STAFF PAPER

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Project	**Leases**		
Paper topic	Lessee disclosures requirements		

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Introduction

1. At this meeting, we are seeking Capital Markets Advisory Committee (CMAC) members' feedback on the usefulness of, and Global Preparers Forum (GPF) members' feedback on the cost and complexity of, lessee disclosures that will be discussed by the IASB and the FASB (the boards) as part of their redeliberations on the proposed changes to lease accounting.[1] In particular, we are seeking CMAC members' and GPF members' views on the following proposed disclosure requirements:

   (a) maturity analysis (see paragraphs 6–9);

   (b) reconciliation of a right-of-use (ROU) asset and a lease liability (or other quantitative disclosures) (see paragraphs 10–14); and

   (c) qualitative disclosures (see paragraphs 15–17).

[1] 2013 Exposure Draft *Leases* (the '2013 ED').

Information about the Capital Markets Advisory Committee (CMAC) is available at http://www.ifrs.org/The-organisation/Advisory-bodies/CMAC/Pages/CMAC.aspx

Information about the Global Preparers Forum (GPF) is available at http://www.ifrs.org/The-organisation/Advisory-bodies/Pages/Global-preparers-forum.aspx

IASB's recent tentative decisions

2. At the 2014 March joint board meeting, the IASB tentatively decided to adopt a single lessee accounting model. Under that approach:

   (a) a lessee would recognise a ROU asset and a lease liability for all leases and account for them similarly to finance leases. A lessee would recognise:

      (i) in the balance sheet:

         1. ROU assets (presented together or alongside property, plant and equipment); and
         2. lease liabilities (presented together or alongside other similar financial liabilities).

      (ii) in the income statement:

         1. amortisation expense for the ROU asset (typically as an operating expense, similarly to depreciation of property, plant and equipment); and
         2. interest on the lease liability (similarly to interest on other financial liabilities).

   (b) the IASB tentatively decided that a lessee would *not* be required to recognise lease assets and liabilities for short-term leases (ie leases of 12 months or less) and leases of small assets (for example, leases of laptops, office furniture, telephones).

   (c) a lessee would initially measure the ROU asset and the lease liability at the present value of the contractual lease payments (excluding variable payments linked to future use or sales). A lessee would exclude lease payments related to optional renewal periods from the measurement unless the lessee has an economic incentive to exercise that option.

Lessee disclosure requirements proposed in the 2013 Exposure Draft *Leases* (the '2013 ED')

3. The 2013 ED proposed a number of qualitative and quantitative disclosure requirements for a lessee, such as a maturity analysis of undiscounted lease payments, reconciliations of amounts recognised on the balance sheet and qualitative disclosures about leases (for example, information about variable lease payments and options).

4. The boards and the staff obtained feedback from various constituents on the lessee disclosure requirements proposed in the 2013 ED. Although investors and analysts generally considered the proposed requirements as useful, preparers generally thought they were excessive and complex. Appendix A of this paper includes a high level summary of the feedback received on the proposed lessee disclosures in the 2013 ED.

5. The boards will discuss these proposals at a future joint board meeting.

Maturity analysis

6. The 2013 ED proposed that a lessee should disclose a maturity analysis of the lease liability, showing the undiscounted future lease payments on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessee should also provide a reconciliation between the undiscounted lease payments and the lease liability recognised on the balance sheet.

7. The 2013 ED also proposed that a lessee should disclose costs that are recognised in the income statement in the reporting period relating to variable lease payments not included in the lease liability.

8. Investors and analysts that provided feedback to the 2013 ED noted that this information would aid their analysis of liquidity risk but suggested requiring a lessee to provide the following additional information:

(a) a more detailed maturity analysis showing the undiscounted future lease payments for each of the first *ten* years (or, at a minimum, a total for the years 5–10) and a total of the amounts for the remaining years;

(b) disclosures about average lease terms by class of underlying asset and/or average discount rates for all leases; and

(c) additional quantitative information about options and variable lease payments, such as trend lines of variable lease payments, a comparison between lease payments related to optional periods and market rentals, a table illustrating the disclosure of the range of possible lease payments related to all leases (short- and long-term aggregated by major lease type), taking into account management’s expectations for renewal options.

