

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

At the joint IASB and FASB meetings held on 19 October 2011, the Boards made two significant tentative decisions in relation to lessor accounting and the scope of the proposals that we think might warrant action by the AASB¹

Issue	Overview of IASB/FASB discussions	Do the tentative decisions align with AASB views?
<p><i>Lessor – receivable and residual approach</i></p>	<p>The Boards tentatively decided to modify the receivable and residual approach previously agreed in July 2011.</p> <p>Under the modified receivable and residual approach:</p> <ul style="list-style-type: none"> • The residual asset is recognised and measured as an allocation of the carrying amount of the underlying asset. • The residual asset is calculated as the net of: <ul style="list-style-type: none"> ○ the gross residual asset (PV of the estimated residual at the end of the lease term) (subsequently accreted to the residual value at the end of the lease term)²; and ○ deferred profit (gross residual asset less the allocated carrying amount of the asset³). Deferred profit is not accreted and is not recognised in profit until the underlying asset is sold or re-leased. <p>The July 2011 decision to distinguish between whether profit is reasonably assured or not has tentatively been reversed.</p>	<p>In part. The AASB has expressed support for a single model for lessor accounting – a ‘full’ derecognition approach.</p> <p>The modified receivable and residual approach is a modified version of the ‘partial’ derecognition approach described in the exposure draft.</p> <p>Preliminary AASB staff view: AASB staff agree with the decision to remove the distinction between whether profit is reasonably assured or not.</p> <p>AASB staff preference would be a ‘full’ derecognition approach. There appears to be no conceptual basis for the deferral of profit.</p> <p>However, if a ‘partial’ derecognition approach is adopted, AASB staff have some reservations as to the method tentatively decided by the IASB.</p> <p>In particular, AASB staff disagree with the subsequent measurement of the ‘net’ residual asset. The residual asset value is not consistent with the concept of residual value as applied in IAS 16.</p>
<p><i>Scope – Investment properties (lessor)</i></p>	<p>The Boards tentatively decided to provide a scope exception for lessor accounting for investment properties as defined in IAS 40.</p> <p>This decision extends the decision in July 2011 to provide a lessor scope exception only for investment properties measured at fair value⁴.</p> <p>The basis for the October 2011 decision was a concern about the practicality of lessor accounting by lessors for underlying assets subject to multiple leases of physically distinct portions.</p>	<p>No. The tentative decision appears to result in all leases of investment properties being accounted for on the same basis as current operating lease accounting. This includes leases that would currently be considered to be finance leases.</p> <p>In its comment letter to the IASB, the AASB supported the proposal to remove the distinction between operating and finance leases. The AASB did not specifically comment on scope in relation to investment properties measured at cost.</p> <p>Preliminary AASB Staff view: AASB staff disagree with the tentative decision and consider that such a scope exception is inconsistent with the objective of developing a single model for leases.</p>

Question to Board members:

Does the Board want to raise one or both of these issues either directly with the IASB, or through the IASB staff?

¹ The Boards also discussed variable lease payments, transfer/securitisation of lease receivables and transition guidance. An update of these topics will be provided at the December 2011 AASB meeting.

² Discounted using the rate the lessor charges the lessee.

³ The allocated carrying amount is calculated as: Carrying amount of underlying asset less (carrying amount * lease receivable / FV of underlying asset). The calculation of allocated carrying amount is consistent with the July 2011 decision.

⁴ The AASB agreed with the scope exclusion of investment property carried at fair value, however, the AASB suggested that this exclusion should be better justified in the Basis for Conclusions by the IASB.

Appendix A: Example – Manufacturer/dealer lessor

- A manufacturer lessor leases equipment to a lessee for 3 years.
- The asset has a useful life of 6 years.
- The carrying amount of the equipment (cost) is CU100
- The fair value of the equipment at lease commencement is CU120.
- The estimated residual at the end of the lease term is CU55.
- The present value of that estimated residual value is CU43.2.
- The lessee pays CU30 annually.
- The present value of the lease payments at lease commencement is CU76.8.
- The rate the lessor charges the lessee is 8.38%.⁵

IASB re-deliberations July 2011 – Profit is reasonably assured – lease receivable < underlying asset

Year	Lease receivable	Residual asset	Profit	Lease payments	Interest revenue	Residual asset accretion
0	76.8	36.0 ⁶	12.8 ⁷			
1	53.2	39.0	9.5 ⁸	30	6.4	3.0 ⁹
2	27.7	42.3	7.7	30	4.5	3.3
3	0	45.8	5.9	30	2.3	3.5
		Total	35.8			

IASB re-deliberations October 2011 – Modified (deferred profit) receivable and residual approach

Year	Lease receivable	Gross residual asset	Deferred profit ¹⁰	'Net' Residual asset ¹¹	Profit	Lease payments	Interest revenue	Residual asset accretion
0	76.8	43.2 ¹²	7.2	36.0	12.8 ⁶			
1	53.2	46.8	7.2	39.6	10.0 ⁷	30	6.4	3.6 ¹³
2	27.7	50.7	7.2	43.5	8.4	30	4.5	3.9
3	0	55.0	7.2	47.8	6.6	30	2.3	4.3
				Total	37.8			

⁵ Adapted from October 2011 IASB Staff Paper 2L.

⁶ Carrying amount of underlying asset *less* (carrying amount of underlying asset * lease receivable / FV of underlying asset)

⁷ Lease receivable + residual value – carrying amount of underlying asset.

⁸ Interest revenue + residual asset accretion.

⁹ Residual asset * discount rate.

¹⁰ This is the profit not recognised ((120-100=20)-12.8).

¹¹ At initial recognition = Carrying amount of underlying asset *less* (carrying amount of underlying asset * lease receivable / FV of underlying asset). Subsequent measurement = Gross residual – deferred profit.

¹² PV of estimated residual at the end of the lease term.

¹³ Accretion of the residual asset based on the gross residual asset.