



## Boards Substantially Complete Redeliberations on Accounting for Leases

At their July 17 meeting, the FASB and IASB (the Boards) discussed remaining lessee and lessor accounting, disclosure, and transition matters from their joint redeliberations on accounting for leases.<sup>1</sup> The Boards believe they have substantially completed joint redeliberations of their 2010 leases exposure drafts (2010 EDs) and they directed their staff to begin jointly drafting revised exposure drafts (EDs).<sup>2</sup> They expect to issue the revised EDs for comment near the end of 2012 and hope to issue final standards in 2013.

The FASB plans to discuss at a future meeting what changes, if any, should be made to the current lease accounting proposals to accommodate the needs of private companies' financial statement users. The Boards' staff also noted that further joint redeliberations may be necessary to discuss specific issues that are identified while drafting the revised EDs.

Most of the matters discussed by the Boards during the July 17 meeting arose as a result of their tentative decisions on the leases project at their meeting on June 13, 2012.<sup>3</sup> At that meeting, they tentatively decided that the pattern of total noncontingent lease expense recognized by lessees generally would be either front-loaded (referred to as the interest and amortization or I&A method) or straight line (referred to as the single lease expense or SLE method), depending on the outcome of a new lease classification test that would include consideration of the characteristics of the underlying asset and the terms of the lease (the two-method approach). The Boards also tentatively decided to require lessors to apply the same lease classification test to determine whether to account for a lease using the receivable and residual (R&R) model or operating lease accounting.

Several members of each Board indicated in July that they may dissent from publication of revised EDs because of concerns about aspects of the tentative decisions reached in June. In addition, it is not clear to what extent tentative decisions reached earlier in the Boards' redeliberations may need to be revisited in light of their June decisions.

Topics discussed by the Boards at the July 17 meeting included:

- Lessee balance sheet presentation of right-of-use (ROU) assets and lease liabilities for leases accounted for under the SLE method;

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<sup>1</sup> For more information see KPMG's Defining Issues publications on the Boards' joint leases project, and Issues In-Depth No. 10-5, Potential Implications of the FASB, IASB Joint Exposure Draft on Lease Accounting, all available at [www.kpmginstitutes.com/financial-reporting-network](http://www.kpmginstitutes.com/financial-reporting-network).

<sup>2</sup> FASB Proposed Accounting Standards Update, Leases, August 17, 2010, available at [www.fasb.org](http://www.fasb.org), and Exposure Draft ED/2010/9, Leases, August 2010, available at [www.ifrs.org](http://www.ifrs.org).

<sup>3</sup> Refer to KPMG's Defining Issues No. 12-23, Boards Choose Dividing Line on Lessee and Lessor Accounting, available at [www.kpmginstitutes.com/financial-reporting-network](http://www.kpmginstitutes.com/financial-reporting-network).

- Lessee statement of cash flows presentation for leases accounted for under the SLE method;
- Lessee disclosure requirements under the two-method approach;
- Lessee transition for leases accounted for under the SLE method;
- Lessor measurement of the underlying asset upon early termination of a lease accounted for under the R&R model; and
- Interim disclosure requirements for lessees and lessors.

### **Lessee Balance Sheet Presentation**

The Boards tentatively decided that because the measurement basis for ROU assets relating to leases accounted for under the SLE method is different from ROU assets relating to leases accounted for under the I&A method, lessees would be required to provide separate information about ROU assets arising from leases accounted for under each method. Lessees would be required either to present I&A method ROU assets separately from SLE method ROU assets on the balance sheet or separately disclose them in the notes to the financial statements and indicate the balance sheet line item in which the respective ROU assets are included. Lessees would be required to classify all ROU assets (including SLE method ROU assets) in the same categories on the balance sheet as the underlying asset would be if it were owned – i.e., the ROU asset would be presented as if it were a tangible asset, generally within property, plant, and equipment (PP&E).

Lessees would be required either to present liabilities relating to leases accounted for under the I&A method separately from liabilities relating to leases accounted for under the SLE method on the balance sheet or separately disclose them in the notes to the financial statements and indicate the balance sheet line item in which the respective liabilities are included. The Boards observed that without such separate presentation or disclosure requirements, financial statement users would not be able to determine which liabilities give rise to lease interest expense in the income statement, nor understand various items presented in the statement of cash flows. The Boards tentatively agreed that SLE method lease liabilities could be classified on the balance sheet in the same manner as I&A method lease liabilities (or, if they are disclosed separately, even within the same line item), despite the fact that lease interest expense would not be separately recognized for leases accounted for under the SLE method. The lease liabilities under either the SLE method or the I&A method would be initially and subsequently measured in the same manner and, therefore, the Boards agreed that lessees should be permitted to present all lease liabilities together on the balance sheet.

### **Lessee Statement of Cash Flows Presentation**

The Boards tentatively decided that lessees would be required to classify all cash payments for leases accounted for under the SLE method as operating activities in the statement of cash flows to be consistent with their other tentative decisions about the SLE method (i.e., to require lease expense under the SLE method to be presented in one income statement line item and not to present interest expense for such leases). Under the I&A method, cash payments related to principal on the lease liability would be classified as financing activities, while cash payments related to interest on the lease liability would be classified in accordance with current GAAP

(i.e., as cash flows from operating activities for entities applying U.S. GAAP).<sup>4</sup> The Boards directed their staff to provide an analysis of whether to require disclosure of all cash paid for leases during the period, including non-lease components of arrangements with embedded leases.

The Boards also tentatively decided to require lessees to disclose as a noncash transaction ROU assets acquired in exchange for lease liabilities. This supplemental disclosure requirement would apply to leases accounted for under the SLE method as well as those accounted for under the I&A method. IASB members observed that lessees could potentially satisfy this requirement through the rollforward disclosure of changes in ROU asset balances.

## Lessee Disclosures

At the July meeting, the Boards did not revisit the core aspects of their previous tentative decisions on lessee disclosure requirements. However, they concluded that as a result of their tentative decision to adopt the two-method approach for lessee accounting, they should revisit the following previous tentative decisions with respect to required lessee disclosures, which were based on accounting for all leases other than short-term leases using the I&A method:

**Maturity Analysis.** The Boards' previous tentative decisions would require a lessee to disclose a maturity analysis of the undiscounted cash flows for the liability to make lease payments annually for each of the five years following the reporting date and total amounts to be paid thereafter. Lessees applying U.S. GAAP also would be required to include in the maturity disclosure cash flows relating to contractual commitments for services and other non-lease components that are not recorded as part of the lease liability in arrangements that contain leases. The Boards tentatively concluded at the July meeting that:

- Lessees would be permitted to provide a single maturity analysis for all lease liabilities – i.e., separate maturity disclosures would not be required for I&A method lease liabilities and SLE method lease liabilities; and
- Lessees applying U.S. GAAP would not be required to separate the portion of the maturity analysis related to services and other non-lease components for SLE method leases from the portion related to I&A method leases.

