STAFF PAPER

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Project	**Leases**		
Paper topic	Lessee Balance Sheet Presentation		
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Introduction

1. The objective of this paper is to discuss presentation of the lessee's right-of-use (ROU) asset and the liability to make lease payments (lease liability) in a lessee's balance sheet for Type A leases and Type B leases (FASB-only) in light of the recent decisions made about the lessee accounting model during redeliberations.

2. During the March 2014 joint Board meeting the Boards decided to eliminate the lessor receivable and residual approach proposed in the May 2013 ED. Instead, a lessor would be required to apply an approach substantially equivalent to existing IFRS finance lease accounting, including guidance on a lessor's presentation of Type A lease assets. Consequently, this paper does not discuss a lessor's balance sheet presentation.

3. This paper is structured as follows:

    (a) Summary of Staff Recommendations

    (b) Background

    (c) Relevant Decisions Reached in Redeliberations

(d) Presentation of the Type A ROU Asset

(e) Presentation of the Type B ROU Asset (FASB-only)

(f) Presentation of the Lease Liability

(g) Appendix A–Proposed Lessee Balance Sheet Presentation Guidance

4. The staff analysis and the staff recommendations are included within the ROU asset and the lease liability sections.

Summary of Staff Recommendations

5. Consistent with the 2013 ED, the staff recommend that the Boards confirm that a lessee should either present as a separate line item on the balance sheet or disclose in the notes Type A ROU assets. If a lessee does not present Type A ROU assets as a separate line item on the balance sheet, a lessee should (a) present Type A ROU assets within the same line item as the corresponding underlying assets would be presented if they were owned and (b) disclose in the notes which line items in the balance sheet include Type A ROU assets.

   (a) FASB-only: The staff recommend that the FASB confirms that a lessee should either present as a separate line item on the balance sheet or disclose in the notes Type A ROU assets separate from Type B ROU assets. If a lessee does not present Type A ROU assets and Type B ROU assets as a separate line item on the balance sheet (separate from each other), a lessee should disclose in the notes which line items in the balance sheet include Type A and Type B ROU assets. The staff do not recommend specifying how a lessee should present Type B ROU assets on the balance sheet.

6. Consistent with the 2013 ED, the staff recommend that a lessee should either present as a separate line item on the balance sheet or disclose in the notes Type A lease liabilities. If a lessee does not present Type A lease liabilities as a separate line item on the balance sheet, a lessee should disclose in the notes which line items in the balance sheet include Type A lease liabilities. The staff do not recommend specifying how a lessee should present lease liabilities on the balance sheet.

(a) FASB-only: The staff recommend that the FASB confirms that a lessee should either present as a separate line item on the balance sheet or disclose in the notes Type A lease liabilities separate from Type B lease liabilities. If a lessee does not present Type A lease liabilities and Type B lease liabilities as a separate line on the balance sheet (separate from each other), a lessee should disclose in the notes which line items in the balance sheet include Type A and Type B lease liabilities. The staff do not recommend specifying how a lessee should present lease liabilities on the balance sheet.

Background

7. The 2013 ED proposed that a lessee would either present on the balance sheet or disclose in the notes all of the following:

   (a) ROU assets separately from other assets

   (b) Lease liabilities separately from other liabilities

   (c) ROU assets arising from Type A leases separately from ROU assets arising from Type B leases

   (d) Lease liabilities arising from Type A leases separately from lease liabilities arising from Type B leases.

8. The 2013 ED proposed that if a lessee does not present ROU assets and lease liabilities separately on the balance sheet, then the lessee would do both of the following:

   (a) Present ROU assets (both Type A and Type B) within the same line item as the corresponding underlying assets would be presented if they were owned

   (b) Disclose which line items on the balance sheet include ROU assets and lease liabilities.

9. The proposal to present ROU assets consistently with owned assets was based on reflecting the function, or utility, that the lessee obtains from having the right to use the underlying asset. The Boards concluded that presenting leased assets and owned

assets in a similar way would be useful because a lessee often uses owned assets and leased assets for the same purpose and derives similar economic benefits from the use of owned assets and leased assets. However, the Boards wanted to provide flexibility for preparers if there were instances in which it would be useful for ROU assets to be disaggregated from other assets on the balance sheet.

10. The 2013 ED did not prescribe how lease liabilities should be presented on the balance sheet if they are not presented as separate line items. However, the Basis for Conclusions of the 2013 ED stated that the lease liability is a financial liability.

