



FINANCIAL ACCOUNTING STANDARDS BOARD



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Project Update

Leases—Joint Project of the IASB and FASB

Last Updated: February 19, 2010 (Updated sections are indicated with an asterisk *)

***Summary of Tentative Decisions Reached to Date (As of February 18, 2010)**

Definition of a Lease

The Boards have tentatively decided on the following proposed definition of a lease:

A lease is a contract in which the right to use a specified asset is conveyed, for a period of time, in exchange for consideration.

While the definition is not limited to property, plant, and equipment, the proposed new leases requirements do not apply to assets other than property, plant, and equipment.

The Boards also have decided that the right to use an asset is conveyed if the contract conveys the right to use a specified asset and the contract conveys the right to control the use of the underlying asset.

Further guidance will be developed on what constitutes a specified asset. Current leases guidance on when a lease conveys the right to control the use of the underlying asset will be carried forward, but will be rewritten to help clarify its meaning.

Scope

The following will be excluded from the scope of the proposed new leases guidance:

1. Leases of intangible assets

2. Leases to explore for or use natural resources, such as minerals, oil, and natural gas
3. Leases of biological assets
4. Contracts that represent the purchase (lessee) or sale (lessor) of the underlying asset. A contract is a purchase or a sale if at the end of the contract, the contract transfers:
 - (a) Control of the underlying asset
 - (b) All but a trivial amount of the risks and benefits associated with the underlying asset

Control of the underlying asset has generally been transferred/obtained in the following situations:

1. Contracts in which the title of the underlying asset transfers to the lessee automatically
2. Contracts that include a bargain purchase option if it is reasonably certain that the options will be exercised
3. Contracts in which the return that the lessor receives is fixed
4. Contracts in which it is reasonably certain that the contract will cover the expected useful life of the asset and any risks or benefits associated with the underlying asset retained by the lessor at the end of the contract are expected to be not more than trivial.

The Boards tentatively decided that very long leases of land would not be considered purchases or sales. However, the Boards instructed the staff to develop possible criteria for excluding very long leases of land from the scope of the proposed new leases requirements.

The Boards discussed whether to provide a scope exclusion for short-term leases and tentatively decided to permit lessees to use a simplified form of lease accounting for those leases that have a maximum possible lease term of less than 12 months. Under that simplified accounting, lessees would recognize gross amounts payable and a corresponding right-of-use asset in the statement of financial position. The Boards tentatively decided that lessors would also have the option to use the simplified accounting for short-term leases.

The Boards tentatively decided not to provide a scope exclusion for leases of non-core assets.

Timing of initial recognition

Assets and liabilities arise when a contract is signed. Between contract signing and delivery, the unit of account is the contract as a whole, and the contract position would be presented net in the statement of financial position of both the lessee and the lessor.

An entity would initially and subsequently measure the net contract asset or liability on a cost basis, subject to impairment. (Generally, initial measurement of the contract asset would equal the initial measurement of the contract liability.)

An entity would provide disclosures about the assets and liabilities that would arise upon contract signing.

Sale and leaseback transactions

In a sale and leaseback transaction, a seller/lessee would consider whether the entire leased asset qualifies for derecognition. If the entity determines that the transaction qualifies as a sale after applying the applicable guidance for the underlying asset, it would derecognize the leased item and recognize a right-of-use asset and an obligation to make rental payments for the leaseback. The Boards will consider whether additional criteria are needed to help entities determine whether a sale and leaseback transaction represents a sale and how to account for a sale and leaseback transaction when the sales prices or rental payments are not at market rates.

Contingent rentals and residual value guarantees

The obligation to pay rentals recognized by the lessee and the receivable recognized by the lessor would include amounts payable under contingent rental arrangements. A lessor would only recognize a receivable for amounts due under contingent rental arrangements if the receivable could be measured reliably. The obligation/receivable would be measured using an expected outcome technique. The final requirements would clarify that not every possible scenario would need to be taken into account when measuring the obligation/receivable.

Contingent rentals based on an index or rate would be measured using readily available forward rates. If forward rates are not available, the rates at the inception of the lease would be used.