The Boards reached these tentative decisions principally on the basis that the primary objective of the maturity analysis is to provide financial statement users information about the lessee's commitments at the reporting date, and the timing of future cash flows associated with those commitments. The Boards believe that separate maturity analyses by type of lease generally would not provide additional useful information to achieve that objective.

**Rollforward of Lease Liability Balances.** The Boards' previous tentative decisions would require a lessee to disclose a rollforward of opening and closing balances of liabilities to make lease payments. The rollforward disclosure would be required to include at a minimum: (a) liabilities created due to new leases; (b) liabilities cancelled due to terminated leases; (c) cash paid; (d) foreign currency translation adjustments,

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<sup>4</sup> FASB ASC Topic 230, Statement of Cash Flows, available at [www.fasb.org](http://www.fasb.org), and IAS 7, Statement of Cash Flows. IAS 7 permits interest payments to be classified as either an operating or financing activity.

and (e) effects of business combinations. The Boards tentatively concluded at the July meeting that:

- As a result of their earlier tentative decision to require separate presentation or disclosure of I&A method lease liabilities and SLE method lease liabilities, lessees would be required to provide separate rollforward disclosures for lease liabilities under each method; and
- Each rollforward would be required to include the impact of interest on the liability (i.e., the unwinding of the discount on the estimated future lease payments) regardless of whether interest expense is recognized in the income statement, thereby requiring lessees to present and disclose any accrued interest or accretion on the lease liability together with the liability balance itself.

The Boards reached this tentative decision primarily because financial statement users have indicated that information about interest/unwinding of the discount on all lease liabilities would be useful, regardless of whether that interest is separately presented as an expense in the lessee's income statement.

**Rollforward of ROU Asset Balances.** The Boards' previous tentative decisions would require a lessee to disclose a rollforward of opening and closing balances of ROU assets disaggregated by class of underlying asset. The rollforward disclosure would be required to include at a minimum: (a) additions from commencement of leases; (b) disposals from termination of leases; (c) amortization; (d) foreign currency translation adjustments; (e) effects of business combinations; and (f) impairment.

At the July meeting, the FASB tentatively decided to eliminate the ROU asset rollforward requirement mainly because there is no corresponding U.S. GAAP disclosure requirement for PP&E and some elements of the rollforward disclosure would be obtainable by financial statement users from information in the basic financial statements or in other disclosures.<sup>5</sup> FASB members indicated that even though SLE method ROU assets would not be amortized or measured in a manner consistent with I&A method ROU assets, they would not be supportive of a rollforward requirement that would apply only to I&A method ROU assets. FASB members also observed that they did not believe the benefits of the ROU asset rollforward disclosures would justify their cost.

The IASB tentatively decided to require lessees to provide separate rollforward disclosures of I&A method ROU assets and SLE method ROU assets. In reaching this tentative decision, the IASB observed that the ROU asset rollforward requirement is necessary to be consistent with the existing IFRS disclosure requirements for PP&E.<sup>6</sup> IASB members acknowledged that SLE method ROU assets would not be subsequently measured in the same manner as I&A method ROU assets and PP&E. However, they noted that financial statement users have regularly commented on the usefulness of rollforward information. They also indicated that they did not believe the different measurement basis for SLE method ROU assets lessened the usefulness of that information because these assets would, like I&A method ROU assets, be presented together with PP&E in the lessee's balance sheet.

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<sup>5</sup> FASB ASC Topic 360, Property, Plant, and Equipment, available at [www.fasb.org](http://www.fasb.org).

<sup>6</sup> IAS 16, Property, Plant and Equipment.

**Table of Lease Expenses and Cash Payments During the Reporting Period.** The Boards previously reached a tentative decision to require a lessee to disclose lease expenses and cash payments on leases during the reporting period, in a tabular format, disaggregated into: (a) amortization expense; (b) interest expense; (c) expenses relating to variable lease payments not included in the measurement of lease liabilities; (d) expenses for short-term leases not accounted for under the ROU model; and (e) cash flows for principal and interest paid on lease liabilities.

At their July meeting, the Boards tentatively decided to eliminate the requirement for a tabular disclosure of all lease expenses and cash payments on lease liabilities during the reporting period. Instead, they tentatively decided to require lessees to disclose expenses for the period related to variable lease payments not included in the measurement of the lease liability. The Boards concluded that some elements of lease expense that would have been included in the tabular disclosure would be obtainable by financial statement users from information in the basic financial statements or in other disclosures.

### **Lessee Transition**

At their July meeting, the Boards tentatively decided that at the date of initial application of the new leases standard (i.e., the beginning of the earliest comparative period presented in financial statements in which the standard is first applied), for existing operating leases that would be accounted for under the SLE method, lessees would be permitted to either (a) recognize a ROU asset measured at an amount equal to the amount of the related lease liability, adjusted for uneven lease payments, or (b) apply a fully retrospective approach. The lease liability would be measured in the manner previously tentatively decided on by the Boards (i.e., as the present value of remaining estimated future lease payments discounted using the lessee's incremental borrowing rate at the date of initial application).

### **Lessor Measurement of the Underlying Asset upon Early Termination of a Lease Accounted for under the R&R Model**

The Boards tentatively decided at their July meeting that upon early termination of a lease accounted for under the R&R model, the lessor would be required to test its lease receivable for impairment using the Boards' proposed impairment of financial assets guidance.<sup>7</sup> The receivable would be considered to be impaired if its carrying amount exceeded the sum of the portion of the underlying asset's fair value that relates to the lease receivable (i.e., excluding the portion of the underlying asset's fair value relating to the lessor's residual interest) plus any cash expected to be received by the lessor upon lease termination [impairment = carrying amount of lease receivable - (portion of underlying asset's fair value that relates to lease receivable + cash expected to be received upon termination)].<sup>8</sup> After recording any required impairment of the lease receivable, the lessor would measure the underlying asset at the combined amount of the remaining lease receivable plus the net residual asset (i.e., the gross residual asset less any deferred profit). The lessor

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<sup>7</sup> For more information on the Boards' joint project on impairment of financial assets, see KPMG's Defining Issues No. 11-68, Boards Make Progress on Impairment Model for Financial Assets, available at [www.kpmginstitutes.com/financial-reporting-network](http://www.kpmginstitutes.com/financial-reporting-network).

