Leases – Project update May/June 2014

The IASB and FASB held joint meetings in May and June 2014, at which the Boards made a number of tentative decisions in relation to the *Leases* project.[1]

<table>
<tr><th>Issue</th><th>Overview of IASB tentative decisions</th><th>Overview of FASB tentative decisions</th><th>Do the IASB's tentative decisions broadly align with AASB views?[2]</th></tr>
<tr><td>Definition of a lease</td><td colspan="2">The Boards decided the following:
(a) Retain the principles in the 2013 Exposure Draft supporting the definition of a lease that require an entity to determine whether a contract contains a lease by assessing whether:
(i) fulfillment of the contract depends on the use of an identified asset; and
(ii) whether the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration (that is, the customer has the ability both to direct the use of the identified asset and to derive the economic benefits from use of that asset during the period of use).
(b) Clarify the following regarding whether fulfillment of the contract depends on the use of an identified asset:
(i) fulfillment depends on the use of an identified asset when the supplier has no practical ability to substitute an alternative asset or the supplier would not benefit from substituting an asset; and
(ii) a customer should presume that fulfillment of the contract depends on the use of an identified asset if it is impractical for the customer to determine either (1) whether the supplier has the practical ability to substitute an alternative asset or (2) whether the supplier would benefit from the substitution.
(c) Regarding the right to control the use of an identified asset:</td><td>In its comment letter to the IASB, the AASB agreed with the proposed definition of a lease. The AASB also agreed with the approach proposed in the ED to identify whether a contract conveys the right to control the use of the identified asset.
However, the AASB disagreed that a capacity portion of an asset cannot be an identified asset, and recommended that paragraph 11 of the ED be amended to include the capacity portion of an asset as a valid example of an 'identified asset'.
AASB staff view
Consistent with the AASB's comment letter to the IASB, AASB staff agree with the tentative decisions made by the Boards.
AASB staff note that the Boards have did not discuss the guidance in relation</td></tr>
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[1] http://media.ifrs.org/2014/IASB/May/IASB-Update-May-2014.pdf (accessed 1 July 2014)
http://media.ifrs.org/2014/IASB/June/IASB-Update-June-2014.pdf (accessed 30 June 2014)
[2] http://www.aasb.gov.au/admin/file/content106/c2/AASB_comment_letter_to_IASB_ED_2013_6_Leases.pdf (accessed 1 July 2014)

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	(i) provide additional guidance on how to determine which decisions most significantly affect the economic benefits to be derived from use of the identified asset and which party to the contract has the ability to most significantly affect those economic benefits particularly when the supplier and the customer both have decision-making rights; and (ii) remove the guidance that was proposed in the 2013 Exposure Draft on assets that are incidental to the delivery of services.		to a capacity portion of an asset.
Separating lease and nonlease components	The Boards decided to: (a) retain guidance similar to that proposed in the 2013 Exposure Draft for both lessees and lessors on identifying separate lease components. (b) retain guidance similar to that proposed in the 2013 Exposure Draft for lessors on separating lease components from non-lease components and allocating consideration in the contract to those components. That is, a lessor should apply the guidance in the forthcoming revenue recognition Standard on allocating the transaction price to separate performance obligations. A lessor also should reallocate the consideration in a contract when there is a contract modification that is not accounted for as a separate, new contract. (c) change the proposals in the 2013 Exposure Draft for lessees regarding separating lease components from non-lease components and allocating consideration in a contract to those components as follows: (i) A lessee should separate lease components from non-lease components unless it applies the accounting policy election discussed below. (ii) A lessee should allocate the consideration in a contract to the lease and non-lease components on a relative standalone price basis. Activities (or costs of the lessor) that do not transfer a good or service to the lessee are not components in a contract. A lessee also should reallocate the consideration in a contract when (i) there is a reassessment of either the lease term or a lessee's purchase option or (ii) there is a contract modification that is not accounted for as a separate, new contract		In its comment letter to the IASB, the AASB recommended that additional guidance be incorporated into any final Standard to clarify circumstances in which a service is being provided in conjunction with the asset, and to assist in applying the control criterion. **AASB staff view** AASB staff note that the Boards have not decided to specifically include additional guidance to clarify circumstances in which a service is being provided in conjunction with the asset, and to assist in applying the control criterion. However, AASB staff consider that the amendments described in paragraph (c) opposite may alleviate some of the concern as they clarify when activities are components in a contract. AASB staff agree with the Boards' decisions with the exception of paragraph (d). AASB staff disagree

