Boards address sale and leaseback transactions, lessor disclosures

What you need to know

- The Boards continued re-deliberating, at their July 2014 joint meeting, how to clarify and simplify their 2013 joint proposal on leases, reaching converged decisions on most lessor disclosure requirements and some aspects of the accounting for sale and leaseback transactions.
- The IASB decided to limit the immediate gain that seller-lessees would recognise on successful sale and leaseback transactions.
- The FASB determined that a Type A leaseback would preclude sale accounting, but seller-lessees would recognise the entire gain immediately on successful sale and leaseback (i.e., Type B leaseback) transactions.

Highlights

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) (collectively, the Boards) continued to re-deliberate their 2013 joint proposal to put most leases on lessees' balance sheets.

At their July 2014 joint meeting, the Boards reached converged decisions on most lessor disclosure requirements and some aspects of the accounting for sale and leaseback transactions. However, they reached different decisions on seller-lessee gain recognition and the accounting for Type A leasebacks in sale and leaseback transactions. The FASB also deferred decisions on some topics to enable its staff to do more research.

As we have explained in a previous publication, the FASB is pursuing a dual approach to lessee accounting (i.e., there would be two types of leases, Type A and Type B), while the IASB is pursuing a single Type A lease model with an exemption for leases of small assets. Both Boards’ lessee models would provide a recognition and measurement exemption for short-term leases. The latest decisions, like all decisions to date, are tentative.

---

1 See the Exposure Draft: Leases on the IASB’s website.
2 See our IFRS Developments 75: Boards back away from some key aspects of leases proposal (AUZ269).
Key decisions

Sale and leaseback transactions

Consistent with their 2013 proposal, the Boards decided that a seller-lessee would use the definition of a sale in the new joint revenue recognition standard (IFRS 15 Revenue from Contracts with Customers) to determine whether a sale has occurred in a sale and leaseback transaction. That is, a seller-lessee would assess whether the buyer-lessor has gained control of the underlying asset. Control of an underlying asset refers to the ability to direct the use of the asset and obtain substantially all of the remaining benefits from the asset. The Boards also confirmed their earlier decision that the presence of a leaseback, in and of itself, would not preclude a sale. However, each Board decided that different circumstances would preclude a sale.

The FASB decided that a sale and a purchase would not occur when a leaseback involves a Type A lease from the seller-lessee’s perspective. The FASB believes that its Type A lease is effectively a financed purchase of the underlying asset. Therefore, it would be inappropriate for a seller-lessee to account for the sale of an underlying asset that it concurrently repurchases. The IASB did not discuss this issue because it is pursuing a single lessee accounting model (with an exemption for leases of small assets).

Consistent with the new revenue recognition standard, the IASB decided that a sale and a purchase would not occur if the seller-lessee has a substantive option to repurchase the underlying asset because the buyer-lessor would not obtain control of that asset. The presence of a non-substantive repurchase option (e.g., an option that is exercisable only at the end of the underlying asset’s economic life) would not preclude sale accounting. The FASB deferred a decision on whether a substantive repurchase option should preclude a sale and instructed its staff to perform more analysis.

Specifically, the FASB questioned whether an option to repurchase an asset at fair value (at the time of exercise) should preclude a sale.

The IASB decided, subject to its staff performing additional analysis, that when a sale does not occur, the seller-lessee and the buyer-lessor would account for the transaction as a financing. The FASB did not decide whether the liability in a failed sale and leaseback transaction would be accounted for as a financing obligation or another obligation. However, it instructed its staff to perform additional research on the topic.

Accounting for the sale

The Boards decided that when the buyer-lessor obtains control of the underlying asset in a sale and leaseback transaction (i.e., Type B leasebacks only in the FASB’s proposal), the buyer-lessor would recognise the purchase of the asset based on other standards and account for the leaseback under the proposed lessor accounting. The Boards decided that the seller-lessee would do each of the following:

- Derecognise the underlying asset
- Recognise a lease liability and right-of-use asset for the leaseback (subject to the IASB’s exemption for leases of small assets and the joint exemption for short-term leases)
- Recognise a loss (if any) immediately (adjusted for off-market terms)

The Boards reached different decisions on how the seller-lessee would recognise a gain (if any) on the sale (adjusted for off-market terms). The FASB determined that the seller-lessee would recognise the full gain immediately. However, the IASB decided that the seller-lessee’s immediate gain would be limited to the portion related to the residual asset (i.e., the residual interest in the underlying asset transferred to the buyer-lessor). The remaining gain (i.e., related to the leaseback) would be recognised as a reduction to the initial measurement of the right-of-use asset, thus reflected as a reduction in the amortisation of the right-of-use asset over the term of the leaseback. Under the IASB’s approach, a seller-lessee would recognise a smaller immediate gain on a leaseback covering a large portion of the life of the underlying asset as compared to a similar transaction with a shorter leaseback of the same asset.