<sup>8</sup> The staff indicated that in their view one method for estimating the portion of the underlying asset's fair value attributable to the lease receivable would be to determine the present value of remaining estimated cash flows the lessor would have been entitled to under the lease at the date of lease termination.

would then perform an impairment test of the underlying asset under current GAAP (termination of the lease would be considered an event requiring an impairment analysis).<sup>9</sup> The Boards selected this approach instead of two alternative approaches proposed by the staff mainly because in their view:

- It was the least complex approach; and
- It was the only approach that would not result in recognition of the deferred profit on the residual asset, thereby remaining conceptually consistent with their previous tentative decision that deferred profit under the R&R model would only be recognized when the underlying asset is sold to a third party, re-leased, or a reassessment of the lease receivable occurs.

### Interim Disclosures

The Boards tentatively decided at their July meeting not to require any specific interim disclosures for lessees, although the general interim reporting requirements in current GAAP would continue to apply.<sup>10</sup> This decision was based on a combination of factors, including:

- Their view that prescriptive interim disclosures for items that create operating expenses are rare (interim disclosures for pension obligations being one exception);<sup>11</sup> and
- Their belief that, in general terms, the nature of an entity's leasing activities (i.e., the reasons and types of leases into which it enters) does not change on a short-term basis. However, if those activities were to change significantly, the interim reporting requirements in current GAAP would require the entity to disclose the nature and effect of those significant changes.

The FASB tentatively decided to require lessors to provide in interim financial statements a tabular disclosure of lease income on a disaggregated basis. The interim disclosure would be consistent with the annual disclosure requirement the Boards previously tentatively decided upon, which would require separate disclosure of the following components of lease income:

- For leases accounted for under the R&R model:
  - Profit recognized at lease commencement;
  - Interest income on lease receivables;
  - Interest income on residual assets;
- For leases accounted for as operating leases and short-term leases for which the lessor elects not to apply the R&R model, income from noncontingent lease payments; and
- Income from variable lease payments for all leases.

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<sup>9</sup> FASB ASC Topic 360, Property, Plant, and Equipment, available at [www.fasb.org](http://www.fasb.org), and IAS 36, Impairment of Assets.

<sup>10</sup> FASB ASC Topic 270, Interim Reporting, available at [www.fasb.org](http://www.fasb.org), and IAS 34, Interim Financial Reporting.

<sup>11</sup> FASB ASC Topic 715, Compensation—Retirement Benefits, available at [www.fasb.org](http://www.fasb.org).

In reaching this tentative decision, the FASB agreed that interim information about lease revenue would be useful to financial statement users and expressed the view that the incremental effort to produce this tabular disclosure on an interim basis would not be excessive given that current U.S. GAAP relative to segment reporting already requires similar disclosures.<sup>12</sup>

The IASB tentatively decided to require a lessor to disclose income from leases in interim periods. However, the IASB tentatively decided not to require the details about income that would be required in the annual tabular disclosure unless that information would be significant to the interim financial statements. IASB members noted that for some lessors, income from leases may not be significant to total revenues. They also pointed out that this approach would be less costly than the FASB's proposed interim disclosure requirements and would be more consistent with the Boards' decisions on interim disclosures in their joint project on revenue recognition.<sup>13</sup>

### Next Steps

Although several members of each Board indicated in July that they may dissent from publication of revised EDs because of concerns about aspects of the lease accounting proposals, a sufficient number of the members of each Board currently support the proposals to approve the issuance of revised EDs. The Boards' staff indicated that it expects to have the revised EDs ready for issuance near the end of November, and suggested that they would expect to discuss with the Boards at a meeting in September any issues requiring their consideration that are identified during the process of drafting the revised EDs. One of those issues may be lessee accounting for impairment of SLE method ROU assets.

The Boards will discuss the proposed effective date of the final standard after receiving comments on the revised EDs. The Boards agreed that the comment-letter period on the revised EDs would be 120 days. If the timeline for issuance of the revised EDs unfolds as the staff expects, the comment-letter period would encompass the busiest financial reporting season during the year for most calendar-year-end reporting entities.

The FASB has recently received bi-partisan letters signed by 58 members of the U.S. House of Representatives that call for the FASB and IASB to "undertake and publish an all-inclusive economic impact study [of the potential economic consequences of the lease accounting proposals] before any final action is taken on [those proposals]."<sup>14</sup> The representatives requested that the study "examine all potential economic consequences for businesses that own, invest, and rent commercial real estate...[including but not] limited to possible effects, such as higher rents, further reduced property values due to shortened lease terms, administrative costs and problems resulting from obscured financial reporting...the potential increase on borrowing costs for all commercial real estate participants as well as the financial and regulatory impact on lending institutions..." To date, the Boards have not committed to undertake such a study. However, if they were to do so, it would likely impact the timing of issuance and the effective date of the final standard.

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<sup>12</sup> FASB ASC Topic 280, Segment Reporting, available at [www.fasb.org](http://www.fasb.org).

<sup>13</sup> FASB Proposed Accounting Standards Update (Revised), Revenue from Contracts with Customers, November 14, 2011, available at [www.fasb.org](http://www.fasb.org), and IASB ED/2011/6, Revenue from Contracts with Customers, November 2011, available at [www.ifrs.org](http://www.ifrs.org).

<sup>14</sup> See 2012 unsolicited comment letters on Leases (Topic 840), available at [www.fasb.org](http://www.fasb.org).



## Summary of Tentative Decisions Reached in Redeliberations

The following chart summarizes our current understanding of the tentative decisions reached to date by the Boards during their joint redeliberations. Many of the tentative decisions were reached prior to the Boards' tentative decision in June 2012 to pursue a dual-method approach for lessee accounting, and it is not clear to what extent that tentative decision may require prior tentative decisions to be revisited.