11. In addition, the Boards decided that the quantitative disclosure requirements applicable to ROU assets and lease liabilities should be presented separately for Type A leases and Type B leases due to the differences in accounting between those lease types.

Relevant Decisions Reached in Redeliberations

12. At the March 2014 joint Board meeting, the FASB decided on a dual approach for lessee accounting, with lease classification determined in accordance with the principle in existing lease requirements (that is, determining whether a lease is effectively an installment purchase by the lessee). Under this approach, a lessee would account for most existing capital/finance leases as Type A leases (that is, recognizing amortization of the ROU asset separately from interest on the lease liability) and most existing operating leases as Type B leases (that is, recognizing a single total lease expense).

13. The IASB decided on a single approach for lessee accounting. Under that approach, 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).

Presentation of the Type A ROU Asset

Staff Analysis

14. In the 2013 ED, the Boards proposed that all ROU assets, both Type A and Type B, would be presented together with owned assets, if not presented as a separate line item

on the balance sheet. The staff continue to think that ROU assets resulting from Type A leases should be presented in a similar manner as that of owned assets because that presentation for Type A leases provides the most useful information to users of financial statements for the reasons noted in paragraph 9 of this paper. Accordingly, the staff think that the Boards should retain the proposals in the 2013 ED for presentation of ROU assets arising from Type A leases.

Staff Recommendation

15. The staff recommend that the Boards confirm that a lessee should either present as a separate line item on the balance sheet or disclose in the notes Type A ROU assets. If a lessee does not present Type A ROU assets as a separate line item on the balance sheet, a lessee should (a) present Type A ROU assets within the same line item as the corresponding underlying assets would be presented if they were owned and (b) disclose in the notes which line items in the balance sheet include Type A ROU assets.

Question 1: Presentation of the Type A ROU Asset
Question 1 – Do the Boards agree with the staff recommendation that a lessee should either present Type A ROU assets as a separate line item on the balance sheet or disclose in the notes Type A ROU assets. If a lessee does not present Type A ROU assets separately, a lessee should (a) present Type A ROU assets within the same line item as if the underlying assets were owned and (b) disclose in the notes which line items in the balance sheet include Type A ROU assets?

Presentation of the Type B ROU Asset (FASB-only)

16. The 2013 ED proposed that if a lessee does not present ROU assets separately on the balance sheet, then the lessee would present ROU assets (for both Type A leases and Type B leases) within the same line item as the corresponding underlying assets would be presented if they were owned.

17. After reviewing the lessee accounting model and the decisions made by the FASB in March 2014, the staff have reconsidered presentation of ROU assets with a stronger

emphasis on the distinction between Type A leases and Type B leases that arises from a dual model approach.

18. Regarding ROU assets that arise from Type B leases, the staff think that a different presentation from Type A leases may be appropriate. As described in the March 2014 Agenda Paper 3A/FASB Memo 268, the rationale for the FASB's lessee accounting model asserts that Type B leases have a unique and specialized role in business that neither reflects the full transfer of a nonfinancial asset (such as purchasing an asset) nor is equivalent to a service contract. Therefore, a lessee would not need to account for, or present, ROU assets that result from Type B leases consistently with either (a) other nonfinancial assets or (b) assets that may result, principally from the timing of payments, from service contracts (for example, prepaid expenses).

19. Although the staff acknowledge that some constituents think that presenting Type B ROU assets as if the lessee owned the underlying asset is appropriate, others do not think that is appropriate. Therefore, after considering all the input as well as the conclusion that Type B ROU assets are different from other nonfinancial assets, the staff recommend not prescribing where in the balance sheet a lessee should present Type B ROU assets (if not presented as a separate line item).

20. The staff acknowledge that one disadvantage of *not* presenting Type B ROU assets consistently with owned assets would be that it would not provide some users with all of the information that they need on the face of the financial statements. In particular, it would not do so for those users that aim to compare a company that leases its assets with a company that purchases its assets. However, the staff note that the disclosures would provide that necessary information, including the line item in which ROU assets are included and the amount of Type B ROU assets.

21. Given the rationale behind the dual lessee accounting model (that is, that the rights and obligations resulting from a Type B lease are substantially different from those conveyed by ownership of the underlying asset or those conveyed in a Type A lease, which is an *effective* purchase of the underlying asset), some staff think that the FASB should explicitly *prohibit* presentation of Type B ROU assets (when material in aggregate) in the same line item as Type A ROU assets. This presentation would ensure that the differences between Type A leases and Type B leases, which are

embedded in the FASB's lessee accounting model, are reflected in the lessee's balance sheet as well as in the lessee's income statement and statement of cash flows.

