



Memorandum

To:	AASB members	Date:	16 November 2011
From:	Nikole Gyles	Agenda Item:	14.1
Subject:	Leases – project update	File:	

Action

Receive an update on the recent tentative decisions made by the IASB and the FASB in their joint project to ultimately develop a Standard on *Leases* and consider if there are any issues that need to be raised with the IASB on those tentative decisions at this stage.

Staff recommendation

Staff do not consider that there are any issues that are sufficiently substantive to warrant them being raised with the IASB in relation to the tentative decisions made at the October 2011 or November 2011 IASB/FASB meetings (outlined in the table below) prior to the AASB drafting its submission on the imminent IASB ED.

Question to Board members:

Do you agree with staff's recommendation?

Background

The IASB and the FASB have undertaken a joint project to develop a Standard on *Leases*, an original objective of which was that all assets and liabilities arising under lease contracts are recognised in the statement of financial position.

In August 2010, the AASB issued ED 202R *Leases*, which incorporated the IASB's ED/2010/9 *Leases*. The comment period for IASB's ED 2010/6 closed on 15 December 2010 and over 760 comment letters were received (the comment period for AASB ED 202R closed on 12 November 2010 and attracted 16 comment letters). The IASB and FASB began redeliberations on the *Leases* project in January 2011. The IASB subsequently decided in July 2011 to re-expose

the proposals. The IASB work plan (dated 31 October 2011) indicates that the re-exposure of the Exposure Draft on *Leases* is expected to be issued in H1 2012 (comment period not yet finalised) and an IFRS is expected to be issued in H2 2012.

Since January 2011 the AASB only decided to write to the IASB once, and that was in May 2011 on some of the tentative decisions made in the *Leases* project (link to [Letter to IASB - Leases](#)).

At the October AASB meeting staff provided an update on the project incorporating tentative decisions made by the IASB up to October 2011 in relation to the lessor model and scope exemption for investment properties measured at fair value.

This memo provides a report on the outcome of the remaining part of the IASB's October 2011 meeting and the IASB's 1 November 2011 meeting. At the time of writing this memo, the IASB are scheduled to meet on 15-16 November during which *Leases* is expected to be discussed. Staff will provide a verbal update of further IASB developments should any arise prior to the December 2011 AASB meeting.

Tentative decisions made by IASB/FASB on the *Leases* project – November 2011

At the joint IASB and FASB meetings held on 19-20 October 2011 and 1 November 2011, the Boards made some tentative decisions in relation to variable lease payments, securitisation of lease receivables, presentation, transition issues and disclosure. Refer to the table below for our overview of key items discussed and tentative decisions made.

Issue	Overview of IASB/FASB discussions	Do the tentative decisions broadly align with AASB views?
<i>Variable lease payments</i>	<p>The Boards tentatively decided that:</p> <ul style="list-style-type: none"> • if the rate that the lessor charges the lessee does not reflect an expectation of variable lease payments, the lessor would not normally make any adjustments to the residual asset with respect to variable lease payments. • if the rate that the lessor charges the lessee reflects an expectation of variable lease payments, the lessor would adjust the residual asset by recognising a portion of the residual as an expense when the variable lease payments are recognised in profit or loss. The adjustment is made on the basis of the expected variable lease payments. No adjustment is made to the residual asset for any difference between the actual and expected variable lease payments. 	<p>No.</p> <p>The AASB supports the inclusion of contingent rentals in the measurement of assets and liabilities arising from a lease contract.</p> <p>In relation to the specific issue of adjustment to the residual asset, we are concerned that the implications of the IASB's tentative decision are unclear. In any event, the preliminary AASB staff view is that we disagree with the decision. Staff consider there to be no conceptual basis for the decision, and believe that, in practice, such a decision has the potential to generate unnecessary complexity in accounting for variable lease payments.</p>

