

Revised IASB Exposure Draft *Leases*

Additional consultation

Questionnaire for users of financial statements

EFRAG will have access to the information that you provide in response to this questionnaire. Your response will be also shared with participating European national standard setters on an anonymous basis (ie, participants' identity will remain confidential)

Purpose of the consultation

- 1 The IASB and the FASB ('the Boards') are currently engaged in the redeliberation process on the proposals in the Exposure Draft *Leases* ('the ED'). The project was started as a joint project to converge on a single *Leases* standard. While there are some differences in existing Standards, both IFRS and US GAAP require lessees to classify their lease contracts as either finance leases or operating leases. Finance leases are defined as those leases that transfer to the lessee substantially all the risks and rewards incidental to ownership of the leased asset. All other leases are operating leases.
- 2 For leases classified as finance leases, the lessee recognises in its statement of financial position the leased item and an obligation to pay rentals. No similar assets or liabilities are recognised by the lessee when the lease is classified as an operating lease. The lessee recognises lease payments under an operating lease as an expense, normally on a straight-line basis over the lease term. The lessee is required to disclose in the notes information on the amount and timing of future payments for operating leases.
- 3 The ED published in 2013 required a lessee to classify leases as Type-A or Type-B based on the extent of the expected consumption of the economic benefits over the lease term. The ED included a rebuttable presumption that leases of property would be Type-B and leases of other assets would be Type-A. All leases would be recognised on the balance sheet. Type-A leases would be accounted for similar to existing finance leases; for Type-B leases, a lessee would recognise a lease expense that in most cases would be straight-line. Therefore, Type-B leases would maintain the cost recognition pattern of existing operating leases.
- 4 In January 2014, the Boards started their re-deliberations on the *Leases* proposals. In March, the two Boards tentatively decided to support two different approaches for lessees. Similarities and differences between the two approaches are explained below in paragraphs 10 to 25 of the present document.

- 5 Moreover, many preparers have repeatedly expressed concerns that the definition and criteria to identify a lease may capture arrangements that are in substance services.
- 6 This is problematic, because contract services should not be recognised on the balance sheet. Also, some constituents believe that the guidance provided is not sufficient to support consistent application.

General information

- 7 Please indicate how you use financial statements:

| | |
|--------------------------|--|
| | |
| Credit analyst | |
| Sell-side equity analyst | |
| Buy-side equity analyst | |
| Retail investor | |
| Other (please specify) | |

- 8 Participants can elect to reply only to part 1 (question in paragraphs 25/26) or part 2 (question in paragraph 39) and are required to submit their replies **no later than Friday 29th August**. Participants can contact the following persons and organisations in their territory.

| <u>Country</u> | <u>Contact</u> | <u>Contact name</u> | <u>Phone number</u> | <u>E-mail address</u> |
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PART 1 - DESCRIPTION OF THE IASB AND FASB APPROACHES TO LESSEE ACCOUNTING

Common features

- 9 Including the tentative decisions made at the June 2014 meeting, the two Boards are converged on the following aspects in relation to lessee accounting:
- (a) A lessee should recognise a right-of-use asset and a liability on its balance sheet for all leases (other than short-term leases);
 - (b) The criteria and guidance to identify if an arrangement contains a lease;
 - (c) When a contract includes both a lease and service components (such as maintenance), a lessee shall separate the contract and allocate the total payments to the different components, A lessee recognises an asset and a liability only for the lease component;
 - (d) Right-of-use assets and lease liabilities shall be presented or disclosed separately from other assets or liabilities;
 - (e) A lessee shall initially measure the lease liability as the present value of the future lease payments and the right-of-use asset at the amount of the lease liability plus initial direct costs; and
 - (f) The guidance on discount rates, options and variable lease payments.