22. Other staff think that the FASB should not prescribe a particular presentation for Type B ROU assets that are not presented separately on the balance sheet to provide preparers with the flexibility to determine the appropriate presentation.

23. Under either approach, the staff think that it is important to require that the lessee disclose (a) the balance sheet line item in which the ROU assets are included and (b) the amount of Type B ROU assets recognized.

Staff Recommendation

24. The staff recommend that the FASB confirm that a lessee should either present as a separate line item on the balance sheet or disclose in the notes Type A ROU assets separate from Type B ROU assets. If a lessee does not present Type A ROU assets and Type B ROU assets as a separate line item on the balance sheet (separate from each other), a lessee should disclose in the notes which line items in the balance sheet include Type A and Type B ROU assets.

25. The staff do not recommend specifying how a lessee should present Type B ROU assets on the balance sheet. Because the staff think that Type B ROU assets are different from other nonfinancial assets, there is no need to specify a presentation for those assets by reference to other existing nonfinancial assets if they are not presented separately on the balance sheet. However, the staff note that a lessee's presentation of its Type B ROU assets should be rational and consistent for similar leases.

[Note: Some of the staff think that the FASB also should explicitly *prohibit* presentation of Type B ROU assets, when material in aggregate, from being presented in the same line item as Type A ROU assets for the reasons outlined in paragraph 21.]

Questions 2-3: Presentation of the Type B ROU Asset (FASB-only)
Question 2 – Does the FASB agree with the staff recommendations that Type A ROU assets and Type B ROU assets should either be presented as a separate line item on the balance sheet or disclosed separately in the notes? Question 3 – Does the FASB want to prohibit the presentation of Type B ROU assets in the same line on the balance sheet as Type A ROU assets?

Presentation of the Lease Liability

Staff Analysis

26. The 2013 ED did not specify how a lessee should present lease liabilities on the balance sheet or how a lessee should characterize lease liabilities (that is, as debt-like liabilities or non-debt-like liabilities, or operating-type liabilities). However, the Basis for Conclusions of the 2013 ED stated that a lease liability is a financial liability. Lease liabilities meet the definition of financial liabilities under both U.S. GAAP and IFRS. At lease commencement, a lessee has a contractual obligation to make lease payments to the lessor.

27. However, some feedback has suggested that the lease liability, especially for Type B leases, could be appropriately characterized as an operating liability on the basis of its treatment in bankruptcy and on existing guidance in U.S. GAAP for other liabilities that are considered operating liabilities, as described further below. This is not to say that the lease liability is not a financial liability, but only that it is operating in nature.

28. Consistent with the rationale described in the staff analysis above for the Type B ROU asset, the staff think that Type B leases have a unique role or a specialized role that neither reflects the full transfer of a nonfinancial asset (for example, the purchase of a piece of equipment) nor is equivalent to a service contract. Therefore, Type B leases are not equivalent to a financed purchase of a nonfinancial asset and the lease liability does not need to be explicitly characterized as a debt-like obligation.

29. The main example that many constituents provided during outreach relates to how leases are treated in the event of bankruptcy in some jurisdictions (namely, the United

States). Under bankruptcy law in these jurisdictions, existing operating leases would be treated differently from existing capital leases, which are more akin to an asset being purchased (either on credit from the supplier or through third-party financing). Existing capital leases would survive bankruptcy as an asset or a lease and result in a claim on the assets of the bankruptcy estate in most scenarios. Conversely, existing operating leases would not result in a claim and would disappear in most bankruptcy scenarios. Accordingly, following this bankruptcy treatment, a lessee would generally characterize Type A leases as debt-like obligations whereas it might be more appropriate to analogize Type B leases to operating-type liabilities (for example, restructuring liabilities or asset retirement obligations). However, the staff note that bankruptcy laws (as well as other factors) differ by jurisdiction. Although characterization of Type B lease liabilities as operating in nature may best depict those liabilities in some jurisdictions, it may not do so in others.

30. The staff also note that for U.S. GAAP, characterization of the lease liability as operating in nature further supports recognition of a single lease expense for Type B leases. This is because, under U.S. GAAP, an entity generally does not present accretion of the discount on operating liabilities as interest expense but, rather, as an operating expense. The guidance on the accretion of the discount on restructuring liabilities (Topic 420 on exit or disposal cost obligations) is as follows:

> **420-10-35-4** Changes due to the passage of time shall be recognized as an increase in the carrying amount of the liability and as an expense (for example, accretion expense). Accretion expense shall not be considered interest cost for purposes of applying Subtopic 835-20.