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	(iii) A lessee should use observable stand-alone prices, if available, and otherwise it would use estimates of the stand-alone price of lease and non-lease components (maximising the use of observable information). (d) permit a lessee, as an accounting policy election by class of underlying asset, to not separate lease components from non-lease components. Instead, a lessee should account for lease and non-lease components together as a single lease component.		with the Boards' decision to permit a lessee not to seprate lease componenents. AASB staff are not convinced that this expedient is necessary for the model to work in practice, and consider that this accounting policy choice unnecessarily increases complexity of the model.
Initial direct costs	The Boards decided: (a) that only incremental costs should qualify as initial direct costs. (b) that initial direct costs should include only incremental costs that an entity would not have incurred if the lease had not been obtained (executed) (for example, commissions or payments made to existing tenants to obtain the lease). (c) that both lessees and lessors should apply the same definition of initial direct costs. (d) the following regarding initial direct costs: (i) A lessor in a Type A lease (except those who recognise selling profit at lease commencement) should include initial direct costs in the initial measurement of the lease receivable by taking account of those costs in determining the rate implicit in the lease. A lessor who recognises selling profit at lease commencement should recognise initial direct costs associated with a Type A lease as an expense at lease commencement. (ii) A lessor in a Type B lease should recognise initial direct costs as an expense over the lease term on the same basis as lease income. (iii) A lessee should include initial direct costs in the initial measurement of the right-of-use asset and amortise those costs over the lease term.		The AASB did not specifically comment on initial direct costs in its comment letter to the IASB. **AASB staff view** AASB staff agree with the Boards' tentative decisions.

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<tr><td>Subleases</td><td colspan="2">The boards tentatively decided that an intermediate lessor (that is, an entity that is both a lessee and a lessor of the same underlying asset) should account for a head lease and a sublease as two separate contracts (accounting for the head lease in accordance with the lessee accounting proposals and the sublease in accordance with the lessor accounting proposals), unless those contracts meet the contract combinations guidance adopted by the boards at the April 2014 joint board meeting.</td><td>The AASB did not specifically comment on the issue of subleases.
AASB staff view
AASB staff agree with the Boards’ tentative decision.</td></tr>
<tr><td></td><td>The IASB tentatively decided that, when classifying a sublease, an intermediate lessor should determine the classification of the sublease with reference to the ROU asset arising from the head lease.</td><td>The FASB tentatively decided that, when classifying a sublease, an intermediate lessor should determine the classification of the sublease with reference to the underlying asset (for example, the item of property, plant, and equipment that is the subject of the lease), rather than with reference to the right-of-use (ROU) asset arising from the head lease.</td><td>The AASB did not specifically comment on the issue of subleases.
AASB staff view
AASB staff agree with the IASB’s tentative decision.</td></tr>
<tr><td></td><td colspan="2">The boards tentatively decided that an intermediate lessor should not offset lease assets and lease liabilities arising from a head lease and a sublease that do not meet the respective IFRS and US GAAP financial instruments requirements for offsetting.
The boards tentatively decided that an intermediate lessor should not offset lease income and lease expense related to a head lease and a sublease, unless it recognises sublease income as revenue and acts as an agent (assessed in accordance with the “principal-agent” guidance in the recently published standard on revenue from contracts with customers).</td><td>The AASB did not specifically comment on the issue of subleases.
AASB staff view
AASB staff agree with the Boards’ tentative decision.</td></tr>
<tr><td>Lessee balance sheet presentation</td><td>The IASB tentatively decided that a lessee should either present as a separate line item on the balance sheet or disclose ROU assets in the notes. If a lessee does not present ROU assets as a separate line item on the balance sheet, the lessee should present ROU assets within the same line item in which the corresponding underlying assets would be presented</td><td>The FASB tentatively decided that a lessee should either present as separate line items on the balance sheet or disclose in the notes Type A ROU assets (which are effectively purchases of the underlying asset) and Type B ROU assets. If a lessee does not present Type A ROU assets or Type B ROU assets as separate line items on the</td><td>In its comment letter to the IASB, the AASB noted the following in relation to disclosure:
The AASB considers that the overall volume of disclosure proposed in the ED to be excessive. The level of disclosure appears to highlight the</td></tr>
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	if they were owned, and disclose in the notes which line item in the balance sheet includes ROU assets.	balance sheet, the lessee should disclose in the notes which line items in the balance sheet include Type A ROU assets and Type B ROU assets. A lessee is prohibited from presenting Type A ROU assets within the same line item as Type B ROU assets.	*significant complexity associated with the proposed model. In particular, the AASB notes that much of the proposed disclosure could be reduced if a single model, rather than a dual model, were to be adopted.* *The AASB also questions the need for additional lease-accounting-specific disclosure requirements. The AASB's preference would be for lease disclosure to follow existing disclosure requirements of Standards, to the extent possible. For example, disclosures relating to right-of-use assets could be based on the existing requirements of IAS 38 if it is considered to be an intangible asset (alternatively, the disclosure requirements could be based on IAS 16 if the right-of-use is considered a tangible asset).* **AASB staff view** Consistent with the views expressed by the AASB in its comment letter to the IASB, AASB staff **would prefer** for lease disclosure to follow existing disclosure requirements of Standards. However, if this view is not adopted by the IASB, AASB staff **can accept** the