Differing features

- 10 The approaches of the two Boards differ in relation to:
- (a) The subsequent measurement of the right-of-use asset for those leases that, in the FASB model, are not in substance purchases of the underlying asset;
 - (b) The presentation of the lease expense in the income statement;
 - (c) The presentation of the lease payments in the statement of cash flows; and
 - (d) In the IASB approach, an exemption for 'small' assets (eg laptops and office furniture).

IASB approach

- 11 The IASB approach requires a lessee to recognise a right-of-use asset and a lease liability at the commencement date of each lease. A lessee may elect not to recognise assets and liabilities in relation to:
- (a) Short-term leases; and
 - (b) Leases of 'small' assets.
- 12 After commencement, a lessee shall measure the lease liability at the present value of future lease payments and amortise the right-of-use asset over the lease term in accordance with the requirements in IAS 16. This results generally in a straight-line amortisation of the right-of-use asset and a declining interest expense on the lease liability.

FASB approach

- 13 The FASB model distinguishes between leases that are in substance purchases of the underlying asset (written as leases) and leases that are not in substance purchases of the underlying asset. The distinction is based on the principle used in IAS 17 to distinguish finance leases from operating leases.
- 14 A lessee shall recognise a right-of-use asset and a liability for all leases, whether they are in substance purchases or not. A lessee may elect not to recognise assets and liabilities for short-term leases.
- 15 For leases that are in substance purchases, a lessee shall account for the transaction in the same manner as any other financed purchase. After commencement, this results generally in a straight-line depreciation of the asset and a declining interest expense on the liability.
- 16 After commencement, leases that are not in substance purchases are accounted for using a single approach that recognises a single lease expense measured generally on a straight-line basis over the lease term. The lease liability is measured at each reporting date at the present value of future lease payments, while the right-of-use asset equals the lease liability (as adjusted for any prepaid/accrued rent).

How the approaches depict leases

- 17 In substance, the IASB approach considers all leases as finance leases. The IASB approach views a lease as providing a lessee with a non-financial asset that it typically uses over time and for which it pays over time. Accordingly, the IASB approach requires a lessee to account for the right-of-use assets consistently with other non-financial assets and lease liabilities consistently with other similar financial liabilities.
- 18 Compared to the current requirements and the FASB approach, the IASB approach removes the need for a classification of leases, which some may consider as improving comparability. However, others may disagree that all leases should be treated in the same way.
- 19 Concerning presentation, under the IASB approach, a lessee shall present the interest expense on the lease liability within finance (interest) costs and the amortisation of the right-of-use asset typically within the same line item as depreciation on items of property, plant and equipment (ie within operating expenses).
- 20 The IASB does not specify how a lease liability is presented. However, the IASB staff noted that under the general requirements of IAS 1, a lessee would either present these liabilities in a separate line or include them with other financial liabilities.
- 21 The FASB approach maintains the view that some leases are in substance purchases of the underlying asset, and some leases are not. For the latter the lease expense is recognised generally on a straight-line basis because it represents the generally equal benefit the lessee receives each period throughout the lease term, as well as the periodic cost of the access to that benefit. Compared to the IASB approach, in most cases the FASB approach maintains the same profile of recognition of lease expenses and reduces the extent of change imposed on preparers.
- 22 Concerning presentation, for leases that are not in substance purchases the single expense is shown as an operating cost in its entirety and is not broken down between amortisation and interest.

- 23 The FASB does not specify how a lease liability is presented, but has indicated that a lessee cannot present the total liabilities as a single separate line or include them in the same line, but it has to separate the liabilities arising from leases that are in substance purchases and other leases.
- 24 The FASB staff noted that this would generally allow lessees on the US to present lease liabilities from leases that are not in-substance purchases as operating liabilities (e.g., akin to a restructuring liability that is still financial in nature, but not ‘debt-like’); given the different legal treatment of these liabilities in case of a bankruptcy procedure.