The carrying amount of the obligation/receivable would be reassessed at each reporting date if any new facts or circumstances indicate that there is a material change in the obligation/receivable.

The discount rate (for both lessees and lessors) would not be revised when there are subsequent changes in the amounts payable under contingent rentals unless the rentals are contingent on variable reference interest rates.

For lessees, changes in amounts payable under contingent rental arrangements arising from current or prior periods should be recognized in profit or loss. All other changes should be recognized as an adjustment to the lessee's right-of-use asset.

For lessors, changes in amounts payable under contingent rental arrangements should be treated as adjustments to the original transaction price and be allocated to the lessor's

performance obligation. If a change is allocated to a satisfied performance obligation, the change would be recognized in revenue. If a change is allocated to an unsatisfied performance obligation, the carrying amount of the lessor's performance obligation would be adjusted. The staff will provide additional analysis on when a lessor's performance obligation is satisfied in a lease contract.

Residual value guarantees for lessees would be accounted for in the same way as contingent rental arrangements.

Definition of initial direct costs

Initial direct costs are incremental costs directly attributable to negotiating and arranging a lease. The proposed new leases requirements will include additional guidance to illustrate which costs could be considered initial direct costs.

Definition of the interest rate implicit in the lease

The Boards tentatively decided that the rate the lessor uses to discount lease payments should be the rate that the lessor is charging the lessee. That rate would take into account the nature of the transaction as well as the specific terms of the lease (rental payments, lease term, contingent rentals, etc.). The Boards also tentatively decided to include guidance in the proposed new leases requirements on how to determine the discount rate to be used in different circumstances.

Lessor Accounting

Performance obligation approach

The Boards decided to adopt the performance obligation approach to lessor accounting. Under that approach, a lessor would recognize:

1. An asset representing its right to receive rental payments from the lessee (a lease receivable)
2. A liability representing its performance obligation under the lease—that is, its obligation to permit the lessee to use one of its assets (the leased item). The lessor would satisfy that performance obligation (and would recognize revenue) over the lease term.

Initial measurement of the lessor's receivable and the lessor's performance obligation

Initial measurement of the lessor's right to receive rental payments would be at the present value of the lease payments discounted using the rate the lessor is charging the lessee plus any initial direct costs incurred by the lessor.

Initial measurement of the lessor's performance obligation would be at the transaction price (that is, the customer consideration, which will be measured at the present value of

the lease payments discounted using the rate the lessor is charging the lessee).

Subsequent measurement of the lessor's receivable and the performance obligation

Subsequent measurement of the lessor's receivable would be at amortized cost using the effective interest method.

Subsequent measurement of the lessor's performance obligation would reflect decreases in the obligation to permit the lessee to use the leased item over the lease term.

Lease contracts with options to extend or terminate the lease

The Boards made the following decisions regarding lease contracts that grant the lessee the right to extend or terminate the lease:

1. The accounting by lessors for those options would be symmetrical with the accounting by lessees for those options. However, the Boards noted that the objective of symmetry might not result in the same measurement of lease payments by the lessee and the lessor.
2. A lessor's receivable and performance obligation should be recognized based on the lease payments that would be received over the lease term. The recognized leased term would be the longest possible lease term that is more likely than not to occur.
3. The lease term would be reassessed at each reporting date. Detailed examination of every lease would not be required unless there is a change in facts or circumstances that would indicate that the lease term may need to be revised.
4. Any change to the lease receivable resulting from a reassessment of the lease term would be recorded as an adjustment to the performance obligation.
5. The lessor's discount rate would not be revised when there are subsequent changes in the expected lease term.

Investment properties

The Boards tentatively decided that if a lessor of investment properties measures its investment properties at cost, it would apply the proposed new lessor accounting requirements to the lease.

The IASB tentatively decided that if a lessor of investment properties measures its investment properties at fair value in accordance with IAS 40, Investment Property, it would not apply the proposed new lessor accounting requirements to the lease.

