

Leases Project Update Tentative decisions made by IASB/FASB on the *Leases* project – August 2011

At the joint IASB and FASB meetings held on 20-22 July 2011, the Boards made the significant tentative decision to re-expose the leases proposals. The Boards also discussed lessor accounting, the accounting for lease payments that depend on an index or a rate, the accounting for embedded derivatives in lease contracts and issues relating to presentation and disclosure. AASB staff intend considering the implications of these tentative decisions in detail as part of the comment letter process on the re-exposed revised proposals.

Refer to table below for an overview of items discussed and tentative decisions made relative to the AASB's views.

Issue	Overview of IASB/FASB discussions	Do the tentative decisions broadly align with AASB views?
<i>Re-exposure</i>	The boards agreed unanimously to re-expose the revised proposals.	Yes. At the April 2011 AASB meeting the AASB discussed the possible need for re-exposure on at least some of the IASB topics, perhaps in the form of a fatal flaw exposure of the final standards before AASB approval. AASB staff consider that the IASB tentative decision to re-expose the revised leases proposals addresses the potential concerns the AASB had in relation to sufficient due process in Australia.
<i>Lessor accounting</i>	The boards tentatively decided that a lessor should apply a single lessor accounting model - the 'receivable and residual' accounting approach (except for short-term leases that a lessor elects not to apply the 'receivable and residual' accounting approach, and leases of investment property measured at fair value, which are out of scope of the proposed Standard). Applying this approach the lessor would: <ul style="list-style-type: none"> • recognise a right to receive lease payments and a residual asset at the date of the commencement of the lease. • initially measure the right to receive lease payments at the sum of the present value of 	In part. In its submission to the IASB in December 2010 the AASB supported a single model for lessor accounting – a 'full' derecognition approach. The 'receivable and residual' accounting approach is a modified version of the derecognition approach as described in the exposure draft – a 'partial' derecognition approach. The key differences between the 'receivable and residual' approach and the derecognition approach proposed

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	<p>the lease payments, discounted using the rate that the lessor charges the lessee.</p> <ul style="list-style-type: none"> • initially measure the residual asset as an allocation of the carrying amount of the underlying asset. • subsequently measure the residual asset by accreting it over the lease term using the rate that the lessor charges the lessee. • recognise profit at the date of the commencement of the lease if it is “reasonably assured”. The profit would be measured as any difference between the previous carrying amount of the underlying asset and the sum of the lease receivable and the residual asset recognised. • recognise profit on the right-of-use asset transferred to the lessee over the lease term if the profit is not “reasonably assured”. • if the right to receive lease payments is greater than the carrying amount of the underlying asset at the date of the commencement of the lease, the lessor would recognise, as a minimum, the difference between those two amounts as profit at that date. <p>For excluded leases (i.e. short-term and investment property at fair value), a lessor should (1) continue to recognise and depreciate the underlying asset and (2) recognise lease income over the lease term on a systematic basis.</p>	<p>in the ED include:</p> <ul style="list-style-type: none"> • accretion of the residual asset over the lease term using the rate charged in the lease. • consideration of whether profit is “reasonably assured” when calculating initial profit and residual value. <p>The AASB supported the proposals for simplified accounting for short-term leases for lessors.</p> <p>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.</p> <p>AASB staff have some reservations about the ‘receivable and residual’ approach (refer to Agenda Paper 5.2 for more detail on the AASB staff concerns).</p> <p>AASB staff recommend that these concerns are raised to the IASB staff.</p>
<p><i>Lease payments that depend on an index or a rate (variable lease payments)</i></p>	<p>The boards tentatively decided that, for lease payments that depend on an index or on a rate that is included in the lessee’s liability to make lease payments and the lessor’s right to receive lease payments:</p> <ul style="list-style-type: none"> • Lease payments that depend on an index or a rate should be initially measured using the index or rate that exists at the date of commencement of the lease. • Lease payments that depend on an index or a rate should be reassessed using the index or rate that exists at the end of each reporting period. • Lessees should reflect changes in the measurement of lease payments that depend 	<p>No.</p> <p>The ED proposed that contingent rentals that depend on an index or a rate should be determined using readily available forward rates or indices. If forward rates or indices are not readily available, the lessee should use the prevailing rates or indices.</p> <p>The AASB did not specifically comment on lease payments that depend on an index or a rate in its comment letter to the IASB, which arguably implies that the AASB agreed with the ED proposals.</p> <p>In relation to reassessment of</p>