Questions

- 25 Assume that the Boards maintain the current scope of application of the proposals, do you prefer:

| | Yes | No |
|--|-----|----|
| The IASB approach, that recognises all leases on the balance sheet and in substance treats all leases as finance leases | | |
| The FASB approach, that recognises all leases on the balance sheet but, after commencement as follows: <ul style="list-style-type: none"> • for leases that are in substance purchases: separate finance and amortisation costs in the income statement and right-of-use assets and liabilities in the balance sheet • for leases that are not in substance purchases: a single lease expense in the income statement and right-of-use assets and lease liabilities, separately presenting these liabilities from the liabilities for leases that are in substance purchases, in the balance sheet | | |

- 26 Please provide your reasons for supporting one or the other approach:

| | Yes | No |
|---|-----|----|
| It provides more relevant information | | |
| It is easier to understand | | |
| It improves comparability of similar transactions | | |
| Other reasons (please explain) | | |
| <i>Please explain the basis of your conclusion:</i> | | |

PART 2 - HOW A LEASE IS DEFINED

General description

- 27 The 2013 ED defined a lease as “a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration”. A contract contains a lease when both the following conditions are met:
- (a) Fulfilment of the contract depends on the use of an identified asset; and
 - (b) The contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.
- 28 The first condition is met when the supplier does not have the practical ability or would not benefit from replacing the underlying asset.
- 29 The second condition is met when, during the lease term, the customer can both:
- (a) Direct the use of the identified asset; and
 - (b) Derive the benefits from the use of the asset.
- 30 Constituents have expressed the view that these criteria may sometimes capture transactions that are viewed as services or may be difficult to apply. The following are examples of situations that have been mentioned as dubious. .

Assessing which party controls – Power to govern the use

- 31 Customer enters into a contract with Supplier for the charter of an identified ship for a five-year period. Customer uses its own personnel to navigate the ship and decides where and when the ship sails. In this case, the contract would include a lease, because the Customer has obtained control of the underlying asset.
- 32 In a different scenario, Customer also hires the crew from the Supplier. During the lease term, Customer can decide whether and what cargo will be transported and the timing and location of the delivery. In this case, the contract might also include a lease, on the grounds that all the significant operating decisions are dependent upon the instructions given by the Customer during the lease term.
- 33 However, if the schedule of the deliveries is pre-determined before the commencement of the contract and the Customer cannot make any change subsequently, the contract does not contain a lease as all the significant operating decisions during the lease term will be made by the Supplier.

Assessing which party has control - contract includes significant services

- 34 Customer enters into a contract with Supplier for the rental of 10 printers. The printers are identified and the Supplier cannot replace them (unless the printers break down). The Supplier provides the consumables and the maintenance of the printers. The Supplier only offers contracts that include the consumables and the maintenance. The printers are located in the Customer’s premises and are operated by the Customer. In this case, the contract would include a lease.

- 35 Based on the proposals, the Customer will need to separate the total contract payments between the lease and the consumables and services. Payments related to consumables and services are recognised as a cost during the lease term and do not give rise to an asset and liability at the beginning of the lease.

Assessing if there is an identified asset – Portion of capacity

- 36 Customer enters into a contract to transport gas with the Supplier. The Supplier owns a pipeline. The volume of gas transported on behalf of the Customer is equal to 50% of the total capacity of the pipeline.
- 37 Based on the proposal, the contract does not contain a lease because the 50% capacity occupied is not physically distinct.
- 38 However, if the volume transported equals to 100% of the total capacity of the pipeline, the Customer would need to assess which party has the right to control the use of the pipeline. If the Customer concludes that it has the right to control the use of the pipeline, the contract is a lease.

Question

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| <p>39 The current definition and criteria to identify a lease are explained above in paragraphs 27 to 30. Based on your knowledge, do you think that some transactions should be excluded from the scope of the Standard and treated as service contracts (i.e., no asset and liability are recognised by the lessee)? If so, please describe the transaction and provide your reasons.</p> |
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