Tentative Decisions in Redeliberations
<b>Scope and Definition of a Lease</b>
<p>A lease would be defined as a contract in which the right to use a specified asset is conveyed, for a period of time, in exchange for consideration as determined based on the substance of the contract by assessing whether both of the following conditions are met:</p> <ul style="list-style-type: none"><li>• The fulfillment of the contract depends on the use of an explicitly or implicitly specified asset or assets<ul style="list-style-type: none"><li>• A physically distinct portion of a larger asset (e.g., a floor of a multi-story building) would be considered a specified asset when the customer has exclusive use of that physically distinct portion</li><li>• A capacity portion of a larger asset that is not physically distinct (e.g., capacity portion of a pipeline) would not be considered a specified asset</li></ul></li><li>• The contract conveys the right to control the use of the specified asset or assets for a period of time<ul style="list-style-type: none"><li>• A contract would convey the right to control the use if the customer has the ability to direct the use, and receive the benefit from the use, of the specified asset or assets throughout the lease term</li></ul></li></ul>
<p><b>The definition of a lease would <i>exclude</i></b> a right to use an explicitly or implicitly identified asset that is inseparable from the provision of a service.</p>
<p><b>In-substance purchases / sales</b> would not be explicitly addressed or excluded from the scope.</p>
<p><b>Leases of intangibles</b> other than right-of-use (ROU) assets would not be required to be accounted for under the leases standard.</p>
<p><b>Scope would include</b> ROU assets in subleases, leases of non-core assets, and long-term leases of land.</p>
<p><b>Leases of assets often treated as inventory</b>, such as non-depreciating spare parts, operating materials, and supplies, and that are associated with the leasing of another underlying asset, would not be excluded from the scope; however, the Boards believe that a ROU asset could not simultaneously also meet the definition of inventory.</p>
<p><b>Scope would exclude:</b></p> <ul style="list-style-type: none"><li>• Leases for the right to explore for or use minerals, oil, natural gas, and similar non-regenerative resources</li></ul>



## Tentative Decisions in Redeliberations

- Leases of biological assets, including, for U.S. GAAP only, timber
- Service concession arrangements (IFRS only)

**Lessee involvement with asset construction** would not be addressed by the standard other than by brief application guidance noting the need to consider the requirements of other standards and the potential that lessee reimbursement of lessor costs may represent prepaid rent.

**A modification to the contractual terms** of a contract that is a substantive change to the existing contract (i.e., that results in a different determination of whether the contract is, or contains, a lease) would result in the modified contract being accounted for as a new contract.

**A change in circumstances** other than a modification to the contractual terms of the contract that would affect the assessment of whether a contract is, or contains, a lease would result in a reassessment of whether the contract is, or contains, a lease.

## Inception versus Commencement Date

All initial measurements of lease assets and liabilities would be based on information at lease commencement.

**Payments before lease commencement** would be treated as prepaid rent.

**Entities reporting under IFRSs** would apply the guidance in IAS 37 if the contract meets the IAS 37 definition of an onerous contract to determine whether a loss should be recorded for a lease prior to lease commencement.<sup>15</sup>

**Entities reporting under U.S. GAAP** would apply the guidance in ASC Topic 450 to determine whether a loss should be recorded for a lease prior to lease commencement.<sup>16</sup>

## Initial Direct Costs

Initial direct costs would be capitalized by lessees and lessors if directly attributable to negotiating and arranging a completed lease.

## Lease Term

Lease term would be the non-cancelable period plus any optional periods for which there is a significant economic incentive to exercise the option to extend the lease (or not to terminate the lease early).

**Lease term assessment** would consider contractual, asset-based, and entity-specific factors, including lessee intentions and past practice.

**Lease term would be reassessed** if economic factors affecting the decision to extend or terminate a lease change significantly.

<sup>15</sup> IAS 37, Provisions, Contingent Liabilities and Contingent Assets.

<sup>16</sup> FASB ASC Topic 450, Contingencies, available at [www.fasb.org](http://www.fasb.org).

## Tentative Decisions in Redeliberations

- Reassessments would take into consideration the same factors considered at lease commencement except for changes in market rates, which would be excluded from consideration
- Changes in estimated future lease payments because of lease term reassessments would be accounted for by lessees applying the ROU model, and by lessors applying the receivable and residual (R&R) model, by adjusting the assets and liabilities recognized (see Lessee Accounting and Lessor Accounting)
- A revised discount rate would be determined as though the lease were a new lease at the date of the revision
- Lessees would adjust their lease liability and ROU asset by an equal amount (see Lessee Accounting)
- Lessors applying the R&R model would adjust their lease receivable and recognize any profit or loss in the same manner as at initial recognition under the R&R model (see Lessor Accounting)
- Lessors applying operating lease accounting would account for changes in straight-line lease income prospectively from the date of reassessment (see Lessor Accounting)

## Discount Rate

**Lessees:** the rate the lessor charges the lessee if the lessor rate is available; otherwise, the lessee's incremental borrowing rate.

**Lessors:** the rate the lessor charges the lessee.

- Indicators include the lessee's incremental borrowing rate, the rate implicit in the lease or, for property leases, the yield on the property (must use the rate implicit in the lease when more than one indicator is available)

**The discount rate would be revised** when there is a change in the lease liability or, for lessors applying the R&R model (see Lessor Accounting), the lease receivable due to a change in the evaluation of whether the lessee will exercise a term option or purchase option, a change in variable lease payments based on an index or rate, and upon the exercise of an option to renew the lease that previously was not included in the estimated lease term.

- A revised discount rate would be determined as though the lease were a new lease at the date of the revision

## Arrangements with Lease / Non-lease Components

**Lessees would separate lease and non-lease components unless** there are no observable prices for the lease and one or more non-lease components, in which case those combined components would be treated as a lease.

- Payments would be allocated between separated lease and non-lease components based on relative stand-alone purchase prices when prices are observable, or using a residual method when stand-alone purchase prices of either the lease or non-lease components are not observable

## Tentative Decisions in Redeliberations

**Lessors would always separate** lease and non-lease components and allocate payments using revenue recognition guidance.

**Lessees and lessors would be required to assess** whether a lease contract includes embedded derivatives that should be bifurcated and accounted for using the applicable GAAP guidance on derivatives.

### Short-term Leases

**Lessees** would be permitted to elect, by class of underlying asset, for leases with a maximum possible term (including optional renewal periods) of 12 months or less, not to recognize lease assets or liabilities under the ROU model in the leases standard and to recognize lease expense generally on a straight-line basis over the lease term (see also Lessee Accounting).

**Lessors** would be permitted to elect, by class of underlying asset, for leases with a maximum possible term (including optional renewal periods) of 12 months or less, not to apply the R&R model in the leases standard and to recognize lease income generally on a straight-line basis over the lease term (see also Lessor Accounting).

**Short-term leases** would include leases that:

- Are cancelable by both the lessee and lessor with minimal termination payments, or
- Include renewal options that must be agreed to by both the lessee and the lessor

if the initial noncancelable period, together with any notice period, is less than one year.

### Lease Classification

All leases other than the following would include a recognized financing element for purposes of profit and loss recognition:

- **Leases of real estate** (e.g., land, buildings – including parts of buildings) where: (a) the lease term is not for a major part of the property's economic life, and (b) the present value of the estimated lease payments is less than substantially all of the fair value of the underlying asset;
- **Leases of non-real estate** assets where: (a) the lease term is insignificant in relation to the economic life of the underlying asset, or (b) the present value of the estimated lease payments is insignificant in relation to the fair value of the underlying asset;
- **For lessees, short-term leases** to which the lessee elects not to apply the ROU model (see also Lessee Accounting); and
- **For lessors, short-term leases** to which the lessor elects not to apply the R&R model (see also Lessor Accounting)

**Lessees would amortize the ROU asset** in leases with a recognized financing element using the interest and amortization (I&A) method and would adjust (rather than amortize) the ROU asset in other leases accounted for under the ROU model using the single lease expense (SLE) method (see also Lessee Accounting).

