
Straight away

IFRS bulletin from PwC

21 October 2011

IASB/FASB leasing redeliberations – October 2011

What is the issue?

The boards met this month to discuss:

- Lessor accounting;
- Lease receivables held for sale;
- Transition; and
- Presentation issues.

The boards' target publication date for the exposure draft is the first half of 2012. A number of key tentative decisions were made during the October meeting. One of the decisions reached on how lessors should account for multiple use assets has led some to question the tentative decisions made earlier on the lessee model. If this issue were to be re-opened, it could put pressure on the boards' timetable.

Lessor accounting – multiple leases of physically distinct portions of an underlying asset (tentative decision)

The boards agreed at an earlier meeting that a physically distinct portion of an asset could be subject to a lease. This month, the boards debated the issues faced by lessors when applying the proposed 'receivable and residual' model to multiple leases of physically distinct portions of an underlying asset, such as shopping centres and telecommunication towers. It was tentatively decided that all assets that meet the definition of an investment property in IAS 40, 'Investment property', will be excluded from the scope of the leasing standard.

This decision broadens the previously agreed scope exemption to include those investment properties measured at cost as well as those at fair value. The IASB board members also briefly discussed a consequential amendment to IAS 40 that could broaden the definition of an investment property.

Certain FASB board members stated that their reason for allowing the above exemption for investment properties was a belief that there is more than one type of lease. As a result of the tentative decision made for lessors, the majority of FASB board members voted to revisit the debate about whether there is more than one type of lease for lessees. They have agreed to have this discussion offline; however, if this issue is re-opened, it could further extend the timeframe before an exposure draft is published.

Lessor accounting – measurement issues (tentative decision)

The boards agreed to amend their July decision as to how the components would be measured under the 'receivable and residual' model. They agreed to remove their previous requirement that a day-one profit should be recognised in the income statement only if it passes a 'reasonably assured' test.

Under the revised model, a lessor will derecognise the underlying asset subject to the lease and instead recognise a lease receivable, measured at the present value

of lease payments, and a gross residual asset, which would be calculated by estimating the present value of the expected future fair value of the residual asset.

The total profit is calculated by comparing the fair value and cost of the underlying asset subject to the lease. The total profit is then allocated between the receivable and gross residual asset. While the profit related to the lease receivable is recognised in the income statement on day-one, any profit related to the residual asset is deferred throughout the lease term. This deferred profit is only realised at the end of the lease term, either upon the sale or re-lease of the underlying asset.

Consistent with the July decision, the receivable and gross residual asset will be subsequently accreted using the rate the lessor charges the lessee. However, the deferred profit relating to the residual asset is not re-measured.

It was also agreed that when the rate the lessor charges the lessee reflects an expectation of variable lease payments (such as usage-based rental of a motor vehicle), the lessor should adjust the residual asset by recognising a portion of its cost as an expense when the variable lease payments are recognised as income.

Lessor accounting – lease receivables held for sale (tentative decision)

It was tentatively agreed that a lessor should not measure a lease receivable at fair value, even if part or all of that receivable is held for the purposes of sale. Instead, a lessor should apply the existing derecognition requirements in IFRS 9, 'Financial instruments'. It was also agreed that lessors should apply the disclosure requirements in IFRS 7, 'Financial instruments: Disclosures', to lease receivables held for sale.

Transition (tentative decision)

It was agreed that lessees and lessors should have the option of applying either a modified or a full retrospective approach to transition.

Under the modified approach, the lessee's incremental borrowing rate on the effective date is used for measuring the lease liability. Acknowledging the expense front-loading issue that many commentators referred to in response to the 2010 exposure draft, the boards agreed that the right-of-use asset should be calculated as the amount that would have arisen if the lessee had always applied the discount rate used at transition. For example, if a lessee applies the new standard in the fourth year of a 10-year lease, with annual payments of C1,000 and a discount rate at the effective date of 5.7%, it would calculate a lease liability of C4,967. Applying the same discount rate, the lease liability at the beginning of the lease term would have been C7,472. The right-of-use asset is then determined to be C4,483, which is the amount derived after four years of hypothetical depreciation.

For lessors applying the modified approach, the discount rate at transition should be the discount rate charged in the lease, determined at the commencement of the lease.

As a further relief, it was agreed that, for leases classified as finance leases under IAS 17, lessees and lessors should use existing carrying amounts at transition, even for complex leases including options and contingent rentals.

Presentation issues (tentative decision)

A number of lessor presentation issues were tentatively agreed. Consistent with the 2010 exposure draft, income and expense should be presented either as separate line items, or net in a single line item based on the lessor's business model. Accretion of the gross residual asset should be presented as part of interest income. It was agreed that presentation of income and expenses from leasing activities can be either in the income statement or disclosed in the notes to the financial statements.