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			disclosure proposed by the IASB.
	The IASB tentatively decided that a lessee should either present as a separate line item on the balance sheet or disclose in the notes lease liabilities. If a lessee does not present lease liabilities as a separate line item on the balance sheet, the lessee should disclose in the notes which line item in the balance sheet includes lease liabilities.	The FASB tentatively decided that a lessee should either present as separate line items on the balance sheet or disclose in the notes Type A lease liabilities and Type B lease liabilities. If a lessee does not present Type A lease liabilities or Type B lease liabilities as separate line items on the balance sheet, the lessee should disclose in the notes which line items in the balance sheet include Type A lease liabilities and Type B lease liabilities. A lessee is prohibited from presenting Type A lease liabilities within the same line item as Type B lease liabilities.	**AASB staff view** Consistent with the views expressed by the AASB in its comment letter to the IASB, AASB staff **would prefer** for lease disclosure to follow existing disclosure requirements of Standards. However, if this view is not adopted by the IASB, AASB staff **can accept** the disclosure proposed by the IASB.
Cash flow presentation	The boards tentatively decided to retain the guidance in the 2013 Exposure Draft requiring a lessor to classify cash receipts from leases within operating activities.		The AASB did not specifically comment on the issue of cash flow presentation. **AASB staff view** AASB staff agree with the Boards' tentative decision.
	The IASB tentatively decided to retain the guidance in the 2013 Exposure Draft for Type A leases requiring a lessee to classify: (a) cash payments for the principal portion of the lease liability within financing activities; (b) cash payments for the interest portion of the lease liability in accordance with the requirements relating to interest paid in IAS 7	The FASB tentatively decided to retain the guidance in the 2013 Exposure Draft requiring a lessee to classify: (a) cash payments for the principal portion of the lease liability arising from Type A leases within financing activities; (b) cash payments for the interest portion of the lease liability arising from Type A leases within operating activities;	The AASB did not specifically comment on the issue of cash flow presentation. **AASB staff view** AASB staff agree with the Boards' tentative decision.

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	Statement of Cash Flows. The IASB also tentatively decided to require a lessee to disclose a single figure for lease cash outflows elsewhere in the financial statements.	(c) cash payments arising from Type B leases within operating activities.	

Next steps

The boards will continue their joint redeliberations of the 2013 ED at a future joint meeting

Staff recommendation

Staff do not consider that there are any issues that are sufficiently substantive to warrant them being raised with the IASB at this stage in relation to the tentative decisions made at the May/June 2014 IASB/FASB meetings (outlined in the table above).

Question to Board members
Do you agree with staff's recommendation?