## Tentative Decisions in Redeliberations

**Lessees would account for short-term leases** to which the lessee elects not to apply the ROU model off-balance-sheet in a manner similar to operating leases under current U.S. GAAP and IFRSs (see also Lessee Accounting).

**Lessors would account for leases with a recognized financing element** using the R&R model and would account for other leases as operating leases (see also Lessor Accounting).

### Lessee Accounting

Lessees would be required to recognize a lease liability and ROU asset for all leases other than short-term leases.

- **The lease liability would be initially measured** at the present value of the estimated future lease payments and subsequently amortized using the effective interest method
- **The lease liability would be reassessed** when facts and circumstances indicate that there is a significant change in estimated future lease payments resulting from changes in expectations about the exercise of purchase and lease term options, estimated payments under residual value guarantees (RVGs), and changes in an index or rate on which lease payments are based
- **The ROU asset would be initially measured** at an amount equal to the lease liability plus any initial direct costs and prepaid rent, less any lease incentives received by the lessee, and subsequently would either be:
  - Amortized in the same manner as PP&E, which would produce a generally accelerated or front-loaded pattern of total lease expense when combined with interest expense on the lease liability (referred to as the I&A method), or
  - Adjusted in the amount necessary to produce a generally straight-line pattern of total lease expense when combined with interest expense on the lease liability (referred to as the SLE method)

depending on the characteristics of the underlying asset and the terms of the lease (see Lease Classification for more information)

- **The ROU asset would be subsequently assessed for impairment** using current guidance in U.S. GAAP and IFRSs and remeasured when the lease liability changes as a result of reassessments that relate to future periods
- **Lessees applying IFRSs** would be permitted to revalue the ROU asset

**Interest expense incurred in a lease** would be included for purposes of determining the interest costs or borrowing costs that would be capitalized under ASC Topic 835 for entities applying U.S. GAAP and IAS 23 for entities applying IFRSs.<sup>17</sup>

<sup>17</sup> FASB ASC Topic 835, Interest, available at [www.fasb.org](http://www.fasb.org), and IAS 23, Borrowing Costs.

## Tentative Decisions in Redeliberations

### Lessor Accounting

Lessors would be required to apply the R&R model or operating lease accounting depending on the characteristics of the underlying asset and the terms of the lease (see Lease Classification for more information).

Under the **R&R model**:

- **The lessor would recognize a lease receivable** initially measured at the present value of estimated future lease payments discounted using the rate the lessor charges the lessee, and subsequently measured at amortized cost using the effective-interest method
  - The lessor would not be permitted to measure the lease receivable at fair value even if it is held for sale
- **The lessor would be required to derecognize** the portion of the underlying asset representing the cost of the right of use transferred to the lessee and reclassify the remaining portion as a residual asset representing its rights to the underlying asset at the end of the lease term
  - The cost of the right of use transferred to the lessee would be determined as  $[\text{present value of the estimated lease payments} \div \text{fair value of the underlying asset} \times \text{carrying amount of the underlying asset}]$
- **The residual asset** would comprise two components: an actual carrying amount (referred to as the net residual asset) and deferred profit
  - Deferred profit would be the difference between the **net residual asset** and a notional amount (referred to as the **gross residual asset**) that initially would equal the present value of the estimated future residual value (i.e., its estimated future fair value) discounted using the rate the lessor charges the lessee
- The lessor would recognize **profit on the transaction** at lease commencement if (a) the fair value of the underlying asset exceeds its carrying amount, or (b) the initial measurement of the lease receivable exceeds the carrying amount of the underlying asset
- No profit would be recognized at lease commencement if the fair value and carrying amount of the underlying asset are the same at lease commencement and the lease receivable does not exceed the carrying amount of the underlying asset
- The **gross residual asset** would be accreted to its estimated future value at the end of the lease term using the rate the lessor charges the lessee
- Any **profit on the residual asset** (i.e., the difference between its allocated cost basis and its notional amount) would be deferred and presented net with the residual asset; none of the deferred profit would be recognized until the underlying asset is sold, re-leased, or a reassessment of the lease receivable occurs
- **Revaluation of the residual asset** would not be permitted (IFRS)
- **Lease receivables would be evaluated for impairment** under ASC Topic 310 on receivables (U.S. GAAP) or IAS 39 on financial instruments (IFRS) but would

## Tentative Decisions in Redeliberations

not otherwise be in the scope of the financial instruments accounting guidance for purposes of initial or subsequent measurement<sup>18</sup>

- **Residual assets would be evaluated for impairment** under ASC Topic 360 on property and equipment (U.S. GAAP) or IAS 36 on impairment of nonfinancial assets other than inventory (IFRS)<sup>19</sup>
  - Lessors would not separately recognize RVGs but would take them into consideration when evaluating whether the residual asset is impaired throughout the lease term regardless of whether the guarantee is provided by the lessee, a related party of the lessee, or a third party
- **Upon early termination of a lease**, the lease receivable would be tested for impairment, the lease receivable and net residual asset would be derecognized, and the underlying asset would be re-recognized at the combined carrying amount of the lease receivable (subsequent to adjustment for any impairment) and net residual asset at the date of termination
  - The underlying asset would be further tested for impairment under ASC 360 (U.S. GAAP) or IAS 36 (IFRS)

**Operating leases** would be accounted for similar to operating leases under current U.S. GAAP and IFRSs (i.e., no lease receivable would be recognized for estimated future lease payments and the underlying asset would not be derecognized).

**Leveraged lease accounting** would be eliminated for lessors applying U.S. GAAP.

**Lessors would apply existing derecognition requirements** (ASC Topic 860 for entities applying U.S. GAAP and IFRS 9 for entities applying IFRSs) to transferred lease receivables, but would allocate the carrying amount of those lease receivables on the basis of their fair value excluding any option elements and variable lease payments that are not transferred.<sup>20</sup>

## Variable Lease Payments

**Variable payments based on an index or rate** would be included in the measurement of the lessee's lease liability and, for lessors applying the R&R model, the lessor's lease receivable using prevailing (spot) rates or indices at lease commencement.

