable consideration in the forthcoming revenue recognition standard.

IASB Conceptual Framework

254. Some constituents suggest that the Boards postpone the leases project until the IASB finalizes its updated Conceptual Framework. Some constituents expressed concerns about the introduction of a new type of asset (that is, the ROU asset) before the definition of an asset is updated. Other constituents do not think that obligations under lease agreements meet the revised definition of a liability as proposed in the IASB's recent Discussion Paper.

FASB Disclosure Framework

255. A few constituents request that the Boards reconcile the increased disclosure requirements in the 2013 ED with FASB's proposed Disclosure Framework.

FASB-only: Nonpublic entities

Background

256. To strive for a reasonable balance between the costs and benefits of information, the FASB decided to provide the following specified reliefs for NPEs:

    (a) To permit NPEs to make an accounting policy election to use a risk-free discount rate to measure the lease liability. If an entity elects to use a risk-free discount rate, that fact should be disclosed.

    (b) To exempt NPEs from the requirement to provide a reconciliation of the opening and closing balance of the lease liability.

257. Only some constituents provided feedback on the proposals related to NPEs in the 2013 ED.

258. Overall, comments from NPEs were not significantly different from those offered by public entities.

Support

Use of a risk-free discount rate

259. Some NPEs and accounting and advisory firms expressed support for the FASB's decision to permit NPEs to use a risk-free discount rate to measure the lease liability. These constituents commented that this exception would help to reduce the costs of implementing the proposed standard and provide flexibility to smaller companies who have limited resources.

Lease liability reconciliation exception

260. The majority of constituents that provided feedback on the NPE accounting proposals support the FASB's decision to exempt NPEs from the requirement to provide a reconciliation of the opening and closing balance of the lease liability.

261. Most of these constituents commented that the users of NPEs' financial statements generally have greater ability to directly access management and to obtain additional information beyond what is included in the financial statements, so the costs of preparing this disclosure outweigh the benefits.

Concerns

Use of a risk-free discount rate

262. The majority of constituents that provided feedback on the NPE accounting proposals, primarily preparers and accountancy bodies, expressed concerns that although use of a risk-free rate would provide some cost relief, it could lead to misstated lease liabilities that do not mirror the economic reality of the lease because it would overstate the lease liabilities as compared to using an incremental borrowing rate.

263. In addition, some constituents note that NPEs may have a higher incremental borrowing rate than an investment grade public entity, which further calls into question use of a risk-free rate.

264. In addition, some users and preparers raised concerns that the financial information used to evaluate entities is the same whether the entity is public or private. Therefore,

any reliefs are problematic as they decrease the consistency and comparability of financial reports.

265. A few public entities highlight that some NPEs are their competitors and this exemption would provide their competitors with an unfair advantage because it would be less costly for NPEs to implement the leases proposals.

Lease liability reconciliation exception

266. Some of the constituents that provided feedback on the NPE accounting proposals expressed concerns that the incremental benefit of exempting NPEs from the requirement to provide a lease liability reconciliation was unsubstantial. As such, these constituents contend that the exemption unjustifiably reduces the comparability of financial information.

Other comments

267. Some constituents, mainly preparers and accounting firms, expressed concerns that the leases proposal would add significant costs to NPEs, including the costs of new accounting systems, information gathering, additional books and records to track book/tax differences, and costs associated with the likely violation of debt covenants. However, other constituents, also including preparers and accounting firms, expressed a desire to keep guidance the same for public and NPEs for the sake of comparable financial information.

Alternative suggestions

268. Some constituents, mainly preparers, suggest that the FASB consider replacing the permissibility of an NPE to use a risk-free discount rate to measure the lease liability with an alternative to estimate its incremental borrowing rate if its actual incremental borrowing rate is unknown, or to use the rate on their most recent line of credit or term loan agreement. These constituents think that this would provide better estimates of the lease liability and would still provide cost relief.

269. Some preparers suggest that the Boards consider requiring NPEs to provide qualitative disclosures about lease liabilities in place of the proposed lease liability reconciliation.

270. Some constituents commented that they would appreciate an analysis/review by the Private Company Council related to leases. They think that this is important due diligence that should be completed prior to making any decisions about NPEs.

271. Some constituents suggest that the FASB provide private companies the option of deferring the effective date for one or two years after the effective date for public companies. These constituents think it is appropriate to allow private companies more time to put in place the necessary systems and processes to apply the guidance and also capitalize on the experience of public companies.

FASB-only: Related party leases

Background

272. In the 2013 ED, the FASB proposed that the recognition and measurement requirements for all leases should be applied by lessees and lessors that are related parties based on the legally enforceable terms and conditions of the lease, acknowledging that some related party transactions are not documented and/or the terms and conditions are not at "arm's length". This is different from current U.S. GAAP guidance, which requires entities to account for leases with related parties on the basis of their economic substance.