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<i>Transfer/ securitisation of lease receivable</i>	<p>The Boards discussed the measurement of lease receivables held for the purpose of sale and the derecognition guidance to be applied when lease receivables are transferred or sold.</p> <p>The Boards tentatively decided that a lessor:</p> <ul style="list-style-type: none"> • should not measure a lease receivable at fair value, even if part or all of that lease receivable is held for the purpose of sale. • Should apply the existing derecognition requirements (IFRS 9) to lease receivables. The carrying amount of a lease receivable should be allocated on the basis of its fair value, excluding any option elements and variable lease payments that are not transferred. 	<p>n/a</p> <p>This issue was not considered in ED/2010/9.</p> <p>Preliminary staff view: <i>Agree</i> with the tentative decision to measure lease receivables held for the purpose of sale consistently with other lease receivables.</p>
<i>Presentation</i>	<p>The Boards tentatively decided that a lessor should present:</p> <ul style="list-style-type: none"> • The accretion of the residual asset as interest income. • The amortisation of initial direct costs as an offset to interest income. • Lease income and lease expense in the statement of comprehensive income either in separate line items (gross) or in a single line item (net), depending on which presentation best reflects the lessor's business model. <p>The Boards also tentatively decided that a lessor should separately identify income and expenses arising from leases either by separate presentation in the statement of comprehensive income or by disclosure in the notes to the financial statements.</p>	<p>No.</p> <p>The AASB noted the following in relation to a similar issue in its comment letter to the IASB:</p> <p><i>“With regards to whether items should be presented on the face of the ... statement of financial position or in the notes, the AASB thinks that IAS 1 Presentation of Financial Statements contains sufficient guidance to allow entities to make this decision and therefore think that this issue does not need to be addressed in individual Standards.”</i></p> <p>Preliminary staff view: Staff <i>agree</i> with the tentative decisions in relation to presentation of the accretion, amortisation, and net/gross presentation. Consistent with the view expressed by the AASB in its comment letter to the IASB, staff <i>disagree</i> with including guidance on whether items should be presented on the face of the statement of comprehensive income.</p>
<i>Transition</i>	<p>The Boards made a number of tentative decisions in relation to transition requirements and transition disclosures for lessees and lessors, including:</p> <ul style="list-style-type: none"> • finance lease lessees existing at the beginning of the earliest comparative period presented would not be required to make any adjustments to the carrying amount of the lease assets and lease liabilities. • operating lease lessees would be required to: <ul style="list-style-type: none"> ○ recognise liabilities to make lease payments at the present value of the remaining lease payments, 	<p>Preliminary staff view: Staff <i>agree</i> with the tentative decisions as practical expedients.</p>

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	<p>discounted using the lessee's incremental borrowing rate as of the effective date for each portfolio of leases with reasonably similar characteristics.</p> <ul style="list-style-type: none"> ○ Recognise right-of-use assets on the basis of proportion of the liability to make lease payments at lease commencement, relative to the remaining lease payments. ○ Recognise any difference in retained earnings. <ul style="list-style-type: none"> ● lessors with finance leases or sales-type leases and direct finance leases existing at the beginning of the earliest comparative period presented would not be required to make adjustments to the carrying amount of the assets associated with those leases. ● operating lease lessors with operating leases existing at the beginning of the earliest comparative period presented should: <ul style="list-style-type: none"> ○ recognise a right to receive lease payments, measured at the present value of the remaining lease payments, discounted using the rate charged in the lease that was determined at the date of commencement of the lease (subject to adjustment for any impairment). ○ recognise a residual asset consistent with the initial measurement of the residual asset under the receivable and residual approach. ○ derecognise the underlying asset. ● for a sale and leaseback transaction that resulted in a finance lease a lessee would not need to re evaluate the sale recognition conclusion reached previously, would not remeasure lease assets and lease liabilities that had been previously recognised in the statement of financial position, and would continue to amortise any deferred gain or loss on sale over the lease term in the statement of comprehensive income. ● for a sale and leaseback transaction that resulted in an operating lease classification or for which the sale recognition criteria were previously not met, a seller/lessee would re evaluate the sale conclusion based on the criteria for transfer of control of an asset in the proposed revenue standard. 	