- For **inflation-indexed payments** there would be no escalation included in the initial measurement of the lessee's lease liability and, for lessors applying the R&R model, the lessor's lease receivable
- Variable payments based on an index or rate would be **reassessed** each period

<sup>18</sup> FASB ASC Topic 310, Receivables, available at [www.fasb.org](http://www.fasb.org), and IAS 39, Financial Instruments: Recognition and Measurement.

<sup>19</sup> FASB ASC Topic 360, Property, Plant, and Equipment, available at [www.fasb.org](http://www.fasb.org), and IAS 36, Impairment of Assets.

<sup>20</sup> FASB ASC Topic 860, Transfers and Servicing, available at [www.fasb.org](http://www.fasb.org), and IFRS 9, Financial Instruments.

## Tentative Decisions in Redeliberations

- The **discount rate** would be revised upon a change in variable lease payments based on an index or rate
- **Changes to a lessee's lease liability** resulting from changes in variable lease payments that depend on an index or rate would be reflected in (1) net income to the extent that those changes relate to the current period and (2) as an adjustment to the ROU asset to the extent that those changes relate to future periods
- **For lessors applying the R&R model**, changes to the lessor's lease receivable resulting from changes in variable lease payments that depend on an index or rate would be recognized in profit or loss

### **Variable payments that in-substance represent minimum lease payments**

would be included in the measurement of the lessee's lease liability and, for lessors applying the R&R model, the lessor's lease receivable.

**Variable payments that are not based on an index or rate** and are not in-substance minimum lease payments would be excluded from the measurement of the lessee's lease liability and, for lessors applying the R&R model, the lessor's lease receivable, and recognized as an expense as incurred or income as earned.

- For lessors applying the R&R model, a portion of variable lease payments contemplated when pricing the lease would be treated as a cost when received by adjusting the carrying amount of the residual asset; any difference between contemplated variable lease payments and actual variable lease payments would be recognized immediately in the income statement
- For lessors applying the R&R model, variable lease payments not contemplated when pricing the lease would not affect the carrying amount of the residual asset

**For lessors applying operating lease accounting**, variable lease payments that are not based on an index or rate and are not in-substance minimum lease payments would be recognized as income when earned.

**No reliability standard** for variable lease payments would apply to lessees or lessors because only variable payments based on an index or rate and in-substance minimum lease payments would be included in the lessee's lease liability and, for lessors applying the R&R model, the lessor's lease receivable.

## Other Lease Payments

Measurement of the lessee's lease liability would include an estimate of **amounts payable under RVGs** provided by the lessee to the lessor.

- The amount to be reflected in the measurement of the lessee's lease liability would be the difference between the expected residual value and the guaranteed residual value
- RVGs included in the measurement of the lessee's ROU asset would be amortized (adjusted) consistently with the ROU asset
- Amounts payable under RVGs would be required to be reassessed when events



## Tentative Decisions in Redeliberations

or circumstances indicate that there has been a significant change in the amounts expected to be payable and the amount of the change would be recognized (a) in net income to the extent that it relates to current or prior periods and (b) as an adjustment to the ROU asset to the extent that it relates to future periods

- The allocation of changes in estimates to current and prior periods versus future periods would reflect the pattern in which the economic benefits of the ROU asset will be consumed or were consumed; if that pattern could not be reliably determined, all changes in estimates would be allocated to future periods

Measurement of the lessee's lease liability and, for lessors applying the R&R model, the lessor's lease receivable would include **lease termination penalties**.

- The amount of termination penalty payments to be included in the measurement of the lessee's lease liability and, for lessors applying the R&R model, the lessor's lease receivable would be consistent with the lease term (i.e., if there is not a significant economic incentive for the lessee to forgo the option to terminate the lease early, the termination penalty would be included in the measurement of the lessee's lease liability and the lessor's lease receivable)
- Reassessment requirements for termination penalty payments would be the same as lease term reassessment requirements

**For lessors applying operating lease accounting**, straight-line rental income would include lease termination penalties consistent with the lease term.

**Payments for exercise of purchase options** would be included in the measurement of the lessee's lease liability and, for lessors applying the R&R model, the lessor's lease receivable if there is a significant economic incentive to exercise the option.

- Reassessment requirements for purchase options would be the same as lease term reassessment requirements
- Lessee's ROU asset would be amortized over the useful life of the underlying asset rather than the lease term when there is a significant economic incentive to exercise a purchase option

**Foreign currency exchange gains and losses** related to the liability to make lease payments on leases denominated in a foreign currency would be recognized in profit and loss consistently with foreign exchange guidance in current IFRSs and U.S. GAAP.

## Subleases

A lessee-sublessor would account for assets and liabilities arising from the head lease using the applicable lessee accounting method (based on the lease classification guidance) and account for assets and liabilities arising from the sublease using the applicable lessor accounting model (based on the lease classification guidance).

## Tentative Decisions in Redeliberations

**The sublessor would evaluate its ROU asset** rather than the underlying asset to determine the appropriate lessor accounting model to apply to the sublease.

### Sale-Leasebacks

A sale and leaseback of the underlying asset would be recognized if the requirements for sale recognition in the revenue recognition standard are met; otherwise the transaction would be accounted for as a financing.

The seller-lessee would recognize a gain or loss on transactions not accounted for as financings.

- Amount of gain / loss would be based on the transaction price if at market; otherwise, gain / loss would be adjusted to reflect current market lease rates for the underlying asset

### Lessee Presentation and Disclosures

Lessees would **separately present ROU assets and lease liabilities** (segregated by lease classification – i.e., I&A and SLE) either in the statement of financial position or in the notes to the financial statements.

- If not separately presented in the statement of financial position, lessees would be required to disclose the line items in the statement of financial position in which ROU assets and lease liabilities are included
- Lessees would present ROU assets in the statement of financial position as the underlying asset would be if it were owned

**Under the I&A method**, lessees would present separately interest expense and amortization expense in the income statement (they would not be combined as lease expense).

**Under the SLE method**, lessees would combine interest expense and the adjustment of the ROU asset as a single lease expense in the income statement.

**Under the I&A method**, in the statement of cash flows, lessees would classify cash paid for:

- Principal on lease liabilities as financing activities
- Interest on lease liabilities using applicable U.S. GAAP (as operating activities) or IFRSs (as either operating or financing activities)
- Variable lease payments not included in lease liabilities as operating activities

**Under the SLE method and for short-term leases** not accounted for under the ROU model, in the statement of cash flows, lessees would classify all cash payments as operating cash flows.

Lessees would be required to include as a **supplemental noncash transaction disclosure** the acquisition of a ROU asset in exchange for a liability to make lease payments for leases accounted for under both the I&A and SLE methods.

