# STAFF PAPER

January 2014

**FASB | IASB Meeting**

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| **Project** | **Leases** | | |
| Paper topic | Cover Memo | | |
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## Introduction and objective of the meeting

1. The purpose of this paper is to provide an overview of the agenda papers prepared for the January 2014 joint Board meeting relating to the leases project.
2. The objective of the January meeting is to have an in-depth discussion of:
   (a) The possible ways forward for lessor accounting; and
   (b) The possible ways forward for lessee accounting, taking into account any possible ways of providing cost relief for small ticket leases.
3. The staff are not asking the Boards to reach decisions on the lessee and lessor accounting models at this meeting. Instead, the staff will ask whether the Boards have any questions on the possible approaches discussed in the agenda papers and whether there are other approaches that the staff should explore.
4. The Boards will be asked to reach decisions at future Board meetings.

### Overview of agenda papers

5. The staff has prepared the following papers for discussion:

   (a) **Lessor Accounting Model** (Agenda Paper 3A/FASB Memo 262), which discusses the following three approaches with respect to classifying leases as either Type A or Type B within the dual lessor accounting model:

      (i) *Approach 1* – An approach that would determine lessor lease classification (Type A vs. Type B) based on whether the lease is effectively a financing or a sale, rather than an operating lease (that is, the concept underlying existing U.S. GAAP and IFRS lessor accounting). That determination would be made based on whether the lease transfers substantially all the risks and rewards incidental to ownership of the underlying asset.

      (ii) *Approach 2* – This approach would also determine lessor lease classification (Type A vs. Type B) based on whether the lease is effectively a financing or a sale, rather than an operating lease. However, this approach would require that for any lease that gives rise to selling profit (or loss) – generally those of manufacturer and dealer lessors, the lessor would classify the lease as a Type A lease only if it transfers control of the underlying asset to the lessee (that is, meets the requirements for a sale in the forthcoming revenue recognition standard). Leases that do not give rise to selling profit (or loss) – generally those of financial lessors, would be classified in the same manner as all leases under Approach 1.

      (iii) *Approach 3* – An approach that would determine lessor lease classification (Type A vs. Type B) based on the lessor's business model.

   (b) **Lessor Type A Accounting** (Agenda Paper 3B/FASB Memo 263), which discusses the following two approaches for accounting for Type A leases by lessors:

      (i) *Approach A* – To retain the receivable and residual approach proposed in the 2013 ED for all Type A leases.

(ii) *Approach B* – To eliminate the receivable and residual approach proposed in the 2013 ED and instead apply existing IFRS finance lease accounting (which is also existing U.S. GAAP sales-type lease accounting) to all Type A leases, subject to potential minor drafting improvements.

(c) **Lessee Small-Ticket Leases** (Agenda Paper 3C/FASB Memo 264), which discusses the following alternatives to provide relief in applying the leases guidance to small-ticket leases held by a lessee:

(i) Providing explicit materiality requirements within the leases guidance.

(ii) Expanding the recognition and measurement exemption for short-term leases.

(iii) Permitting the leases guidance to be applied at a portfolio level.

(iv) Providing an explicit scope exclusion for small-ticket leases or leases of noncore assets.

(d) **Lessee Accounting Model** (Agenda Paper 3D/FASB Memo 265), which discusses the following three approaches for the lessee accounting model:

(i) *Approach 1* – Proposes a single approach, according to which a lessee would account for all leases as the purchase of a ROU asset on a financed basis. Accordingly, a lessee would account for all leases as Type A leases (that is, recognizing amortization of the ROU asset separately from interest on the lease liability).

(ii) *Approach 2* – Retains a dual-approach, with lease classification similar to that proposed in the 2013 ED, but offers targeted simplifications and improvements to the lease classification test. A lessee would account for all leases of assets other than property as Type A leases and most property leases as Type B leases (that is, recognizing a single lease expense).

(iii) *Approach 3* – Proposes a dual approach, with the lease classification principle consistent with existing U.S. GAAP

(ASC Topic 840, *Leases* – formerly Statement of Financial Accounting Standard No.13, *Accounting for Leases*) and IFRS (IAS 17 *Leases*). A lessee would account for the vast majority of existing capital (U.S. GAAP)/finance (IFRS) leases as Type A leases, and the vast majority of existing operating leases as Type B leases.

(e) **Examples—Lessee and Lessor Accounting Models** (Agenda Paper 3E/FASB Memo 266), which illustrates the application of the possible approaches regarding lease classification for both lessees and lessors.

6. The staff have included the lessee small-ticket leases paper in this package of papers for discussion. This is because we think that consideration of possible ways to provide cost relief for small-ticket leases could be relevant when considering the possible ways forward for lessee accounting. Accordingly, it may be beneficial to read Agenda Paper 3C/FASB Memo 264 before reading Agenda Paper 3D/FASB Memo 265.

7. The staff have included papers on both the lessee and the lessor accounting models for discussion at this meeting. This is because we think it may be beneficial for the Boards to consider the overall accounting model (from both the lessee's and lessor's perspective) when separately considering the possible ways forward for lessee and lessor accounting.