



Memorandum

To:	AASB members	Date:	11 October 2011
From:	Nikole Gyles	Agenda Item:	8.1
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.

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 September 2011 IASB/FASB meeting 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 30 September 2011) indicates that the re-exposure of the Exposure Draft on *Leases* is expected to be issued in H1 2012 and an IFRS is expected to be issued in H2 2012.

The AASB wrote to the IASB in May 2011 on some of the tentative decisions made in the *Leases* project (link to [Letter to IASB - Leases](#)). At the September AASB meeting staff provided an update on the project incorporating tentative decisions made by the IASB up to August 2011.

This memo provides a report on the outcome of the IASB's September 2011 meeting. At the time of writing this memo, the IASB are scheduled to meet 19-21 October 2011 during which *Leases* is expected to be discussed. Staff will provide a verbal update of further IASB developments should any arise prior to the October 2011 AASB meeting.

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

At the joint IASB and FASB meetings held on 19-21 September 2011, the Boards made some tentative decisions in relation to the scope of the proposals and lessor accounting. The Boards also discussed lessee transition guidance; however, no decisions were made in relation to this issue.

Refer to the table below for our overview of items discussed and tentative decisions made.

Issue	Overview of IASB/FASB discussions	Do the tentative decisions broadly align with AASB views?
<i>Scope – Inventory</i>	The Boards tentatively decided not to provide a scope exclusion from the leases standard for assets that are often treated as inventory, such as non-depreciating spare parts, operating materials, and supplies, and that are associated with the leasing of another underlying asset.	n/a This issue was not considered in the ED. The AASB did not comment on this issue in its comment letter to the IASB. AASB Staff view: AASB Staff agree with the IASB's tentative decision not to include a specific scope exclusion for inventory on the basis that a right of use asset could not also meet the definition of inventory.
<i>Lessor – Application of financial asset guidance to the right to receive lease payments</i>	The Boards tentatively decided that: <ul style="list-style-type: none"> • A lessor should subsequently measure the right to receive lease payments using the effective interest method. • A lessor should refer to existing financial instruments guidance (IASB - IAS 39 <i>Financial Instruments: Classification and Measurement</i>) to assess the impairment of that right to receive lease payments. • The leases standard should not contain an option for fair value measurement of the right to receive lease payments. 	In part. The tentative decisions are broadly consistent with the ED proposals. <i>Effective Interest Method</i> In its comment letter to the IASB the AASB agreed with the subsequent measurement of the lease receivable using the effective interest method. <i>Impairment</i> In its comment letter to the IASB the AASB agreed that the measurement (including impairment) of lease receivables should be

Memorandum

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		<p>determined on the same basis as for other financial assets.</p> <p>However, the AASB noted that any new proposals on the measurement of financial assets at amortised cost should be considered in the context of their application to lease receivables, and guidance added to the lease requirements as necessary.</p> <p><i>Fair Value Option</i></p> <p>The AASB did not comment to the IASB on whether lessors should have the ability to fair value the right to receive lease payments.</p> <p>AASB Staff view: AASB Staff disagree with the IASB's decision not to permit revaluation of the lease receivable on the basis that other non-financial assets are permitted to be measured at fair value and financial assets are permitted, or required, to be measured at fair value in some circumstances¹.</p>
<p><i>Lessor – Other subsequent measurement issues</i></p>	<p>The IASB tentatively decided that a lessor should refer to IAS 36 <i>Impairment of Assets</i> to assess the impairment of the residual asset.</p>	<p>No.</p> <p><i>Impairment of the residual asset</i></p> <p>The tentative decision is consistent with the ED proposals.</p> <p>The AASB did not comment on impairment of the residual asset in its comment letter to the IASB.</p> <p>AASB Staff view: AASB Staff agree with the requirement to apply IAS 36 to the impairment of the residual asset. However, AASB staff note that this requirement appears to be inconsistent with the IASB's previous tentative decisions regarding the residual asset being characterised as a financial asset for the purposes of subsequent measurement.²</p>

¹ For example, financial instruments are permitted to be measured at fair value to eliminate an accounting mismatch, and are required to be measured at fair value if cash flows are not solely payments of principal and interest

² As discussed at the September 2011 AASB meeting, Agenda Paper 5.3, paragraph 8(b):

Page 17 of IASB Agenda Paper 5G notes that 'the residual represents the right to the cash flows that the lessor expects to receive at the end of the lease term that will ultimately be realised through sale, residual value guarantees, or re-lease of the underlying asset. Consequently, some lessors view the residual asset to be more akin to a financial asset'. AASB staff disagree with treating the residual asset as a financial asset and consider that a residual asset is the rights in the underlying asset that the lessor retains. This potential difference in views as to what the residual asset represents influences the discussion as to the appropriate measurement model. AASB staff consider it to be inappropriate to measure non-financial assets at amortised cost applying the effective interest method.