## Tentative Decisions in Redeliberations

**Lessees would be required to disclose** quantitative and qualitative financial information identifying and explaining amounts recorded in the financial statements that enables financial statement users to evaluate the amount, timing, and uncertainty of cash flows arising from lease contracts and how the lessee manages those cash flows including, but not limited to:

- The nature of, and restrictions imposed by, lease arrangements (description, terms of renewals, termination, RVGs, variable lease payments, etc.)
- Information about significant judgments and assumptions made in applying the standard such as whether an arrangement contains a lease, amortization methods, likelihood of exercise of renewal and termination options, determination of discount rate, allocation of payments between lease and non-lease components, etc., and changes to those judgments and assumptions
- **For entities applying IFRSs only**, a reconciliation between the opening and closing balances for ROU assets disaggregated by class of underlying asset and segregated between ROU assets relating to leases accounted for under the I&A method and those relating to leases accounted for under the SLE method
- A reconciliation between the opening and closing balances for liabilities to make estimated future lease payments, segregated between liabilities relating to leases accounted for under the I&A method and those relating to leases accounted for under the SLE method
  - Lessees would *not* be required to disaggregate this reconciliation by class of underlying asset
  - Lessees would be required to include the effect of interest on the liability (i.e., the unwinding of the discount on the estimated future lease payments) as part of the reconciliation regardless of whether interest expense is recognized in the income statement (this would require the lessee to present and disclose any accrued interest or accretion on the lease liability together with the liability balance)
- A maturity analysis of the gross undiscounted liability to make estimated future lease payments showing, at a minimum, contractual payments on an annual basis for the first five years, and a lump sum for the remainder, reconciled to the liability recognized
  - Lessees applying U.S. GAAP would be required to include in their maturity analysis cash flows related to services and other non-lease components embedded in lease contracts that are accounted for separately from the leases
- Information about the principal terms of any lease that has not yet commenced if the lease creates significant rights and obligations for the lessee
- Lease expense relating to variable lease payments not included in the lease liability
- A qualitative disclosure about circumstances or expectations that the entity's short-term lease practices would result in a material change in the next reporting period as compared with the current reporting period

## Tentative Decisions in Redeliberations

- The nature and amount of significant subleases
- Sale and leaseback terms and conditions, gains, and losses

### **Lessees would *not* be required to disclose:**

- Discount rates used to calculate the lease liability
- The fair value of the lease liability
- The existence and principal terms of any options for the lessee to purchase the underlying asset, or initial direct costs incurred on a lease
- Information about arrangements that are no longer determined to contain a lease

No **interim disclosure requirements** would be added to those under existing standards (ASC Topic 270 for entities applying U.S. GAAP and IAS 34 for entities applying IFRSs).<sup>21</sup>

## Lessor Presentation and Disclosures

**For leases accounted for under the R&R model**, lessors would present lease receivables and residual assets (including deferred profit) as, or totaling to, a single caption (e.g., lease assets), or disclose them separately in the notes if not separately presented.

**Income and expense from lease transactions accounted for under the R&R model** would either be presented separately in the income statement or disclosed in the notes to the financial statements.

- If not separately presented in the income statement, lessors would be required to disclose the line items in the income statement in which the amounts are included
- Gross or net presentation of up-front profit from lease transactions in the income statement would depend on the nature of the lessor's business model
- Accretion of the residual asset would be presented as interest income in the income statement
- Amortization of initial direct costs included in the lessor's lease receivable would offset interest income on the lease receivable in the income statement

Lessors would **classify all cash inflows from leases as operating activities** in the statement of cash flows.

**Lessors would be required to disclose** quantitative and qualitative financial information identifying and explaining amounts recorded in the financial statements that enables financial statement users to evaluate the amount, timing, and

<sup>21</sup> FASB ASC Topic 270, Interim Reporting, available at [www.fasb.org](http://www.fasb.org), and IAS 34, Interim Financial Reporting.

## Tentative Decisions in Redeliberations

uncertainty of cash flows arising from lease contracts and how the lessor manages those cash flows including, but not limited to:

- The nature of, and restrictions imposed by, lease arrangements (description, terms of renewals, termination, purchase options, RVGs, variable lease payments, etc.)
- Information about significant judgments and assumptions made in applying the standard such as whether an arrangement contains a lease, likelihood of exercise of renewal and termination options, purchase options, determination of discount rate, allocation of payments between lease and non-lease components, etc., and changes to those judgments and assumptions
- Information about the nature of significant service obligations related to leases
- The nature and amount of significant subleases
- A table of all lease-related income items recognized in the reporting period (interim periods as well as annual periods for lessors applying U.S. GAAP only) disaggregated into:
  - For leases accounted for under the R&R model:
    - Profit recognized at lease commencement (split into revenue and cost of sales if that is how the lessor has presented the amounts in the income statement)
    - Interest income on lease receivables
    - Interest income on residual assets
  - For leases accounted for as operating leases and short-term leases for which the lessor elects not to apply the R&R model, income from noncontingent lease payments
  - Income from variable lease payments
- For leases accounted for under the R&R model:
  - A reconciliation between the opening and closing balances for lease receivables and residual assets
  - A maturity analysis of the gross undiscounted lease receivable showing, at a minimum, contractual payments on an annual basis for the first five years, and a lump sum for the remainder, reconciled to the receivable recognized
  - Information about exposure to the underlying asset and how that exposure is managed, including guaranteed versus unguaranteed residual asset carrying amounts
  - For lessors applying IFRSs, IFRS 7 disclosures relating to risks surrounding the lease receivable<sup>22</sup>

<sup>22</sup> IFRS 7, Financial Instruments: Disclosures.

## Tentative Decisions in Redeliberations

- For lessors applying U.S. GAAP, credit quality disclosures
- Lessors would *not* be required to disclose:
  - Initial direct costs incurred during the period
  - Information about discount rates used to calculate lease receivables
  - The fair value of the lease receivables or residual assets
- For operating leases (i.e., those not accounted for under the R&R model):
  - A maturity analysis of the gross undiscounted future noncancelable lease payments showing, at a minimum, contractual payments on an annual basis for the first five years, and a lump sum for the remainder, separate from the maturity analysis for the R&R model
  - The cost and carrying amount of property on lease or held for lease by major classes of property according to its nature or function, and the amount of accumulated depreciation in total as of the date of the latest statement of financial position presented

Lessors would be required to provide the applicable **disclosures for transferred lease receivables** (ASC Topic 860 for entities applying U.S. GAAP and IFRS 7 for entities applying IFRSs).

Other than the table of lease income, no other **interim disclosure requirements** would be added to those under existing standards (ASC Topic 270 for entities applying U.S. GAAP and IAS 34 for entities applying IFRSs).