Because the FASB does not have an option to measure investment properties at fair value, the Boards instructed the staff to prepare an agenda request discussing whether to permit or require investment properties to be carried at fair value under U.S. generally accepted accounting principles (GAAP).

Lessee Accounting

Right-of-use approach

The Boards reaffirmed the right-of-use approach for lessees, which is described in the Discussion Paper. The Discussion Paper states that, for all leases, a lessee should recognize an asset representing its right to use the leased item for the lease term (the right-of-use asset) and a liability for its obligation to pay rentals.

Initial measurement of the right-of-use asset and lease obligation

Initial measurement of the lessee's right-of-use asset would be at cost in which cost is the present value of the lease payments plus any initial direct costs incurred by the lessee.

Initial measurement of the lessee's obligation to pay rentals would be at the present value of the lease payments discounted using the lessee's incremental borrowing rate. The Boards noted that the interest rate implicit in the lease will often equal the incremental borrowing rate. Consequently, the Boards tentatively decided that the interest rate implicit in the lease can be used if it can be readily determinable.

Subsequent measurement of the right-of-use asset and lease obligation

Subsequent measurement of the lessee's right-of-use asset would be at amortized cost and would be described as amortization rather than as rental expense.

Subsequent measurement of the lessee's obligation to pay rentals would be at amortized cost using the effective interest method. The obligation arising in a simple lease would not be revised for any changes in the lessee's incremental borrowing rate. The lessee's discount rate would not be revised when there are subsequent changes in the expected lease term. Subsequent measurement of the obligation at fair value is not permitted.

Impairment of the right-of-use asset

The lessee's right-of-use asset would be considered for impairment by referring to existing applicable standards for impairment. A lessee preparing financial statements in accordance with IFRS would follow IAS 36, *Impairment of Assets*. A lessee applying U.S. GAAP would follow the guidance on accounting for intangibles in Topic 350 of the *FASB Accounting Standards Codification*TM.

Revaluation of the right-of-use asset

IFRS preparers would be permitted to revalue their right-of-use assets using the revaluation model in IAS 38, *Intangible Assets*. U.S. GAAP preparers would not be permitted to revalue their right-of-use assets unless required to do so to recognize an impairment loss.

Lease contracts with options to extend or terminate the lease

The Boards made the following decisions regarding lease contracts that grant the lessee the right to extend or terminate the lease:

1. Uncertainty about the lease term would be addressed through recognition; that is, one of the possible lease terms is selected and the accounting is based on that term.
2. The recognized lease term would be the longest possible lease term that is more likely than not to occur.
3. In determining the lease term, the lessee would consider all relevant factors.
4. Options to renew a lease that are priced at market value at the date of renewal would be considered when determining the lease term.
5. The lease term would be reassessed at each reporting date. Detailed examination of every lease would not be required unless there is a change in facts or circumstances that indicates that the lease term may need to be revised.
6. Any change to the obligation to pay rentals resulting from a reassessment of the lease term would be recorded as an adjustment to the right-of-use asset.
7. The lessee's discount rate should not be revised when there are subsequent changes in the expected lease term.

Transition

A lessee would apply the proposed new leases requirements by recognizing and measuring an obligation to pay rentals and a right-of-use asset for all outstanding leases as of the date of initial application of the proposed new leases guidance, except for simple leases that are currently classified as capital/finance leases (see the following paragraph). The obligation to pay rentals would be measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate on the transition date. The right-of-use asset would be measured on the same basis as the liability, subject to any adjustments required to reflect impairment.

For simple leases (leases that do not have options, contingent rentals, and/or residual value guarantees) that are currently classified by lessees as capital/finance leases, the measurement of the assets and liabilities would not be changed on transition or subsequently. For IFRS preparers, the revalued amount of property, plant, and equipment could be carried forward as the carrying amount of the asset for simple finance/capital leases. Additional adjustments for prepaid or accrued rentals should be made when lease payments are uneven over the lease term.

See also decisions reached within the [FASB Discussion Paper](#).

Next Steps

The Boards will continue discussing lessee and lessor accounting issues at future meetings.