273. In addition, the 2013 ED requires lessees and lessors to apply the disclosure requirements for related party transactions found in Topic 850, *Related Party Disclosures.*

274. Most constituents did not comment on the proposed guidance for related party leases.

Support

275. Of those constituents that commented on the related party lease proposals, most agree that it was not necessary to provide different recognition and measurement requirements for related party leases. These constituents note that it would be more costly and time consuming to evaluate related party leases using different requirements than for unrelated party leases. These constituents emphasize that existing guidance is difficult to apply. Some of these constituents elaborated by noting that there are so many potential subjective judgments on lease term, discount

rate, etc. when evaluating the economic substance of the transaction that the resulting information may not be more decision-useful than the amounts reported based on the legally enforceable terms and conditions.

276. Almost all constituents that provided feedback on related party leases, including both supportive and concerned constituents, agree that no additional disclosures were necessary beyond what Topic 850 requires.

Concerns

277. Some constituents disagree with the related party proposals, noting that the reported information will be less useful to users of financial statements. Some constituents further note the misalignment of the related party proposals with the Conceptual Framework, indicating that financial reporting is supposed to reflect the economic substance of transactions into which an entity enters.

278. A few constituents expressed concern about the possibility of structuring opportunities to achieve off-balance sheet treatment. For instance, it would be possible under the proposals for an entity to exclusively enter into a series of short-term leases with a related party, which it might be unable to do with an unrelated party.

279. In our outreach activities the Board and the staff heard some concerns that the proposals will complicate intercompany and intra-entity reporting when recording related party leases for an entity’s standalone financial statements (as opposed to the consolidated statements) as currently, those arrangements are not separately accounted for.

Alternative suggestions

280. A few constituents suggest that the FASB provide an accounting policy election not to apply the proposed recognition and measurement requirements to related party leases. These constituents suggest that the FASB retain current operating lease accounting for related party leases and require the disclosures in Topic 850.

FASB-only: Leveraged leases

Background

281. In the 2013 ED, the FASB proposed to eliminate the existing U.S. GAAP guidance on leveraged leases. For leases currently accounted for as leveraged leases, the lessor would apply the proposed lessor guidance as of the commencement date (that is, a retrospective application).

282. Most constituents did not comment on the FASB's proposed elimination of leveraged lease accounting. Those constituents who commented on the proposal largely did so because they disagree with the FASB decision to eliminate the existing guidance on leveraged lease accounting.

Support

283. No constituents specifically expressed support for the FASB decision to eliminate the current U.S. GAAP leverage lease guidance. However, during outreach activities, certain constituents explained that leveraged lease accounting has become more infrequent and, of those constituents that participated in field visits and had leveraged leases, those leases were generally old and nearing completion.

Concerns

284. Almost all constituents who commented on the proposals with respect to leveraged lease accounting think the characteristics of leveraged leases are fundamentally different from the characteristics of other leasing arrangements. They note that the proposed guidance for lessors in the 2013 ED disregards the tax attributes embedded in leveraged lease transactions.

285. These constituents also expressed concern about the challenge of retrospectively applying the lessor proposals to leveraged leases. They think that this exercise will be extremely costly with little benefit to users.

Alternative suggestions

286. Many constituents recommend that the FASB should retain leveraged lease accounting because the economics of these transactions are based on tax benefits, and

they think leverage and income are best reflected by this model on the basis of how an entity views its investments.

287. Almost all of the constituents who provided feedback on this topic request grandfathering of existing leveraged leases.

FASB-only: Other consequential amendments

Removal of existing guidance

288. A few constituents commented on the proposed removal of the concept of integral equipment from the FASB Accounting Standards Codification. These constituents suggest treating integral equipment as property for purposes of determining the lease classification. They think such classification matches economic reality with accounting presentation.

289. A few constituents commented on the removal of existing guidance on build-to-suit leases. These constituents request that the FASB retain this guidance, as they are unsure of whether a lessee should capitalize costs incurred during the construction of an asset that will be leased upon completion.

Amendments to existing guidance

290. A few constituents commented on the proposed consequential amendments to other areas outside of Accounting Standards Codification (ASC) 840 on leases.

291. The majority of these comments relate to the consequential amendments to ASC 980-840 on accounting for leases for entities with regulated operations. The 2013 ED proposes to supersede this guidance, which commenting constituents think will have a significant impact on regulated entities. The elimination of this guidance results in front-loaded amortization and interest expense, as opposed to an expense equal to the amount permitted for rate-making purposes, which is not indicative of the economic effects of the rate-making process.

292. One constituent expressed concern about certain of the consequential amendments to the guidance on variable interest entities, indicating that the FASB should retain much of the language proposed for deletion and should instead, more narrowly, delete

specific wording that is not proposed to be retained subsequent to issuing a final leases standard (for example, “direct financing lease”).