## Business Combinations

The following guidance would apply to the measurement of lease assets and lease liabilities acquired in a business combination:

- **If the acquiree is a lessee**, the acquirer would recognize a lease liability and a ROU asset
  - The lease liability would be measured at the present value of estimated future lease payments as if the associated lease contract is a new lease at the acquisition date
  - The ROU asset would be measured at an amount equal to the lease liability, adjusted for any off-market terms in the lease contract
- **If the acquiree is a lessor applying the R&R model**, the acquirer would recognize a lease receivable and a residual asset
  - The lease receivable would be measured at the present value of estimated future lease payments as if the associated lease contract is a new lease at the acquisition date
  - The residual asset would be measured as the difference between the fair value of the underlying asset at the acquisition date and the carrying amount of the lease receivable

## Tentative Decisions in Redeliberations

- **If the acquiree is a lessor under an operating lease**, the acquirer would apply the guidance that relates to acquired operating leases in ASC Topic 805 (entities applying U.S. GAAP) or IFRS 3 (entities applying IFRSs)<sup>23</sup>
- **If the acquiree has short-term leases** (that is, leases for which, at the date of acquisition, the maximum remaining term of the lease contract is 12 months or less), an acquirer would not recognize separate assets or liabilities related to the lease contract at the acquisition date

## Lessee Transition

Lessees would have the **option to elect full retrospective application** for all leases.

Lessees would be permitted to retain the carrying amounts of **assets and liabilities recognized for all capital (finance) leases and short-term leases** and reclassify assets and liabilities for capital (finance) leases as ROU assets and lease liabilities, respectively.

**For operating leases**, lessees would be able to apply a **modified retrospective transition approach** under which they would have the option to elect either or both of the following transition reliefs:

- Not to evaluate initial direct costs for leases that began before the effective date
- Use of hindsight when preparing comparative financial information

**Under the modified retrospective approach**, at the date of initial application, the lessee would recognize and measure a liability to make estimated future lease payments and a ROU asset.

- Liability measured at the present value of remaining estimated future lease payments discounted using the lessee's incremental borrowing rate at effective date
- Incremental borrowing rate would be determined at a group level for leases with similar characteristics and remaining terms
- ROU asset for leases accounted for under the I&A method determined as a proportion of the lease liability at lease commencement calculated on the basis of remaining estimated future lease payments
- ROU asset for leases accounted for under the SLE method measured at an amount equal to the lease liability
- At adoption, eliminate any prepaid or accrued rentals with an offsetting adjustment to the ROU asset, subject to an impairment review

A **cumulative-effect adjustment** would be recognized in opening retained earnings at the date of initial application for the net change in recognized assets and liabilities.

<sup>23</sup> FASB ASC Topic 805, Business Combinations, available at [www.fasb.org](http://www.fasb.org), and IFRS 3, Business Combinations.



## Tentative Decisions in Redeliberations

### Lessor Transition

Lessors would have the **option to elect full retrospective application** for all leases.

Lessors would be permitted to retain the carrying amounts of assets recognized for all **sales-type, direct financing, and short-term leases**.

**For operating leases** to be accounted for under the R&R model, lessors would be able to apply a **modified retrospective transition approach** that would give them the option to elect either or both of the following transition reliefs:

- Not to evaluate initial direct costs for leases that began before the effective date
- Use of hindsight when preparing comparative financial information

**For the modified retrospective approach**, at date of initial application lessors would derecognize the underlying asset and recognize and measure a receivable for estimated future lease payments discounted at the rate the lessor charges the lessee (subject to adjustments required to reflect impairment, if any) and a residual asset.

- Rate lessor charges lessee would be determined as of lease commencement date
- Residual asset would be determined as required by the R&R model using information as of the date of initial application
- Prepaid or accrued lease payments would adjust the cost basis of the underlying asset that is derecognized at the date of initial application

Lessors would continue to account for **securitized operating lease receivables** as secured borrowings using current U.S. GAAP and IFRSs regardless of whether the lessor elects a fully retrospective approach to transition.

A **cumulative-effect adjustment** would be recognized in opening retained earnings at the date of initial application for the net change in recognized assets and liabilities.

### Other Transition Considerations

For **sale-leaseback transactions**:

- That resulted in **capital (finance) lease classification**, a seller/lessee would not reevaluate the sale recognition conclusion previously reached, would not remeasure lease assets and lease liabilities previously recognized on the statement of financial position, and would continue to amortize any deferred gain or loss on sale over the lease term in the income statement
- That resulted in **operating lease classification** or for which the sale recognition criteria previously were not met, a seller/lessee would reevaluate the sale conclusion based on the revenue recognition criteria for transfer of control of an asset and, if the criteria were met, the seller/lessee would measure lease assets and lease liabilities using the transition guidance for leases that are currently classified as operating leases and would recognize any deferred gain or loss in opening retained earnings upon transition to the new leases guidance

A seller-lessee would have the **option to elect full retrospective application**.

## Tentative Decisions in Redeliberations

Lessees that previously recognized assets or liabilities relating to **favorable or unfavorable terms in acquired operating leases** would derecognize those assets or liabilities and adjust the carrying amount of the ROU asset by the amount of any asset or liability derecognized.

**Lessors applying the R&R model** that previously recognized assets or liabilities relating to favorable or unfavorable terms in acquired operating leases would derecognize those assets or liabilities and adjust retained earnings upon transition.

**No specific transition guidance** would be provided for:

- Short-term leases
- Leases of investment property measured at fair value
- Leveraged leases
- Subleases
- Useful lives of leasehold improvements
- Build-to-suit leases
- In-substance purchases and sales

**The transition exception** in paragraph 16 of EITF Issue 01-8 **on the definition of a lease** would no longer be available; consequently, an entity applying U.S. GAAP would be required to account for a lease in an arrangement that contains a lease based on the facts and circumstances existing at the effective date of the new leases standard, even when it previously applied that transition exception.<sup>24</sup>

**Lessees and lessors would be required to provide transition disclosures** consistent with ASC Topic 250 for entities applying U.S. GAAP and IAS 8 for entities applying IFRSs without the disclosure of the effect of the change on income from continuing operations, net income, any other affected financial statement line item, and any affected per-share amounts for the current period and any prior periods retrospectively adjusted.<sup>25</sup>

Lessees and lessors would be required to **disclose any transition reliefs elected**.

<sup>24</sup> EITF Issue No. 01-8, Determining Whether an Arrangement Contains a Lease, available at [www.fasb.org](http://www.fasb.org). The transition guidance in Issue 01-8 was not included in the FASB's Accounting Standards Codification.

<sup>25</sup> FASB ASC Topic 250, Accounting Changes and Error Corrections, available at [www.fasb.org](http://www.fasb.org), and IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

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