IASB/FASB Meeting 22 July 2010

IASB Agenda reference	2J
FASB Agenda reference	121

Staff Paper

Project	**Leases**
Topic	**Revised proposed wording for lessor accounting approach**

Introduction

1. At an IASB only meeting on Thursday 22 July, the IASB indicated some support for FASB alternative B as described in agenda paper 2I/Memo 120.
2. This paper sets out the IASB's proposed changes to the FASB's original wording.

Proposed wording

New text is highlighted.

Alternative B:

1. Objective: A lessor shall account for a lease contract based on whether the lessor retains exposure to significant risks or benefits associated with the underlying asset either:

   (a) during the expected term of the current lease contract; or

   (b) subsequent to the term of the current lease contract by having the expectation or ability to generate significant returns by leasing that asset multiple times subsequent to the current contract.

Comment [r1]: The IASB would like to understand why there is no reference to sale or usage or the asset after the end of the current lease contract and why "ability" has been included in the text

2. For purposes of this assessment, risks associated with the counterparty credit risk of the lessee shall not be considered.

3. A lessor that retains exposure to significant risks or benefits associated with the underlying leased asset shall apply the performance obligation approach to such leases. A lessor that does not retain exposure to significant risks or benefits associated with the underlying leased asset shall apply the derecognition approach. This assessment shall be made at the inception of the lease and not reassessed subsequently.

4. A lessor shall consider the following factors when determining whether it retains ~~its~~ exposure to significant risks or benefits associated with the underlying leased asset during the expected term of the current lease contract:

   (a) The existence of significant contingent rentals during the expected lease term that are based on the use or performance of the underlying asset

   (b) The existence of options to extend or terminate the current lease term

   (c) The existence of contractual material non-distinct services provided under the current lease contract

5. A lessor shall consider whether the term of the lease is short in relation to the useful life of the asset when determining whether it retains exposure to significant risks or benefits associated with the underlying leased asset subsequent to the term of the current lease contract.

Note: Under Approach B, if a lease is accounted for under the derecognition approach, the residual asset shall be measured initially and subsequently at its fair value with changes in the fair value recognized in net income. That is, the residual asset would be measured similarly to investment property as defined in IAS 40 (and as tentatively decided in the FASB project on investment property accounting).

Comment [r2]: The IASB would like to discuss this proposed change and the FASB's reasons for recommending it.

Application guidance

6. The existence of contractual material non-distinct services may expose the lessee to a significant risk that the lessee will terminate the lease early because of the non-provision of those services. Where the risk that the lessee will terminate the lease early is significant, the lessor is likely to be exposed to significant risks and benefits associated with the underlying asset during the term of the lease contract.

7. For assets with an indefinite useful life (for example land), the lessor should consider whether the present value of any expected returns after the end of the current lease are significant. If the present value of any expected return is not significant the lessor is unlikely to be exposed to significant risks and benefits associated with the underlying asset subsequent to the term of the current lease contract.

Comment [r3]: We would like to discuss if this should be included in the basis, or application guidance or removed.

Basis

8. In most cases an entity's business model will be indicative of whether a derecognition or a performance obligation approach would be appropriate.

   (a) The derecognition approach is likely to be appropriate where the entity's business model is primarily the provision of finance, where the profit of that business unit is derived from interest income and the principal risk associated with the business activity is credit risk.

   (b) The performance obligation approach is likely to be appropriate where the entity's business model is primarily to generate a return from the active management of the underlying assets either from leasing these assets to multiple lessees during their life or from use or sale of the asset at the end of the lease. The lessor may also generate a variable return during the term of the lease by accepting payments that are contingent on the usage or performance of the underlying asset. In this business model the principal risk associated with the business activity is asset risk.