

STAFF PAPER

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Accounting Standards Advisory Forum

Project	Leases
Paper topic	Leases 2013 Exposure Draft—feedback on the main proposals
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Introduction and objective of the meeting

1. In May 2013, the IASB and the FASB published for public comment an Exposure Draft on Leases—the comment period ends on 13 September 2013.
2. The IASB anticipates that it will receive comment letters from the ASAF members. Nonetheless, at this meeting, the IASB would like to listen to your views to develop further our understanding of the issues you raise or alternatives you propose in your comment letters.
3. This paper includes a high-level summary of the main proposals in the Exposure Draft and asks questions about those proposals.

Topic 1: Lessee and lessor accounting models

4. The Exposure Draft proposes that all entities would recognise assets and liabilities arising from a lease.
5. The boards have proposed a dual accounting model for both lessee and lessor accounting in which the accounting will depend on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset. For practical purposes, this assessment would often depend on the nature of the underlying asset.

Lessee accounting model

6. The boards have concluded that a lease creates assets and liabilities for a lessee and, therefore, should be recognised on a lessee's balance sheet. According to the

proposals, a lessee would recognise assets and liabilities for all leases of more than 12 months. A lessee would recognise a lease liability and a right-of-use asset representing its right to use the leased asset (the underlying asset) for the lease term.

7. The 2010 Leases Exposure Draft proposed a single lessee accounting model, in which a lessee would recognise interest on the lease liability separately from amortisation of the right-of-use asset for all leases. In response to concerns raised by respondents to the 2010 Exposure Draft and to better reflect the differing economics of different leases, the 2013 Exposure Draft proposes a dual approach to the recognition of expenses and cash flows.
8. For most leases of assets other than real estate (for example, equipment, aircraft, cars, trucks), a lessee would classify the lease as a Type A lease and would:
 - (a) recognise a right-of-use asset and a lease liability, initially measured at the present value of lease payments; and
 - (b) recognise interest on the lease liability separately from amortisation of the right-of-use asset.
9. For most leases of real estate (ie land and/or a building or part of a building), a lessee would classify the lease as a Type B lease and would:
 - (a) recognise a right-of-use asset and a lease liability, initially measured at the present value of lease payments; and
 - (b) recognise a single lease cost, combining interest on the lease liability with amortisation of the right-of-use asset, on a straight-line basis. [The interest and amortisation components of that cost would be disclosed in the notes.]

Lessor accounting model

10. For most leases of assets other than real estate, a lessor would classify the lease as a Type A lease and would:
 - (a) derecognise the underlying asset and recognise a lease receivable and a residual asset (representing the rights the lessor retains relating to the underlying asset);

- (b) recognise interest income on both the lease receivable and the residual asset over the lease term; and
 - (c) recognise any profit relating to the lease at the commencement date.
11. For most leases of real estate, a lessor would classify the lease as a Type B lease and would apply an approach similar to existing operating lease accounting in which the lessor would:
- (a) continue to recognise the underlying asset; and
 - (b) recognise lease income over the lease term, typically on a straight-line basis.

Questions regarding lessee and lessor accounting models

- 1 The proposed dual approach adds complexity to the accounting model by requiring entities to classify their leases and possibly account for those leases in two different ways. Do you think that some leases are economically different from other leases? If so, do you believe that a dual lessee and lessor accounting approach results in benefits in improved financial reporting that outweigh the additional costs of having a dual approach? Why or why not?
- 2 If you agree that a dual accounting approach is appropriate, do you agree with the lessee accounting proposals, in which most real estate (property) leases would be reported differently from most other leases in a lessee's income statement and cash flow statement? If not, what would you suggest and why?
- 3 The boards are of the view that the lessor accounting proposals will provide a more faithful depiction of how different types of leases are priced by lessors and, thus, provide better information about a lessor's leasing activities to users of financial statements. Do you agree with the lessor accounting proposals? If not, what would you propose and why?
- 4 Do you have any suggestions for changes the boards can make to the proposals regarding the lessee and lessor accounting models that would help to simplify the proposals without significantly impacting the usefulness of the information for investors and analysts?

