International Financial Reporting Standards

Exposure Draft -*Leases*

The views expressed in this presentation are those of the presenter,
not necessarily those of the IASB or IFRS Foundation

Why a lease project?

- **Existing lease accounting doesn’t meet users’ needs**
  – Accounting depends on classification
  – Users adjust financial statements to recognise assets and liabilities arising in operating leases
- **Complexity**
  – Difficult to define dividing line between finance and operating

Scope

- Includes simplified accounting for short-term leases
  - Lessee: recognise gross asset and gross liability
  - Lessor: use accrual accounting
- Includes certain requirements for sale/leasebacks
- Excludes:
  - Lessors with investment property at fair value under IAS 40
  - Purchase and sale contracts
  - Leases of intangible assets
  - Leases of biological assets or to explore for or use natural resources

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Lessee model

Lessee has acquired a right to use the underlying asset and is paying for that right with its lease payments

All leases in scope	
Balance sheet	**Income Statement**
• Right-of-use asset* X	• Amortisation expense X
• Liability to make lease payments X	• Interest expense X

* Shown in the property, plant and equipment category

Lessee measurement

	Initial Measurement	Subsequent Measurement
Liability to make lease payments	PV of lease payments discounted using incremental borrowing rate	Amortised cost No revision of incremental borrowing rate
Right-of-use asset	Cost (= liability to make lease payments)	Amortised cost (option to revalue*)

*Revaluation of entire class of PP&E is required if right-of-use is revalued

Lessor model

- Based on exposure to risks or benefits of the underlying asset during or subsequent to the expected term of the lease contract
- Counterparty credit risk is not considered

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

No → **Derecognition approach**

Yes → **Performance Obligation approach**

Lessor model

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

No

Derecognition approach	
Balance sheet	**Income Statement**
• Residual asset X	• Revenue X
	• Cost of sales (X) (gross or net based on business model)
• Right to receive lease payments X	• Interest income X

Lessor model

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

Yes

Performance obligation approach

Balance sheet (Gross with linked presentation)		**Income Statement** (Separate presentation –IASB)	
• Underlying asset	X	• Lease income	X
• Right to receive lease payments	X	• Depreciation expense	(X)
• Lease liability	(X)	• Interest income	X
Net lease asset (liability)	X		

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Lessor model - measurement

	Initial Measurement	Subsequent Measurement
Derecognition approach		
Right to receive lease payments	PV of lease payments discounted using the rate charged in the lease	Amortised cost
Residual asset	Allocated carrying amount	No remeasurement (except for impairment)
Performance Obligation approach		
Right to receive lease payments	PV of lease payments discounted using the rate charged in the lease	Amortised cost
Lease liability	Transaction price (= right to receive payments)	Recognise income as the liability is satisfied over the lease term

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Options to extend lease term

- Include longest possible lease term that is more likely than not to occur
  - In lessee's liability to make lease payments
  - In lessor's right to receive lease payments

- Reassess if facts or circumstances indicate that there is a significant change
  - Adjust liability and right-of-use asset for lessees
  - Adjust right to receive and liability or residual asset for lessors

- Purchase options
  - Account for only when they are exercised

Contingent rentals

- Include expected outcome in lease asset and liability
  - Lessees must always include, Lessors only if measured reliably
- Include residual value guarantees
- Reassess if facts or circumstances indicate a significant change

Lessees	Lessors	
	<u>Derecognition approach:</u>	<u>Performance obligation approach:</u>
Adjust liability to make payments and profit or loss *for changes related to current or past periods* or right-of-use asset *for changes related to future periods*	Adjust right to receive rentals and profit or loss	Adjust right to receive rentals and profit or loss *to the extent liability is satisfied* or liability *to the extent not yet satisfied*

Options to extend and contingent rentals: potential concerns

Concerns	Response
Options to extend	
Subjectivity of judgement	Requirement to reassess (true-up information)
Renewals are avoidable –understates financial flexibility	Provides estimates of likely cash outflows
Contingent rentals	
Subjectivity of information	Requirement to reassess (true-up information)
Cost/benefit of determining information	Ignoring would lead to structuring
Reliable measurement	Some users prefer estimates to no information

Disclosures

- Identify and explain the amounts recognised in the financial statements arising from leases; and
- Describe how leases may affect the amount, timing and uncertainty of the entity's future cash flows.
- Include:
  - Nature of lease contracts
  - Accounting policy for models used (lessor)
  - Maturity analyses
  - Income recognition information
  - Discount rates
  - <u>Roll-forward</u> of right-of-use asset / liability to make lease payments (lessees)
  - <u>Roll-forward</u> of right to receive payments / lease liability or residual asset (lessors)

Transition

- All leases
  - Simplified retrospective approach
  - Present value of remaining lease payments

- First time adoption
  - Same treatment as transition

What next?

Discussion paper March 2009

Exposure Draft 17 August 2010

Comment period ends 15 December 2010

Outreach and fieldwork

IFRS planned Q2 2011

IASB contacts

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Questions or comments?

Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.

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