9. The maturity analysis proposed in the 2013 ED is similar to the maturity analysis required by existing US GAAP and is more detailed than the maturity analysis required by existing IFRS (IAS 17 *Leases*). Based on existing IFRS, a lessee should disclose the future lease payments for each of the following periods: not later than one year, later than one year and not later than five years and later than five years. The following extracts from the most recent Annual Financial Report of a sample of IFRS and US GAAP preparers show the varying granularity of lessee disclosures under existing requirements.

(a) *Company A*—maturity analysis in accordance with existing US GAAP showing the undiscounted future lease payments on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. This disclosure is consistent with the proposals in the 2013 ED.

The aggregate minimum non-cancelable annual lease payments under leases in effect on February 1, 2014 are as follows:

($ in millions) Fiscal Year		
2014	$	1,105
2015		1,087
2016		915
2017		738
2018		586
Thereafter		1,716
Total minimum lease commitments	$	6,147

The total minimum lease commitment amount above does not include minimum sublease rent income of $27 million receivable in the future under non-cancelable sublease agreements.

(b) *Company B*—maturity analysis in accordance with existing requirements under IFRS providing additional information (beyond the minimum requirements) on the entity's leasing commitments (annual undiscounted lease payments for each of the following 16 years).

C. Minimum rental commitments (cash basis)

Minimum future rentals in the following tables only correspond to long-term rental commitments in the Hotels Division for hotels opened or closed for repairs.

Undiscounted minimum lease payments in foreign currencies converted at the average exchange rate based on latest known rates, are as follows:

Years	(in millions of euros)	Years	(in millions of euros)
2014	(407)	2023	(200)
2015	(398)	2024	(185)
2016	(374)	2025	(163)
2017	(350)	2026	(144)
2018	(339)	2027	(96)
2019	(327)	2028	(78)
2020	(289)	2029	(62)
2021	(237)	2030	(43)
2022	(218)	> 2030	(280)
		TOTAL	**(4,190)**

At December 31, 2013, the present value of future minimum lease payments, considered as representing 7% of the minimum lease payments used to calculate the "Adjusted funds from ordinary activities/adjusted net debt" ratio, amounted to €(2,676) million.

Interest expense on adjusted net debt, estimated at 7%, amounted to €187 million. The difference between the minimum rent (€407 million) and interest expense (€187 million) amounted to €220 million. This corresponds to the implicit repayment of adjusted debt ("Standard & Poor's method) and therefore constitutes an adjustment for the calculation of the adjusted funds from operations/adjusted net debt ratio (see note (b) in the Key Management Ratios).

(c) *Company C*—maturity analysis in accordance with existing requirements under IFRS providing additional information (beyond the minimum requirements) on the entity's leasing commitments (annual undiscounted lease payments for the following 25 years in 5-year buckets).

C. Commitments under operating leases

The Group leases various stores, offices, warehouses and equipment under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

	2014 £m	2013 £m
Total future minimum rentals payable under non-cancellable operating leases are as follows:		
Within one year	**296.9**	276.9
Later than one year and not later than five years	**1,034.1**	1,064.5
Later than five years and not later than ten years	**1,020.1**	1,053.7
Later than ten years and not later than 15 years	**672.0**	695.1
Later than 15 years and not later than 20 years	**358.3**	366.8
Later than 20 years and not later than 25 years	**236.3**	247.0
Later than 25 years	**1,064.1**	1,143.0
Total	**4,681.8**	4,847.0

The total future sublease payments to be received are £44.9m (last year £50.6m).

Questions for the CMAC and GPF members

Question 1—Maturity analysis

CMAC: In the context of your assessment of a lessee's liquidity risk, does a maturity analysis of the contractual lease payments included in lease liabilities (as proposed in the 2013 ED; see paragraph 6) provide you with adequate information? If not, what additional information about future lease commitments should a lessee provide (for example, future lease payments for each of the first ten years, average lease term by class of underlying asset, average discount rate, options)? Why?

GPF: Do you consider that a maturity analysis of the contractual lease payments included in lease liabilities (as proposed in the 2013 ED; see paragraph 6) would be too costly to provide? If yes, why?
What other type of information about future lease commitments would you be able to provide at a reasonable cost to assist analysts and investors in their assessment of a lessee's liquidity risk?

Reconciliation of a ROU asset and a lease liability (or other quantitative disclosures)

10. The 2013 ED proposed that a lessee should disclose a reconciliation of opening and closing balances of ROU assets by class of underlying asset. This reconciliation would include items such as:

(a) additions due to leases commencing or being extended;

(b) reductions due to leases being terminated;

(c) remeasurements relating to a change in inflation-linked lease payments;

(d) amortisation; and

(e) impairment.

11. The 2013 ED also proposed that a lessee should disclose a reconciliation of opening and closing balances of lease liabilities. This reconciliation would include items such as:

(a) interest on the lease liability;

(b) cash paid;

(c) liabilities created due to leases commencing or being extended;

(d) liabilities extinguished due to leases being terminated; and

(e) remeasurements relating to a change in an index or a rate used to determine lease payments.

12. Many preparers who provided feedback to the 2013 ED indicated that such reconciliations would generally be very costly to prepare.

13. However, most investors and analysts supported the proposals for lessees to provide reconciliations of both the ROU asset and the lease liability. In their view, these disclosures would provide valuable information needed when analysing the changes that occurred during the period in the related amounts. The feedback received regarding a reconciliation of changes in the lease liability is also consistent with that received from investors about additional information needed about non-cash changes in an entity's debt. Nonetheless, some investors and analysts suggested that a breakdown of lease expenses in the income statement (for example, amortisation, interest, variable lease payments, short-term leases) by class of underlying assets might be more beneficial.

14. Below, we have prepared illustrative examples of reconciliations of opening and closing balances of the ROU asset and lease liability as proposed in the 2013 ED. The examples assume that the lessee is an airline with aircraft leases and real estate leases (for example, buildings at airports and offices). As an alternative to

such reconciliations, we also included an example of breakdown of lease expense (see (c)) as suggested in paragraph 13.

(a) The opening and closing balance of ROU assets in 20X1 is as follows ($ in millions):

Right-of-use assets (20X1)	**Aircraft leases**	**Real estate leases**	**Total**
Opening balance	**1,424**	**586**	**2,010**
New leases	216	79	295
Amortisation	(130)	(71)	(201)
Closing balance	**1,510**	**594**	**2,104**

(b) The opening and closing balance of lease liabilities in 20X1 is as follows ($ in millions):

Lease liabilities (20X1)	**Aircraft leases**	**Real estate leases**	**Total**
Opening balance	**1,692**	**625**	**2,317**
New leases	216	79	295
Interest	134	36	170
Cash paid	(294)	(107)	(401)
Closing balance	**1,748**	**633**	**2,381**

(c) The breakdown of lease expense in 20X1 is as follows ($ in millions):

Lease expense (20X1)	**Aircraft leases**	**Real estate leases**	**Total**
Amortisation	130	71	**201**
Interest	134	36	**170**
Variable lease payments linked to sales	-	10	**10**
Total	**264**	**117**	**381**

Questions for the CMAC and GPF members

Question 2—Reconciliation of a ROU asset and a lease liability (or other quantitative disclosures)

CMAC: Considering that many preparers indicated that the reconciliation of the opening and closing balances of ROU assets by class of underlying assets and of lease liabilities proposed in the 2013 ED would be costly to provide, are reconciliations of both lease assets and liabilities essential for your analyses? If not, are there alternative quantitative disclosures that would be useful for your analyses (for example, breakdown of annual lease expense and closing ROU assets balances by class of underlying assets or only a reconciliation of lease liabilities)? Why?

GPF: Do you consider that the reconciliation of the lease assets and lease liabilities proposed in the 2013 ED would be too costly to provide? If yes, why?
What other quantitative information about leases during the reporting period would you be able to provide at a reasonable cost to assist analysts and investors in their analyses? Why?

Qualitative disclosures

15. The 2013 ED proposed that a lessee should provide qualitative disclosures about leases. For example, a lessee would be required to disclose:

    (a) a general description of its lease contracts;

    (b) information about the terms and conditions of variable lease payments, options and residual value guarantees; and

    (c) information about leases that have not yet commenced but that create significant rights and obligations.

16. Some preparers who provided feedback to the 2013 ED expressed concerns about the application and usefulness of the proposed qualitative disclosures. Some noted that a lease portfolio could be so diverse that any qualitative disclosures might be too generic and not provide any meaningful information. For example, a retailer consulted during outreach noted that it has over 6,000 leases of retail stores – a large proportion of these leases have unique terms and conditions.

17. The following extracts from the most recent Annual Financial Report of a sample IFRS preparers show the varying amount of information provided under existing requirements.

(a) *Company D*

The Group has entered into operating leases in respect of vehicles, equipment, warehouses, office equipment and retail stores. These non-cancellable leases have remaining terms of between 1 month and approximately 20 years. Contingent rentals are payable on certain retail store leases based on store revenues. The majority of the Group's operating leases provide for their renewal by mutual agreement at the expiry of the lease term.

(b) *Company E*

Operating leases. Beneficial ownership of a lease is attributed to the lessor if this is the party to which all the substantial risks and rewards incidental to ownership of the asset are transferred. The lessor recognizes the leased asset in its statement of financial position. recognizes the lease payments made during the term of the operating lease in profit or loss. obligations arising from operating leases are mainly related to long-term rental or lease agreements for cell towers, network infrastructure, and real estate.

Some leases include extension options and provide for stepped rents. Most of these leases relate to cell towers in the United States.

(c) *Company F*

NOTE 6 RENTAL EXPENSE

Rental expense amounted to €894 million at December 31, 2013 compared with €938 million at December 31, 2012.

In accordance with the policy described in note 1.E.4, the expense reported on this line only concerns operating leases. Finance leases are recognized in the statement of financial position as an asset and a liability. The amount of the liability at December 31, 2013 was €49 million (see note 29.1).

Rental expense is recognized on a straight-line basis over the lease term, even if payments are not made on that basis. Most leases have been signed for periods exceeding the traditional nine-year term of commercial leases in France, primarily to protect against the absence of commercial property rights in certain countries.

None of the leases contains any clauses requiring advance payment of rentals in the case of a ratings downgrade or other adverse events affecting and there are no cross-default clauses or covenants.

The €894 million in rental expense corresponds to 1,109 hotel leases, including less than 1% with a purchase option. Where applicable, the option price corresponds to either a pre-agreed percentage of the owner's original investment or the property's market value when the option is exercised. The options are generally exercisable after 10 or 12 years. Certain contracts allow for the purchase of the property at the appraised value at the end of the lease.

A. Rental expense by business

Rental expense can be analyzed as follows by business:

(in millions of euros)	2012	2013
HOTELS	(943)	(896)
Upscale and Midscale Hotels	(579)	(539)
Economy	(364)	(357)
OTHER BUSINESSES	5	2
TOTAL	**(938)**	**(894)**

B. Rental expense by type of contract

Rental expense breaks down as follows by type of contract:

(in millions of euros)	Number of hotels [1]	2013 rental	Fixed rental expense	Variable rental expense
Fixed rent with purchase option	9	(15)	(15)	-
Fixed rent without purchase option	275	(233)	(233)	-
Fixed rent with a variable portion [2]	61	(78)	(64)	(14)
Land rent	-	(9)	(6)	(3)
Office rental expenses (Hotels business)	-	(27)	(26)	(1)
Fees on intragroup rent guarantees on Hotels business	-	(15)	(14)	(1)
TOTAL HOTEL FIXED RENTAL EXPENSE	345	(377)	(358)	(19)
Variable rent with a minimum [3]	115	(90)	(75)	(15)
Variable rent with a minimum and cap [4]	16	(23)	(10)	(13)
Variable rent without a minimum [5]	633	(406)	-	(406)
TOTAL HOTEL VARIABLE RENTAL EXPENSE	764	(519)	(85)	(434)
TOTAL HOTEL RENTAL EXPENSE	**1,109**	**(896)**	**(443)**	**(453)**
Rental expense not related to hotels	-	(12)	(11)	(1)
Internal lease guarantee fees	-	14	13	1
TOTAL RENTAL EXPENSE	**1,109**	**(894)**	**(441)**	**(453)**

(1) Rental expense by brand and type of contract at December 31, 2013 is presented as follows:

Leased hotels at December 31, 2013	Fixed rent with purchase option	Fixed rent without purchase option	Fixed rent with a variable portion	Variable rent with a minimum	Variable rent with a minimum and cap	Variable rent without a minimum	Total
	1	3	-	2	-	5	11
	-	6	2	3	-	3	14
	1	5	1	2	1	1	11
	1	34	8	21	4	94	162
	-	6	-	1	-	10	17
	3	43	17	11	3	70	147
	-	7	-	-	4	-	11
	2	96	13	63	3	183	360
	-	5	8	1	-	4	18
	1	65	12	10	1	104	193
	-	1	-	-	-	158	159
	-	4	-	1	-	1	6
TOTAL	**9**	**275**	**61**	**115**	**16**	**633**	**1,109**

(2) Fixed rent expense with a variable portion includes a fixed portion and a variable portion. The variable portion is generally a percentage of revenue or a percentage of EBITDAR.
(3) This rent expense depends on a percentage of revenue or a percentage of EBITDAR with a fixed contract guaranteed minimum.
(4) This rent expense depends on a percentage of revenue with a fixed contract guaranteed minimum which is also caped.
(5) Variable rent without a minimum is generally based on a percentage of revenue (601 hotels), or a percentage of EBITDAR (32 hotels). None of the leases contains any minimum rent clauses. Variable rents without a minimum based on a percentage of EBITDAR amount to 644 million at December 31, 2013.

Questions for the CMAC and GPF members

Question 3—Qualitative disclosures

CMAC: What types of meaningful qualitative disclosures do you need that preparers would be able to provide without resulting in boilerplate information? Why?

GPF: What types of qualitative disclosures about a lessee's leases do you think a preparer could, at a reasonable cost, provide that would be useful to investors and analysts? Why?

Appendix A—Feedback received on the lessee disclosure proposals included in the 2013 ED

A1. This Appendix includes a high level summary of feedback received on the lessee disclosure requirements included in the 2013 ED.

Support

A2. The majority of investors and analysts 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 investors and analysts 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.

A3. Most investors and analysts, as well as some academics and regulators, support the proposals for lessees to provide reconciliations of the ROU asset and the lease liability. In their view, these disclosures would provide valuable information when analysing the changes that occurred during the period in the related amounts.

A4. 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 maturity analysis of the lease liability showing the undiscounted lease payments on an annual basis for each of the first five years after the reporting date and a total thereafter. Investors and analysts commented that this information would aid their analysis of a lessee's liquidity risk.

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

Concerns

A5. Many constituents disagree with the disclosure proposals in the 2013 ED.

A6. Preparers generally think that the proposed lessee disclosure requirements 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 recognise lease assets and liabilities.

A7. Some preparers think that:

(a) 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 not otherwise be required to meet the recognition and measurement requirements.

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

Alternative suggestions

A8. Investors and analysts provided several suggestions to enhance the proposed disclosure requirements for lessees, including:

(a) a single disclosure of the total lease expense and a breakdown of the components of that expense, including information about expenses recognised 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; and

(d) in a table, 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; and

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