

October 28, 2010



Leases

This presentation has been prepared to help stakeholders understand the updated workplan for the projects in the Memorandum of Understanding between the FASB and IASB. The views expressed in this presentation are those of the presenter. Official positions of the IASB and the FASB are reached only after extensive due process and deliberations.

Participants in today's webcast:

Larry Smith – Board Member

Kevin Stoklosa – Assistant Technical Director

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Housekeeping items

- Slides can be downloaded by clicking on the button below the slides window
- To ask a question, type into the designated text box on your screen and click “submit”
- Remember to turn off your pop-up blocker
- A recording of the webcast will be available online at www.fasb.org
- CPE credit is not available for this webcast

Agenda

- Project overview & objectives
- Summary of proposed guidance
- Preliminary feedback

Proposed lease accounting project

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Project added to agenda July 2006



Discussion paper March 2009



Exposure Draft – August 17, 2010
Comment period ends December 15, 2010



Outreach and fieldwork



FINAL STANDARD planned 2011

Summary of Proposed Guidance

Definition & scope

- Lease = A contract in which the right to use a specified asset (the underlying asset) is conveyed, for a period of time, in exchange for consideration.
- Apply to all leases, including leases of right-of-use assets in a sublease, except:
 - Leases of intangible assets
 - Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources
 - Leases of biological asset
 - IASB investment properties – fair value under IAS 40 [FASB current project]
- Difference between service and lease component (distinct / non-distinct)
- Include:
 - Long-term leases of land
 - Non-core assets
- Simplified accounting for short-term leases:
 - Lessee (optional): recognize gross asset and gross liability
 - Lessor (optional): use accrual accounting

Statement of Financial Position

Income Statement

Recognition and Initial Measurement

Right of Use Asset = Cost (amount of liability, plus any initial direct costs incurred by the lessee)

Liability to Make Lease Payments = Cost (PV of lease payments discounted using the lessee's incremental borrowing rate or, if it can be readily determined, the rate the lessor charges the lessee)



For all leases in scope

Subsequent Measurement

Reflect usage of **right to use asset** over the lease term

- Systematic basis (Straight-line)
- Impairment assessment

Measure the **liability to make lease payments** at amortized cost

- Effective interest method
- No revision of discount rate

Reassess **liability to make lease payments** if facts and circumstances indicate there would be a significant change.

Amortization expense

Interest expense

Lessor model

- On the basis of whether the lessor retains significant risks or benefits of the underlying asset during or subsequent to the expected term of the lease contract

Does the lessor retain significant risks or benefits of the underlying asset?

No

Derecognition approach

Yes

Performance Obligation approach

Lessor model: derecognition approach

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Statement of Financial Position

Income Statement

Recognition and Initial Measurement

Residual Value Asset:

Derecognize the portion of the carrying amount of the underlying asset that represents the lessee's right to use the underlying asset during the lease term

Reclassify the remaining portion of the carrying amount of the underlying asset (**residual asset**) that represents the rights in the underlying asset that the lessor retains.

Right to Receive Lease Payments (lease receivable) = Cost (PV of lease payments discounted using the rate the lessor charges the lessee + any initial direct costs incurred by the lessor)

Lease Income = PV of lease payments (classify as revenue)

Lease Expense = Cost of the portion of the underlying asset derecognized (classify as cost of sales)

Subsequent Measurement

Interest Income

Residual asset - assess for impairment.

Measure the **lease receivable** at amortized cost using the effective interest method.

Reassess **lease receivable** if facts and circumstances indicate there would be a significant change

Lessor Model: performance obligation approach

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Statement of Financial Position

Income Statement

Recognition and Initial Measurement

Right to Receive Lease Payments (lease receivable) =
Cost (PV of lease payments discounted using the rate the lessor charges the lessee plus any initial direct costs incurred by the lessor)

Lease Liability = Cost (PV of lease payments discounted using the rate the lessor charges the lessee)

Underlying asset remains recorded

Subsequent Measurement

Measure the **right to receive lease payments** at amortized cost using the effective interest method.

Reflect decreases in **lease liability** over the lease term (based on pattern of use or straight-line).

Underlying asset continues to be depreciated.

Reassess **right to receive lease payments** if facts and circumstances indicate there would be a significant change.

Interest income

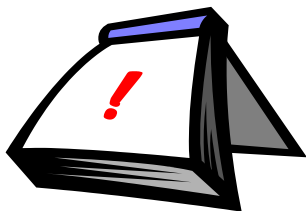
Lease income

Depreciation expense

Renewal or purchase options

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Initial recognition	<ul style="list-style-type: none">• Recognize liability to make lease payments/right to receive lease payments for longest <u>possible</u> lease term that is more likely than not to occur• Consider all relevant factors
Subsequent recognition	<ul style="list-style-type: none">• Reassess term at each reporting date if facts or circumstances indicate a significant change• Recognize change in liability (lessee)/asset (lessor)<ul style="list-style-type: none">• Lessee – as adjustment to right-of-use asset• Lessor<ul style="list-style-type: none">• Derecognition – derecognize or re-recognize portion of residual value asset• Performance obligation – as adjustment to lease liability

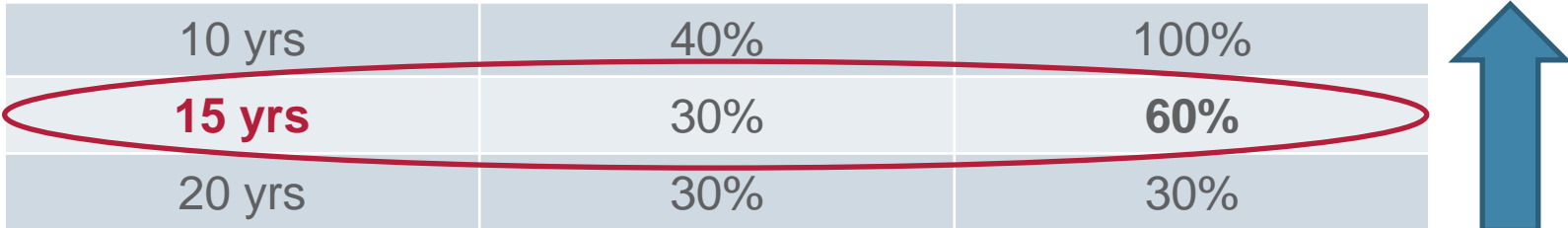


Purchase option is not recognized until exercised!

Example – lease term

An entity has a lease that has a non-cancellable 10-year term, an option to renew for 5 years at the end of 10 years and an option to renew for an additional 5 years at the end of 15 years. Assume that the entity determines the probability for each term as follows:

Lease Term	Probability	Cumulative Probability
10 yrs	40%	100%
15 yrs	30%	60%
20 yrs	30%	30%



There is a 60 percent chance that the term will be 15 years, which is the longest possible term more likely than not to occur. Therefore, the lease term is 15 years.

Contingent rent, penalties and RVGs

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Initial recognition/ measurement

- Measure using expected outcome technique (probability weighted average)
- **Lessee** – Recognize as part of liability
- **Lessor** – Recognize as part of receivable, to the *extent contingent rentals can be measured reliably*

Subsequent measurement

- Reassess at each reporting date if facts or circumstances indicate a significant change
- **Lessee** – Recognize change in liability and:
 - If arising from current or prior periods, in profit or loss
 - All other changes as adjustment to right-of-use asset
- **Lessor** - Recognize change in lease receivable
 - Derecognition – in profit or loss
 - Performance obligation
 - If attributable to satisfied lease liability, recognize in revenue
 - If attributable to unsatisfied lease liability, adjust lease liability

Example – contingent payments

- Company A enters into an arrangement to lease a retail outlet in an office building.
- 15-yr non-cancellable lease with no renewal options.
- Annual lease payments of \$2M/yr plus an additional contingent rent of 2% of gross revenue per year
- Company A's incremental borrowing rate is 8%
- No purchase option or residual value guarantee

Expected Contingent Rentals

	Outcome 1 Constant Revenue	Outcome 2 Revenue Growth 2%/Year	Outcome 3 Revenue Growth 5%/Year	Outcome 4 Revenue Decline 2%/Year	Total
Sales over 15 years, assuming \$10M in year 1	\$ 150,000,000	\$ 172,934,169	\$ 215,785,636	\$ 130,715,449	
Total contingent rent 2%	3,000,000	3,458,683	4,315,713	2,614,309	
Present value	1,711,896	1,919,088	2,297,568	1,534,344	
Probability	25%	40%	25%	10%	
	\$ 427,974	\$ 767,635	\$ 574,391	\$ 153,434	\$ 1,923,434

Right-of-Use Asset/Liability to Make Lease Payments

Contingent rentals	\$ 1,923,434
Annual lease payments (PV of \$2M/year for 15 years)	17,118,957
Total right-of-use asset/liability to make lease payments	\$ 19,042,391

Lessee Accounting

	US GAAP – Operating Lease	US GAAP – Capital Lease	Exposure Draft – Right-of-Use Model
Balance Sheet		<ul style="list-style-type: none"> • Asset (PP&E) • Liability to make lease payments 	<ul style="list-style-type: none"> • Right-of-use asset • Liability to make lease payments
Income Statement	<ul style="list-style-type: none"> • Rental Expense 	<ul style="list-style-type: none"> • Depreciation Expense • Interest Expense 	<ul style="list-style-type: none"> • Amortization of right-of-use asset • Interest Expense
Statement of Cash Flows	<ul style="list-style-type: none"> • Operating Activity 	<ul style="list-style-type: none"> • Financing Activity 	<ul style="list-style-type: none"> • Financing Activity

Summary of Proposed Changes to the Financial Statements

Lessor Accounting

	US GAAP – Operating Lease	US GAAP – Direct Finance Lease	US GAAP – Sales-Type Lease	Exposure Draft – Performance Obligation Model	Exposure Draft – Derecognition Model
Balance Sheet		Recognize: <ul style="list-style-type: none"> • Net investment in lease (receivable) Derecognize: <ul style="list-style-type: none"> • Underlying Asset 	Recognize: <ul style="list-style-type: none"> • Net investment in lease (receivable) Derecognize: <ul style="list-style-type: none"> • Underlying Asset 	<ul style="list-style-type: none"> • Right to receive lease payments • Lease liability 	Recognize: <ul style="list-style-type: none"> • Right to receive lease payments • Residual Asset Derecognize: <ul style="list-style-type: none"> • Underlying Asset
Income Statement	<ul style="list-style-type: none"> • Rental Income • Depreciation Expense 	<ul style="list-style-type: none"> • Interest Income 	<ul style="list-style-type: none"> • Revenue/Income • Cost of Sales • Interest Income 	<ul style="list-style-type: none"> • Lease Income • Depreciation expense • Interest Income 	<ul style="list-style-type: none"> • Revenue/Income • Cost of Sales • Interest Income
Statement of Cash Flows	<ul style="list-style-type: none"> • Operating Activity 	<ul style="list-style-type: none"> • Operating Activity 	<ul style="list-style-type: none"> • Operating Activity 	<ul style="list-style-type: none"> • Operating Activity 	<ul style="list-style-type: none"> • Operating Activity

- To enable users to evaluate the nature, amount, timing, and uncertainty of cash flows arising from lease contracts and how the entity manages those cash flows
- Includes:
 - Nature of lease contracts
 - Nature and amount of significant subleases
 - Information about short-term leases
 - Maturity analyses
 - Significant assumption and judgments (including discount rate)
 - Lessee: reconciliation of right of use assets and liabilities; information about sale and leaseback transaction
 - Lessor: information about exposure to risks; impairment losses; reconciliation of (a) right to receive lease payments (b) lease liability (c) residual asset; class of residual assets; service obligations

- All outstanding leases at date of adoption
 - Simplified retrospective approach
 - Present value of remaining lease payments at:
 - Incremental borrowing rate at date of adoption (lessee)
 - Rate charged in the lease (lessor)
 - Date of adoption = earliest period presented in F/S
- Scope exception for transition
 - “Simple” capital leases – carry forward prior accounting
 - Short term leases

Preliminary Feedback

Lessees

- Basic agreement with right-of-use model
- Concerns:
 - Complexity in considering contingent rents and estimating lease term
 - Income statement impact (amortization and interest expense instead of rent expense)
 - Differentiating leases from services
 - Cost/benefits (non-core assets, short-term leases)
 - Transition

Lessors

- Concerns:
 - Lessor model – when to apply performance obligation or derecognition approach
 - Complexity in considering contingent rents and estimating lease term
 - Income statement impact (proposals require recognition of interest income & lease income)
 - Differentiating leases from services
 - Transition

To learn more and submit feedback

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FASB Technical Plan and Project Updates - Windows Internet Explorer

http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=900000011123

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Project Update

Leases—Joint Project of the FASB and the IASB

Last updated on September 14, 2010. Please refer to the [Current Technical Plan](#) for information about the expected release dates of exposure documents and final standards.

(Updated sections are indicated with an asterisk *)

This project update summarizes the project activities and decisions of the FASB and the IASB (Boards). It was prepared by the staff and is for the information and convenience of their constituents. All decisions of the Boards are tentative, may change at future Board meetings, and do not change current accounting and reporting requirements. Decisions of the Boards become final only after extensive due process.

[*Outreach/Field Work](#)
[Due Process Documents](#)
[Project Objective and Summary of the Proposed Model](#)
[Decisions Reached at the Last Meeting](#)
[Summary of Decisions Reached to Date](#)
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***OUTREACH/FIELD WORK**

Preparer Questionnaire

On September 2, 2010, the Boards published a questionnaire for lessees and lessors as part of their outreach on the Leases project.

In the questionnaire, the Boards are surveying organizations on their use of and

- FASB website: www.fasb.org
 - Projects Tab
 - Leases
- IASB website: www.ifrs.org
 - Press Release
 - FASB In Focus/IASB Snapshot
 - Podcast
 - Exposure Draft (FASB/IASB)
 - Comment Letters
 - Outreach/Fieldwork Info
- Discussion Paper: Effective Dates and Transition

Questions or comments?