IASB-only: Consequential amendments to IAS 40

293. A majority of constituents agree with the proposal to amend IAS 40 *Investment Property* to include ROU assets within the scope of IAS 40 if they meet the definition of investment property. These respondents stated that:

(a) Including ROU assets within the scope of IAS 40 would provide users with more relevant and useful information about those assets.

(b) Including ROU assets within the scope of IAS 40 is appropriate because leases can give rise to assets that meet the definition of investment property. Accordingly, excluding those assets from the scope of IAS 40 would be inconsistent with the IASB’s definition of investment property and the right of use lessee accounting model.

294. Some constituents, however, disagree with the proposal to include ROU assets within the scope of IAS 40 for the following reasons:

(a) It would be costly and difficult to measure ROU assets at fair value for recognition or disclosure purposes, especially for ‘accidental lessors’ (that is, entities that are not in the business of leasing properties and sublease only a few of their properties) because:

(i) There is no methodology established for measuring ROU assets at fair value, and there is often no active market for these assets

(ii) There are a number of different factors that could make measurement at fair value difficult including options, variable lease payments, discount rates, land and building elements and the existence of the lease liability

(b) ROU assets are different from other investment properties because:

(i) The lessor does not own the underlying property and often is unable to sell it

(ii) There is an attached liability that in many cases must accompany the asset if it is transferred

(iii) The ROU asset is an intangible asset

295. Constituents made various suggestions to amend the 2013 ED's proposals in this area, including:

(a) Retaining the existing option in IAS 40 for operating lease assets but applying that option to Type B ROU assets.

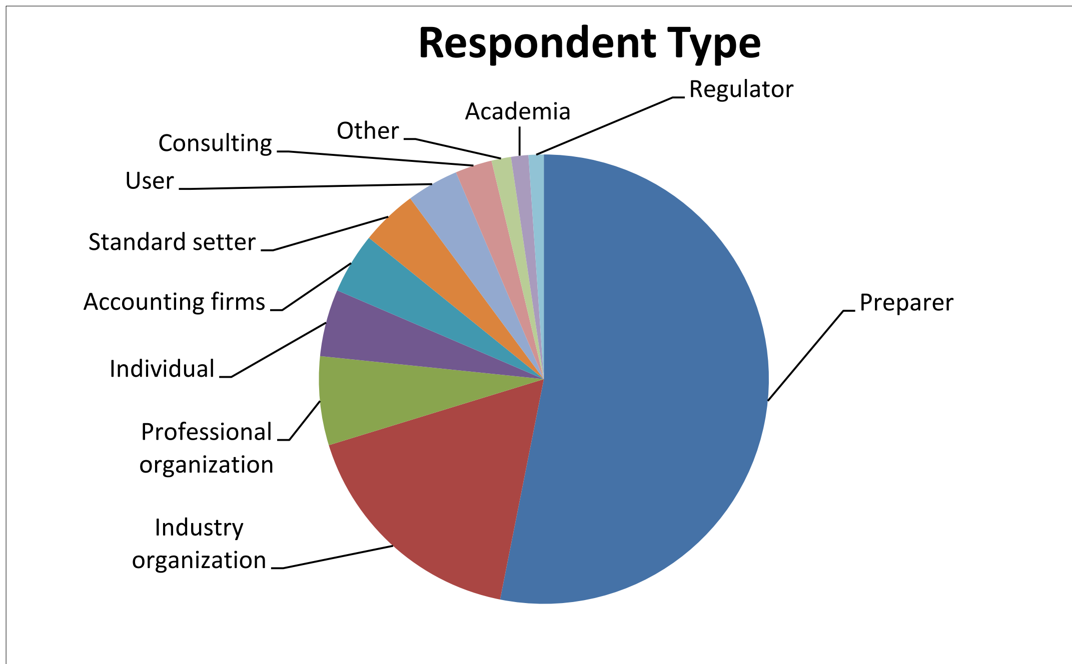
(b) Waiving the requirement to disclose the fair value of ROU assets when the lessor has elected the cost measurement option for investment property.

296. A few constituents made suggestions regarding the interaction between Type A leases and IAS 40. These constituents recommend that IAS 40 would apply to property that meets the definition of investment property, even if that property were subject to a Type A lease. That could be done by either including a scope exclusion within the final leases standard for lessors that measure investment property at fair value, or requiring that a lessor's residual asset in a Type A lease be included within the scope of IAS 40.

Appendix – Comment letters demographic information

A1. The following is a summary of 638 comment letters received as of November 7, 2013.

A2. This pie chart illustrates the comment letters by respondent type:



A3. This pie chart illustrates the comment letters by geographic region: