IFRS

STAFF PAPER

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Accounting Standards Advisory Forum

Project	**Leases**		
Paper topic	Possible ways forward and simplifications for lessee and lessor accounting		
CONTACT(S)	Roberta Ravelli	rravelli@ifrs.org	+44 (0) 207 246 6935
	Patrina Buchanan	pbuchanan@ifrs.org	+44 (0) 207 246 6468

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Introduction and objective of the meeting

1. At this meeting, as highlighted in our email of 14 January 2014, we would like to discuss with you the possible ways forward for lessee and lessor accounting and some potential simplifications to the 2013 *Leases* ED that are currently being considered by the IASB and the FASB (the boards) and the staff.

2. This paper includes an overview of possible approaches and simplifications in each of the following areas:

   (a) Topic 1: Lessee accounting model

   (b) Topic 2: Small-ticket leases

   (c) Topic 3: Lessor accounting model

   (d) Topic 4: Measurement

   (e) Topic 5: Separation of lease and non-lease components.

3. More detailed information regarding the possible approaches for lessee accounting, lessor accounting and small-ticket leases is included within agenda papers 4B-4F. These papers are exactly the same as agenda papers 3A-3E discussed by the boards at their January 2014 joint board meeting.

4. At this meeting, we are seeking the views of ASAF members specifically relating to the questions set out below. Consequently, we ask ASAF members to disregard the questions for the IASB that are contained within the IASB agenda papers.

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Questions for ASAF members
For each of the possible approaches and simplifications (set out below), what are your views on: a) the relative effect of the approach or simplification in terms of its effectiveness in reducing costs associated with applying the proposals in the 2013 ED? It would be helpful if you could identify whether you think the simplification would result in significant, moderate or little cost relief. Please explain why. b) the effect of the approach or simplification on the benefits for investors and analysts of the proposed changes to lessee and lessor accounting? It would be particularly helpful if you could substantiate the reasons for your views.

Background

5. In May 2013, the boards published for public comment the 2013 Exposure Draft *Leases* (the '2013 ED'). The comment period ended in September 2013. The boards and staff obtained feedback from investors and analysts, preparers, accounting practitioners, standard setters and other constituents in over 640 comment letters, at public round-table discussions, and at private outreach meetings, including fieldwork meetings.

6. At the January 2014 joint board meeting, the boards began their redeliberations on leases. They discussed possible ways forward for lessee and lessor accounting and possible simplifications for small-ticket leases. They did not make any decisions. We expect decisions to be made on these topics at the March 2014 joint board meeting. The discussion with ASAF will help to inform the boards before this meeting.

7. The boards have not yet discussed topic 4 *Measurement* and topic 5 *Separation of lease and non-lease components*.

Topic 1: Lessee accounting model

8. During the January 2014 joint board meeting the boards discussed three alternative approaches to lessee accounting. All three approaches would require a lessee to recognise an asset and liability for all leases of more than 12 months.

The right-of-use (ROU) asset would be a non-financial asset. The lease liability would be a financial liability, measured similarly to other financial liabilities. The main difference between the approaches relates to the recognition and presentation of lease expenses in the income statement.

9. The three approaches being considered by the boards can be described as follows:

   (a) *Approach 1* is a single lessee accounting model, according to which a lessee would recognise amortisation of the ROU asset separately from interest on the lease liability for all leases ('Type A' accounting proposed in the 2013 ED for most equipment and vehicle leases).

   (b) *Approach 2* is a dual lessee accounting model, with lease classification similar to that proposed in the 2013 ED, but offers targeted simplifications and improvements to the lease classification test. For all leases of assets other than property, a lessee would recognise amortisation of the ROU asset separately from interest on the lease liability ('Type A' accounting). For most property leases, a lessee would recognise a single, typically straight-line, lease expense ('Type B' accounting proposed in the 2013 ED for most property leases).

   (c) *Approach 3* is a dual lessee accounting model, with lease classification consistent with existing IAS 17 *Leases*. For leases currently classified as finance leases, a lessee would recognise amortisation of the ROU asset separately from interest on the lease liability ('Type A' accounting). For leases currently classified as operating leases, a lessee would recognise a single, typically straight-line, lease expense ('Type B' accounting).

10. To address some comments made at the January 2014 joint board meeting, the staff is also considering the following:

    (a) An alternative approach based on Approach 1. According to this alternative approach, a lessee would have the option to either:

        (i) apply 'Type A' accounting to all leases, other than short-term leases; or

        (ii) apply 'Type B' accounting to all property leases for which the lessee does not obtain control of the property, and apply

'Type A' accounting to all other leases, other than short-term leases.

(b) The rationale for 'Type B' accounting within Approach 3 and, for example, exploring whether a lessee should present the ROU asset and lease liability differently when applying 'Type B' accounting. For example, should the boards stipulate that the ROU asset be presented as an 'other asset' rather than presented in the same manner as owned assets (ie generally as property, plant and equipment)? Should the liability be presented similarly to liabilities recognised in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* rather than liabilities recognised in accordance with IFRS 9 *Financial Instruments*?

Topic 2: Small-ticket leases

11. The boards are considering the following possible simplifications for small-ticket leases held by a lessee:

    (a) *Simplification 1* is to extend the recognition and measurement exemption for short-term leases in two possible ways:

        (i) to increase the short-term threshold beyond 12 months; or

        (ii) to change the definition of a short-term lease to be consistent with the proposed definition of lease term.

    (b) *Simplification 2* is to clarify that a lessee can apply the leases guidance at a portfolio level.

    (c) *Simplification 3* is to introduce a scope exclusion for leases of assets that are neither 'core' to a lessee's operations nor individually significant.

12. During the January 2014 joint board meeting, the boards asked the staff to explore an additional possible simplification to introduce a scope exclusion for entities with leases that are within a particular quantitative threshold (for example, entities with leases that equal less than 5% of non-current assets).

13. The staff is also considering whether a scope exclusion could be developed for small-ticket leases, described along the following lines:

Small-ticket leases are leases of assets that have both of the following characteristics:

(a) The value of the asset is individually small.

(b) The asset is a non-specialised asset that would be used, without modification, by entities across industry sectors.

Examples could be used to illustrate that small ticket leases generally would include leases of some classes of IT and office equipment, such as laptops, desktops, water dispensers, mobile phones, office furniture. Small ticket leases would *not* include, for example, leases of cars, trucks, real estate.

Topic 3: Lessor accounting model

14. The 2013 ED proposed that a lessor would apply an approach similar to existing operating lease accounting (‘Type B’ accounting) to most leases of property and the receivable and residual approach (‘Type A’ accounting) to most other leases (except short-term leases).

15. The boards are considering three alternative approaches with respect to classifying leases as either Type A or Type B within the dual lessor accounting model. None of the three approaches would achieve symmetry between the lessor and lessee accounting models. This is because, having considered all of the feedback received throughout the project, the staff has concluded that achieving symmetry between the lessee and lessor accounting models should not be paramount for any final leases standard.

16. The three approaches being considered by the boards can be described as follows:

(a) *Approach 1* and *Approach 2* are similar to existing IFRS. A lessor would determine lease classification (Type A vs. Type B) based on whether the lease is effectively a financing or a sale, rather than an operating lease, based on whether the lease transfers substantially all the risks and rewards incidental to ownership of the underlying asset. *Approach 2*, however, would preclude upfront recognition of selling profit (or loss) unless the lessee obtains control of the underlying asset as a result of the lease (consistent with the notion of a sale in the forthcoming revenue recognition standard).

(c) *Approach 3* would determine lessor lease classification (Type A vs. Type B) based on the lessor's business model.

Topic 4: Measurement

17. The staff is also considering the following possible simplifications regarding measurement.

Lease term

18. The 2013 ED proposed the reassessment of the lease term if either of the following would occur:

    (a) a change in a relevant factor that causes the lessee to either have or no longer have a significant economic incentive to exercise an option or terminate the lease; or

    (b) the lessee either elects to exercise an option even though the entity had previously determined that the lessee did not have a significant economic incentive to do so or does not elect to exercise an option even though the entity had previously determined that the lessee had a significant economic incentive to do so.

19. The staff is considering the following simplifications regarding the reassessment of the lease term:

    (a) to remove the reassessment requirements (ie reassess only when a renewal or termination option is exercised or not exercised as described in paragraph 18(b) above); or

    (b) to require reassessment only upon the occurrence of one or more "triggering events" that would indicate a significant change in relevant factors relating to the exercise of renewal or termination options.

Variable lease payments

20. The 2013 ED proposed that a lessee would perform an ongoing reassessment of lease assets and liabilities to reflect revisions to the lease payments that vary because of changes in an index or a rate.

21. The staff is considering the following simplifications regarding the subsequent measurement of variable leases payments that depend on an index or a rate:

(a) to remove the reassessment requirements; or

(b) to require reassessment only when there is evidence that remeasuring the liability would lead to a significant change in that measurement.

Lessee's incremental borrowing rate

22. The 2013 ED proposed that a lessee would measure the ROU asset and lease liability at the present value of the lease payments discounted using the lessee's incremental borrowing rate, if the rate the lessor charges the lessee cannot be readily determined. The 2013 ED defined a lessee's incremental borrowing rate as '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'.

23. The staff is considering whether to simplify the proposal by including practical expedients to determine a lessee's incremental borrowing rate (for example, permitting the use of a lessee's secured borrowing rate or an estimate of that rate; permitting the use of a credit-adjusted risk free rate).

Topic 5: Separation of lease and non-lease components

24. The 2013 ED proposed that a lessee would account for each lease component separately from non-lease components of a contract. Nonetheless, in order to do so, a lessee would have been required to obtain stand-alone observable prices for at least some components of a multi-element contract.

25. The staff is considering the following simplifications regarding the separation of lease and non-lease components:

    (a) *Simplification 1* is to permit, by class of underlying asset, a lessee to account for lease and non-lease components together as a single lease component rather than separating the components, possibly only in some circumstances (eg if the lessee determines that the service component is small).

    (b) *Simplification 2* is to permit a lessee to estimate the payments relating to lease and non-lease components in the absence of observable stand-alone prices (similar to the requirements in paragraphs 14 and 15 of IFRIC 4 *Determining whether an Arrangement contains a Lease*).