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	<p>on an index or a rate (a) in net income to the extent that those changes relate to the current reporting period and (b) as an adjustment to the right-of-use asset to the extent that those changes relate to future reporting periods.</p> <ul style="list-style-type: none"> The boards will discuss at a future meeting how a lessor should reflect changes in the measurement of lease payments that depend on an index or a rate. 	<p>contingent rental 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>
<i>Embedded derivatives in lease contracts</i>	<p>The boards tentatively decided that an entity (both lessees and lessors) should assess whether a lease contract includes embedded derivatives that should be bifurcated and accounted for in accordance with applicable US GAAP and IFRS guidance on derivatives.</p>	<p>n/a</p> <p>The issue of embedded derivatives was not considered in the ED.</p> <p>AASB staff agree with the tentative decision. This decision is consistent with the current treatment in IAS 17.</p>
<i>Statement of Cash Flows</i>	<p>The boards tentatively decided the following in relation to lessees:</p> <ul style="list-style-type: none"> The allocation of principal and interest of cash paid for lease payments within the statement of cash flows would be made in accordance with current applicable IFRS or US GAAP requirements. The cash paid for variable lease payments excluded from the measurement of the right-of-use asset and the liability to make lease payments would be classified as an operating cash flow. The acquisition of a right-of-use asset in exchange for a lease liability would be disclosed in an additional non-cash disclosure in a note to the statement of cash flows. The cash outflows for short-term leases not included in the liability to make lease payments would be included in the operating section of the statement of cash flows. 	<p>n/a</p> <p>In relation to lessors, the ED proposed that cash receipts from lease payments be classified as operating activities in the statement of cash flows. The ED did not include any further proposals in relation to the statement of cash flows.</p> <p>The AASB did not specifically comment on the presentation of lessee cash flows the statement of cash flows in its comment letter to the IASB.</p> <p>In its comment letter to the IASB the AASB agreed 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 agree with the tentative decisions on the basis they are consistent with the IASB’s decision in relation to the treatment of variable lease payments (albeit we disagree with the treatment of variable lease payments).</p>

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<i>Statement of Financial Position</i>	<p>The boards tentatively decided the following in relation to lessees:</p> <ul style="list-style-type: none"> • The leases standard would require that lease assets and lease liabilities be separately presented in the statement of financial position or notes to the financial statements. If not presented on the face of the statement of financial position, the amounts disclosed in the notes would indicate in which line item in the statement of financial position the relevant assets and liabilities are presented. • The presentation of the right-of-use asset would be classified in a consistent manner to classification had the entity owned the asset. 	<p>No.</p> <p>In its comment letter to the IASB the AASB agreed that 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.</p> <p>The AASB considered that IAS 1 provides enough guidance in this area and hence, presentation on the face of the statement of financial position versus the notes should not be dealt with by the proposals.</p> <p>The AASB also thought that the proposals should make it clear that the right-of-use asset is an intangible asset.</p>
<i>Disclosures</i>	<p>The boards discussed and tentatively agreed on a number of disclosure issues, including retaining the proposals in the Leases ED to require reconciliation of the beginning and ending balances of right-of-use assets by underlying asset type and the liability to make lease payments, but not to require a disaggregation of the reconciliation of the lease liability by underlying asset type.</p>	<p>No.</p> <p>In its comment letter to the IASB the AASB expressed concern about the volume of reconciliations appearing in proposals and thought they are excessive (paragraphs 77 and 80 of ED/2010/9).</p> <p>The most recent decisions by the IASB do not reduce the volume of reconciliations and therefore do not address the concerns raised by the AASB.</p>
<i>Early application</i>	<ul style="list-style-type: none"> • Early application should be permitted for first-time adopters. (The FASB tentatively decided unanimously that early application should not be permitted.) • The IASB will consider the issue of early application by other entities at a future meeting. 	<p>Yes.</p> <p>In its submission to the IASB in January 2011 re: <i>Request for Views on Effective Dates and Transition Methods</i> the AASB supported early adoption for individual IFRSs in the absence of correlating issues among those IFRSs. The AASB considered that the time of adoption of the revised IFRS on leases and the revised IFRS on revenue should be the same.</p>