Topic 2: Measurement

12. A lessee and a lessor would measure assets and liabilities arising from a lease by including:
 - (a) lease payments relating to the non-cancellable period of the lease, and
 - (b) lease payments in optional periods only if the lessee has a significant economic incentive to exercise an option to extend the lease, or not to exercise an option to terminate the lease.
13. The boards have indicated that they view the ‘significant economic incentive’ threshold for including lease payments to be a somewhat similar threshold to ‘reasonably certain’ in IAS 17 *Leases* or ‘reasonably assured’ in Topic 840, *Leases*, of the FASB *Accounting Standards Codification*[®]. The boards think that assessing whether a lessee has a significant economic incentive to exercise an option is objective because the lessee is required to have an *economic* incentive—the assessment is not based solely on, for example, management intent or past practice. The 2013 Exposure Draft includes more guidance than IAS 17 or Topic 840 about the factors to consider when determining the lease term.
14. Lease payments included in the measurement of lease assets and liabilities include fixed lease payments and variable lease payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), but exclude other variable lease payments unless those payments are in-substance fixed payments. The lessee and lessor would measure variable lease payments that depend on an index or a rate using the index or rate as at the commencement date.
15. A lessee and a lessor would also discount the lease payments included in the measurement of the assets and liabilities arising from a lease using the rate the lessor charges the lessee. However, if a lessee cannot readily determine the rate the lessor charges the lessee, the lessee would use its incremental borrowing rate.
16. A lessee and a lessor would reassess the measurement of lease assets and liabilities if there is a change in:
 - (a) relevant factors that would result in a change in the lease term; or
 - (b) the index or rate used to determine lease payments.

17. A lessee and a lessor would also reassess the discount rate if there was a change in a reference interest rate and variable lease payments are determined using that rate.

Questions regarding measurement

- 5 Do you agree with the boards' proposals regarding the determination of the lease term? If not, what would you suggest and why? Should the lease term be reassessed after lease commencement?
- 6 Do you agree with the boards' proposals regarding the measurement of variable lease payments, including reassessment if there is a change in the index or rate used to determine lease payments? If not, what would you suggest and why?
- 7 Do you agree with the boards' proposals regarding the discount rate used to measure the assets and liabilities arising from a lease? Why or why not? Should the discount rate be reassessed after lease commencement?
- 8 Do you have any suggestions for changes the boards can make to the proposals regarding measurement that would help to simplify the proposals without significantly impacting the usefulness of the information for investors and analysts?

Topic 3: Scope

18. A lease is defined 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) fulfilment of the contract depends on the use of an identified asset; and
 - (b) the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration
19. A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.
20. The guidance in the Exposure Draft relates only to the accounting for lease components of a contract. If a contract that contains a lease also contains non-lease components, an entity is required to separate the lease components from non-lease components unless a lessee is unable to obtain standalone observable prices for components of the contract

Questions regarding scope

- 9 Do you agree with the proposals regarding the definition of a lease? If not, what would you suggest? Do you think any additional guidance is needed and, if so, what should that be?
- 10 Do you agree with the proposals regarding the separation of lease and non-lease components? If not, what would you suggest?
- 11 Do you have any suggestions for changes the boards can make to the proposals regarding scope that would help to simplify the proposals without significantly impacting the usefulness of the information for investors and analysts?

Topic 4: Other aspects of the proposals

21. The Exposure Draft contains various other proposals, including proposals regarding transition and disclosure.

Questions regarding other aspects of the proposals

- 12 Do you have any specific concerns about the other proposals in the Exposure Draft, and in particular the proposals regarding transition and disclosure?
- 13 Do you have any suggestions for changes the boards can make to the proposals regarding any other aspects that would help to simplify the proposals without significantly impacting the usefulness of the information for investors and analysts?