Memorandum

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	<p>The Boards tentatively decided that a lessor should recognise immediately in profit or loss changes in the right to receive lease payments due to reassessments of variable lease payments that depend on an index or a rate.</p> <p>The IASB tentatively decided that revaluation of the residual asset should be prohibited.</p>	<p><i>Reassessment of variable lease payments</i></p> <p>The tentative decision is consistent with the ED proposals, although the ED proposed reassessment for all variable lease payments, not just those that depend on an index or rate.</p> <p>In its comment letter to the IASB, the AASB did not comment specifically about the reassessment of variable lease payments being recognised in profit or loss, however, in relation to reassessment of variable lease payments more generally, the AASB commented:</p> <p><i>“The AASB agrees that reassessment of estimates is necessary, however, the AASB is concerned that the way in which the proposals are currently expressed would lead entities to reassess their estimations every reporting period. The AASB thinks that the approach taken to reassessment should be similar to that in IAS 36 Impairment of Assets and that reassessment should be required when there has been a ‘trigger’ event.”</i></p> <p>AASB Staff view: AASB Staff agree with the IASB’s tentative decision. This decision is consistent with the treatment proposed in the ED for the derecognition model.</p> <p><i>Revaluation of the residual asset</i></p> <p>The tentative decision is consistent with the ED proposals.</p> <p>In its comment letter to the IASB, the AASB commented that the residual asset should be allowed to be revalued. If this approach is not taken then a method should be applied to the residual value that allows accretion up to the fair value of the residual asset when that fair value is greater than the residual asset carrying amount.</p>
<p><i>Lessor – Residual value guarantees</i></p>	<p>The Boards tentatively decided that:</p> <ul style="list-style-type: none"> • The leases standard would provide guidance on accounting for all residual value guarantees, regardless of whether they are provided by a lessee, a related party or a third party. • A lessor would not recognise amounts expected to be received under a residual value guarantee until the end of the lease. However, the lessor would consider those guarantees when determining whether the residual asset is impaired. 	<p>No.</p> <p>The ED proposed to include an estimate of the expected payment/receipt under residual value guarantees that are provided by the lessee.</p> <p>The AASB noted the following in its comment letter to the IASB:</p> <p><i>“The AASB thinks that lessors/lessees should include receipts/payments to be made under RVGs in the estimation of lease receipts/payments, that are either present in the lease contract, or to be made by a related party....”</i></p> <p><i>“Lessors should also include payments to be made under RVGs by unrelated parties in their estimation of total lease receipts. From an accounting perspective, to lessors it is irrelevant if RVGs payments come from lessees or other</i></p>

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		<p><i>entities. The AASB is concerned that if RVGs are not included in the lessor's lease receivable there is scope for abuse.</i>"³</p> <p>AASB staff also note that the IASB's tentative decision in relation lessors appears to be inconsistent with its tentative decision to include the lessee's residual value guarantees in the initial measurement of the obligation to make lease payments.</p>
<p><i>Presentation: lessor statement of financial position</i></p>	<p>The Boards tentatively decided that a lessor should either:</p> <ul style="list-style-type: none"> • Present the lease receivable and the residual asset separately in the statement of financial position, summing to a total to be called 'lease assets'; or • Present the lease receivable and residual asset together in a single line item—'lease assets'—in the statement of financial position, and separately disclose those two amounts in the notes to the financial statements. 	<p>In part.</p> <p>The ED proposed to present lease receivables separately from other financial assets and the residual asset separately within property, plant and equipment.</p> <p>The AASB noted the following 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><i>“...a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment.”</i></p>
<p><i>Presentation: lessor statement of cash flows</i></p>	<p>The Boards tentatively decided that a lessor should classify the cash inflows from a lease as operating activities in the statement of cash flows.</p>	<p>n/a</p> <p>The tentative decision is consistent with the ED proposals.</p> <p>The AASB did not specifically comment on the presentation of lessee cash flows to the IASB. However, the AASB commented, more generally, that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows, subject to materiality.</p> <p>AASB Staff view: AASB staff agree with the IASB's tentative decision.</p>
<p><i>Lessee transition</i></p>	<p>No decisions were made.</p> <p>The Boards discussed the transition requirements for lessees when first applying the proposed leases standard. The Boards will continue to discuss lessee transition when they discuss lessor transition at a future meeting.</p>	<p>n/a</p> <p>The AASB agreed with the simplified retrospective approach to transition proposed in the ED, but commented that a full retrospective approach should also be allowed as an alternative.</p>

³ Note that this comment was quoted in the September 2011 IASB Agenda Paper 2F.