31. Similarly, the guidance on the accretion of the discount for asset retirement obligations (Topic 410 on asset retirement and environmental obligations) is as follows:

> **410-20-35-5** An entity shall measure changes in the liability for an asset retirement obligation due to passage of time by applying an interest method of allocation to the amount of the liability at the beginning of the period...That amount shall

be recognized as an increase in the carrying amount of the liability and as an expense classified as **accretion expense**. Paragraph 835-20-15-7 states that accretion expense related to exit costs and asset retirement obligations shall not be considered to be interest cost for purposes of applying Subtopic 835-20.

32. Accretion expense is defined in the Accounting Standards Codification's Master Glossary as follows:

Accretion Expense

An amount recognized as an expense classified as an operating item in the statement of income resulting from the increase in the carrying amount of the liability...

33. However, IFRS generally requires an entity to present accretion of the discount on any liability (measured on a discounted basis) as interest expense, regardless of whether the liability is debt-like or operating in nature.

Staff Recommendation

34. The staff recommend that the Boards confirm the following:

(a) A lessee should either present as a separate line item on the balance sheet or disclose in the notes Type A lease liabilities.

(b) If a lessee does not present Type A lease liabilities as a separate line item on the balance sheet, a lessee should disclose in the notes which line items in the balance sheet include Type A lease liabilities.

(c) FASB-only: A lessee should either present as a separate line item on the balance sheet or disclose in the notes Type A lease liabilities separate from Type B lease liabilities.

(d) FASB-only: If a lessee does not present Type A lease liabilities and Type B lease liabilities as a separate line item on the balance sheet (separate from each other), a lessee should disclose in the notes which line items in the balance sheet include Type A and Type B lease liabilities.

35. The staff also do not recommend specifying how a lessee should present lease liabilities on the balance sheet. This recommendation does not call into question that lease liabilities are financial in nature (that is, lease liabilities meet the definition of financial liabilities under both U.S. GAAP and IFRS). However, the staff think that whether a lease liability is or is not characterized as debt-like can vary by jurisdiction (for example, in the United States, current operating lease obligations are not considered debt in the event of bankruptcy, which may suggest that characterization of the obligation as operating rather than debt-like in nature would be appropriate). The staff think that this would allow lessees the flexibility to present their lease obligations in the most appropriate manner in accordance with the circumstances (for example, to characterize a Type B lease liability that is not akin to debt in the United States as an operating obligation), subject to the presentation requirements in the paragraph above and subject to other presentation requirements. Without further guidance regarding presentation, lessees applying IFRS would apply the requirements in IAS 1 *Presentation of Financial Statements*. This is likely to result in a lessee (that applies IFRS) presenting lease liabilities either as a separate line item or together with similar financial liabilities.

Questions 4-5: Presentation of the Lease Liability

Question 4 – Do the Boards agree with the staff recommendations to (a) either present as a separate line item on the balance sheet, or disclose in the notes, Type A lease liabilities; and (b) not specify the presentation of lease liabilities on the balance sheet?

Question 5 – Does the FASB agree with the staff recommendation that Type A lease liabilities should be either presented on the balance sheet or disclosed in the notes separately from Type B lease liabilities?

Appendix A—Proposed Lessee Balance Sheet Presentation Guidance

A1. The staff think that the updated lessee balance sheet presentation guidance would be similar to the following:

(a) A lessee either shall present as a separate line item on the balance sheet or disclose in the notes all of the following:

(i) ROU assets

(ii) Lease liabilities

(iii) FASB-only: ROU assets arising from Type A leases separately from ROU assets arising from Type B leases

(iv) FASB-only: Lease liabilities arising from Type A leases separately from lease liabilities arising from Type B leases.

(b) If a lessee does not present ROU assets and lease liabilities as a separate line item on the balance sheet, the lessee shall do the following:

(i) IASB-only: Present ROU assets within the same line item as the corresponding underlying assets would be presented if they were owned, and disclose which line items in the balance sheet include ROU assets and lease liabilities.

(ii) FASB-only: Present Type A ROU assets within the same line item as the corresponding underlying assets would be presented if they were owned, and disclose which line items in the balance sheet include Type A ROU assets, Type B ROU assets, Type A lease liabilities, and Type B lease liabilities.