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Project	<b>Leases</b>
Topic	<b>Proposed lessor accounting model</b>

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## Introduction

1. At the IASB only meeting on Wednesday, the IASB indicated that the derecognition model for lessor accounting should be used for all leases except leases that:
  - (a) are short in relation to the total life of the underlying asset
  - (b) include a significant risk that the lessee will terminate the lease early because of the non-provision of integral services by the lessor.
2. The purpose of this paper is to get the IASB's agreement to the draft wording set out below.
3. This paper has been circulated to the FASB and will be discussed with them at a joint meeting on Thursday afternoon.
4. It should be noted that this proposal does not change the tentative decision regarding short term leases. That is that a lessor can choose to account for short term leases (leases with a maximum possible lease term of 12 months or less) on an accruals basis.

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This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

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**Proposed wording**

***Standard***

5. A lessor shall apply the derecognition approach to all leases except those leases described in paragraph 6.
6. A lessor shall apply the performance obligation approach to leases that:
  - (a) have a minimum contractual term that is short when compared to the useful life of the underlying asset. The minimum contractual term of a lease is the non-cancellable term excluding any periods covered by options to extend the lease.
  - (b) include a significant risk that the lessee will terminate the lease early because of the non-provision of integral services by the lessor. A service should be considered integral if its provision is essential to the operation of the underlying asset.

***Basis for conclusions***

7. The IASB propose to use a derecognition approach for most lease contracts because:
  - (a) It is consistent with the lessee accounting model because, at the date of commencement of the lease, the lessor satisfies its performance obligation to deliver the underlying asset to the lessee and has the unconditional right to receive lease payments.
  - (b) It is consistent with the view that the lessee has financed its purchase of a right-of-use asset by assuming an obligation to make lease payments, and that the lessor has sold a right-of-use asset because it no longer controls the economic benefits associated with that portion of the asset. The lessor reflects the transfer of control in the statement of financial position by derecognising the leased portion of the underlying asset.

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- (c) It avoids the grossing up of the statement of financial position associated with the performance obligation approach
- 8. However, the IASB concluded that the derecognition approach may not be appropriate for all leases. Some Board members consider that the costs associated with applying the derecognition approach to leases whose term is short in relation to the useful life of the underlying asset may not outweigh the benefits associated with applying a derecognition approach to those leases. Other Board members consider that the derecognition approach may not be appropriate where an entity's business model is primarily to generate a return from the active management of the underlying asset whether from leasing their assets to multiple lessees during their life or from use or sale of the asset at the end of the lease. Consequently, the Board decided to require the performance obligation approach for leases that have a minimum contractual term that is short when compared to the useful life of the underlying asset.
- 9. In addition, the Board noted that if there is a significant risk that the lessee will terminate the lease early because of the non-provision of integral services by the lessor, it is likely that the lessor will not have satisfied its performance obligation to the lessee in full at commencement of the lease. Consequently, the performance obligation approach should be used.

**Questions for the Board**

**Question 1**

Do you support the proposed drafting for the standard section?

**Question 2**

Does the proposed wording for the basis correctly explain why you have adopted this approach?

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**Question 3**

Is there a need for any application guidance? If yes, what should it cover?