IFRS in Focus
Decisions reached on leases project at March 2014 joint IASB and FASB meeting

Summary

- Lessee accounting: IASB decide on a single model approach, with all leases other than 'short-term leases' and leases of 'small assets' to be accounted for 'on balance sheet' in a similar way to current finance lease accounting.
- Lessor accounting: IASB decide to determine the lease classification on the basis of whether the lease was effectively a financing or a sale.
- IASB and FASB reach diverging decisions on a number of aspects of lessee and lessor accounting.

The IASB and its U.S. counterpart the Financial Accounting Standards Board (FASB) held a joint meeting in March to redeliberate the leases project following their 2013 joint exposure draft (ED). This edition of IFRS in Focus summarises the decisions reached during that meeting. (Click **here** for more information on the 2013 ED.)

Lessee Accounting Model

The IASB decided on a single model approach under which the lessee would account for leases as financing the purchase of a right-of-use (RoU) asset. Under this approach, all leases other than 'short-term leases' and leases of 'small assets' would be accounted for in line with current finance lease accounting, with amortisation of the ROU asset (typically straight line) recognised separately from interest expense on the lease liability (using the effective interest rate method). This accounting corresponds to the treatment of 'Type A' leases proposed in the 2013 ED.

IASB and FASB divergence

The FASB decided on a dual model approach similar to that proposed in the 2013 ED, with all leases other than 'short-term leases' being recognised 'on balance sheet', and accounted for either in line with the IASB's approach (Type A), or recognised through a single straight-line expense (Type B). In a departure from the proposals in the 2013 ED, leases would be classified into the two types in accordance with the existing distinction between operating and finance leases in IAS 17 *Leases*.

For more information please see the following websites:

www.iasplus.com

www.deloitte.com

Lessor Accounting Model

The IASB decided that a lessor should determine lease classification on the basis of whether the lease was effectively a financing or sale, rather than an operating lease, using guidance similar to the current requirements in IAS 17. Therefore, lease classification would focus on whether substantially all of the risks and rewards incidental to ownership of the underlying asset have been transferred to the lessee.

The IASB decided to eliminate the receivable and residual approach proposed in the 2013 exposure draft, instead requiring approaches similar to current 'finance lease' and 'operating lease' accounting for lessors.

> **IASB and FASB divergence**
> The FASB decided on a similar approach to the one taken by the IASB. However, the FASB decided that a lessor would not be permitted to recognise a selling profit for any sales type lease that does not transfer control (which similar to the forthcoming revenue standard would be evaluated from the customer/lessee's perspective) of the underlying asset to the lessee at lease inception.

Small-ticket leases

The IASB decided:

- not to include any explicit materiality guidance within the final leases Standard;
- to allow leases to be accounted for at a portfolio level and to include portfolio guidance in the application guidance; and
- to move forward with an explicit lessee recognition and measurement exemption for leases of small assets.

The definition of a 'small asset' was not finalised, this will be considered at a future meeting.

> **IASB and FASB divergence**
> The FASB decided against moving forward with an explicit recognition and measurement exemption for leases of small assets.

Lease term

The IASB decided that an entity should consider all relevant factors when assessing whether there is an economic incentive for the lessee to exercise an option to extend, or not to terminate, a lease or an option to purchase the leased asset. An entity should include such an option in the lease term only if it is *reasonably certain* that the lessee would exercise the option having considered the relevant economic factors.

The IASB also decided that a lessee should reassess the lease term after inception only on occurrence of a significant triggering event that is within the control of the lessee. A lessor should not reassess the lease term.

Short-term leases

The IASB decided to:

- confirm a lessee recognition and measurement exemption for short-term leases;
- change the definition of a 'short-term lease' so that it is consistent with the definition of 'lease term';
- confirm that the short-term lease threshold should be a lease term of 12 months or less; and
- require disclosure of the short-term lease expense recognised in the current period as well as any qualitative information required for leases in general. Disclosure of the short-term lease commitments would also be required if the short-term lease expense recognised does not reflect the short-term lease commitment.

> **What happens next?**
> Redeliberations will continue in future Board meetings with the expected completion date of the project yet to be determined. There are currently no plans for further exposure of the proposals for comment prior to publication of a final standard.

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