

July 2010



International Financial Reporting Standards

147. DSR-Sitzung am 26.07.2010

147_05a_AktuellerStand_ED_Leases



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- Exclude:
 - Leases of intangible or biological assets
 - Leases to explore for or use natural resources
 - Contracts representing the purchase or sale of the underlying asset
- Include long-term leases of land
- Incorporate IFRIC 4 to differentiate service contracts from leases. A lease exists when the lessee:
 - Obtains the use of a specific asset, and
 - Controls the right to use that asset during the lease term

- Right-of-use model
 - Lessee has acquired a right to use the underlying asset and is paying for that right with its rental payments

- The lessee recognises:
 - A right-of-use asset
 - An obligation to pay rentals

Lessee - Measurement

	Initial Measurement	Subsequent Measurement
Obligation to pay rentals	PV of lease payments discounted using incremental borrowing rate	Amortised cost – no revision of incremental borrowing rate
Right-of-use asset	Cost	Amortised cost – option to revalue*

*Re-valuation of entire class of PP&E is required if right-of-use is re-valued

Lessee - Options to extend

- Address uncertainty about lease term through recognition
- Recognise obligation to pay rentals for **the longest possible lease term that is more likely than not to occur**
- Reassess at each reporting date
- Any change in obligation is an adjustment to the right-of-use asset
- Account for purchase option only when they are exercised

Lessee - Options to extend

Example

- A machine is leased for 10 years
- Lease includes an option to extend for an additional 5 years
- Lessee must decide whether to recognise:
 - an obligation to pay 10 years of rentals
 - an obligation to pay 15 years of rentals

Lessee - Contingent rentals

- Include expected payments in obligation to pay rentals
- Reassess at each reporting date
- Recognise change in obligation:
 - arising from current or prior periods in profit or loss
 - all other changes as an adjustment to the right-of-use asset
- Residual value guarantees
 - treat the same as contingent rentals

Lessee - Presentation

- Statement of financial position
 - Obligation to pay rentals
 - Right-of-use asset within PP&E, separately from assets owned
- Statement of comprehensive income
 - Amortisation and interest expense presented separately
- Statement of cash flows –current format
 - Cash payments in financing activities

Lessee - Disclosures

- 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
- Include:
 - Nature of lease arrangements
 - Maturity analysis of contractual and total obligations
 - Roll-forward of right of use asset and obligation to pay rentals
 - Incremental borrowing rate

Lessee - Transition

- All leases except simple finance leases

Obligation to pay rentals	=	Right-of-use asset	=	PV of lease payments
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- Adjust for prepaid or accrued rentals
- Review asset for impairment
- For simple finance leases, the measurement of the assets and liabilities would not be changed on transition or subsequently

Lessor – Hybrid model

- A performance obligation approach for leases that expose the lessor to significant risks and benefits associated with the underlying asset
- A derecognition approach for all other leases

Lessor - Performance obligation approach

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- Lease creates a new asset, and an obligation to permit the lessee to use the leased asset over the lease term
- Lessor recognises
 - Right to receive cash (lease receivable)
 - Performance obligation (liability)
 - Revenue (as performance obligation is satisfied)
- Lessor retains underlying asset

Lessor – Derecognition approach

- Lessor transfers a portion of underlying asset in exchange for a right to receive payments over the lease term
- Lessor:
 - Recognises right to receive cash (lease receivable)
 - Derecognises a portion of underlying asset
 - May (or may not) recognise profit

Performance obligation - Measurement

	Initial Measurement	Subsequent Measurement
Receivable	PV of lease payments discounted using the rate charged in the lease	Amortised cost
Performance obligation	Transaction price (= PV of lease payments discounted using the rate charged in the lease)	As satisfied over the lease term

- Same as lessee accounting
- Recognise change in receivable as an adjustment to the performance obligation
- Purchase option
 - Account for only when they are exercised

Performance obligation - Contingent rentals

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- Include in receivable if **reliably estimable**
- Reassess at each reporting date
- Recognise change in receivable as:
 - Revenue if related to a satisfied performance obligation
 - An adjustment to the performance obligation if related to an unsatisfied performance obligation
- Residual value guarantees
 - Treat the same as contingent rentals

Performance obligation - Presentation

- Statement of financial position

Underlying asset	X
Receivable	X
Performance obligation	(X)
Net leasing asset/liability	X/(X)

- Statement of comprehensive income-separately present:
 - Lease Income
 - Interest income
 - Depreciation

Performance obligation - Disclosure

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- 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
- Include:
 - Nature of lease arrangements, including contingencies
 - Any restrictions on leased assets
 - Maturity analysis of lease receivables
 - Revenue recognition information
 - Roll-forward of receivable and performance obligation

Performance obligation- Transition

- All leases
- Measure using original rate charged by the lessor

Receivable	=	Performance obligation	=	PV of lease payments
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- Reinstate previously derecognised underlying assets
 - Depreciated cost or FV

Derecognition - Measurement

	Initial Measurement	Subsequent Measurement
Receivable	PV of lease payments discounted using the rate charged in the lease	Amortised cost
Residual asset	Allocated carrying value	No remeasurement (except for impairment)

Derecognition – Options to extend

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- Same as performance obligation model except:
 - Recognise change in assessment as a derecognition/re-recognition event for the residual asset
- Purchase options
 - Account for only when they are exercised

Derecognition - Contingent rentals

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- Include in measurement of receivable if amount can be measured reliably
- Reassess at each reporting date, with changes in in profit or loss
- Residual value guarantees
 - Treat the same as contingent rentals

Derecognition - Presentation

- Statement of financial position
 - Present lease receivables separately from other receivables
 - Residual assets separately in PP&E by class of asset
- Statement of comprehensive income
 - Revenue/cost of sales based on lessor's business model
 - Some lessors would present gross, others net (depending on business model)

Derecognition - Disclosure

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- 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
- Include:
 - Nature of lease arrangements, including contingencies
 - Short term leases and service obligations
 - Maturity analysis of lease receivables
 - Revenue recognition information
 - Roll-forward of receivable and residual asset

Derecognition - Transition

- All leases
- Measure using original rate charged by the lessor

Receivable	=	PV of lease payments
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- Residual asset measured at fair value

Lessor – Investment property

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- If investment property at cost, apply new lessor accounting requirements
- The IASB
 - If investment property at fair value in accordance with IAS 40, do not apply new lessor accounting requirements
- The FASB
 - Consider whether to permit or require fair value under US GAAP

- Account for transactions as sale/leasebacks if it is determined that the underlying asset has been sold
 - at the end of the contract control of the underlying asset will be transferred, **and**
 - all but a trivial amount of the risks and benefits associated with the underlying asset have been transferred to the buyer/lessor
- Adjust assets, liabilities, gains and losses recognised to reflect market rentals

- Subleases
 - Account for assets/liabilities in accordance with the related lessee and lessor models
 - Present separately the obligation to pay rentals to the head lessor
 - Disclose the nature and amount of significant subleases
 - Show the leased asset, lease receivable and performance obligation with “linked” presentation under the performance obligation approach
 - Present all assets and liabilities gross under the derecognition approach

- Short-term leases
 - Lessee: recognise gross asset and gross liability
 - Lessor: use accrual accounting
- First time adoption
 - Apply the proposed transition requirements
 - Recognise lease assets and liabilities at the present value of the lease payments for all leases
 - No relief for simple finance leases-account for in the same way as other leases on first time adoption

Other issues

To be addressed in July 2010 board meeting

- Lessors
 - Accounting for services integral to leases
 - Indicators for how to apply hybrid models

What next?