It may not be clear whether a seller-lessee’s repurchase option is substantive.
How we see it

The Boards’ decisions on the immediate gain (if any) to be recognised in a sale and leaseback transaction represent another IFRS and US GAAP difference that would result in similar transactions being accounted for differently.

The Boards proposed in 2013 that a seller-lessee (and a buyer-lessor) would adjust the sale price (and purchase price) in a sale and leaseback transaction for any off-market terms. For example, a transaction might include a sale price that is not at fair value or lease payments that are not at market rates. At the July 2014 meeting, the Boards reaffirmed this approach and clarified that entities would determine such off-market adjustments using the fair value of the underlying asset or the market lease payments, whichever provides the more readily determinable evidence. Entities would be expected to maximise the use of observable prices and information when determining which measure is the most appropriate to use.

When the sale price is (or the total lease payments are) less than the underlying asset’s fair value (or the total market lease payments), a seller-lessee would increase the initial measurement of the right-of-use asset. This treatment would be similar to the proposed accounting for lease prepayments. When the sale price is (or the total lease payments are) greater than the underlying asset’s fair value (or the total market lease payments), a seller-lessee would recognise an additional financial liability (i.e., additional financing from the buyer-lessor) separately from the lease liability. Buyer-lessors would also be required to adjust the purchase price of the underlying asset for any off-market terms. Such adjustments would be recognised as lease prepayments made by the seller-lessee or as additional financing provided to the seller-lessee.

Accounting for the leaseback

The Boards decided that when a sale occurs, both the seller-lessee and the buyer-lessor would account for the leaseback in the same manner as any other lease (i.e., in accordance with the lessee and lessor requirements, respectively, with adjustments for any off-market terms).

Transition

The Boards were scheduled to discuss transition for transactions previously accounted for as sale and leasebacks. However, they deferred their discussion to a future meeting when they will re-deliberate the transition provisions for their entire leases proposal.

Lessor disclosure requirements

The Boards also reached decisions to retain many of the lessor disclosure requirements in their 2013 proposal, including:

- Information about the nature of leases (e.g., general description, existence, terms and conditions of options to extend or terminate the lease)
- Significant assumptions and judgements made in accounting for leases (e.g., determination of whether a contract contains a lease, allocation of contract consideration)
- Information about how the lessor manages risk associated with the residual value of its leased assets, except it would apply to all leases (not just Type A, as initially proposed)
- A table of lease income recognised during the reporting period that includes income from Type A leases (i.e., profit/loss at commencement, interest income), lease payments on Type B leases and variable lease payments

Lessors would be required to disclose more information than today about how they manage the risks related to residual values.
A maturity analysis of undiscounted cash flows (on an annual basis for five years after the balance sheet date and in total thereafter) that comprise Type A lease receivables and a reconciliation to lease receivables presented on the balance sheet (or in the notes)

A separate maturity analysis of undiscounted lease payments (on an annual basis for five years after the balance sheet date and in total thereafter) to be received for Type B leases

The Boards also decided to further simplify the proposed lessor disclosure requirements by:

- Allowing lessors to present interest income on the net investment in Type A leases in the table of lease income, either in aggregate or individually, for each component of the net investment (i.e., lease receivable and residual asset)
- IASB only – Requiring lessors to qualitatively and quantitatively explain significant changes in the balance of net investments in Type A leases rather than requiring them to reconcile the opening and closing balances of lease receivables and residual assets (i.e., the net investment) for Type A leases
- FASB only – Requiring lessors to qualitatively and quantitatively explain significant changes in residual values of Type A leases (disclosure of significant changes in the lease receivable portion of the net investment would follow other US GAAP)

The Boards also decided that for assets leased under Type B leases, lessors would disclose the same information that is currently required\(^3\) for property, plant and equipment (e.g., balances by major class, accumulated depreciation, general description of method of computing depreciation).

**What's next**

Before issuing a standard, the Boards will re-deliberate several remaining issues, including the IASB's recognition and measurement exemption for leases of small assets, lessee disclosures and transition. It is not clear whether, when or to what extent the Boards will discuss the definition of a lease. The FASB will separately discuss leveraged leases and private company and not-for-profit issues.

---

\(^3\) See IAS 16 *Property, Plant and Equipment* and ASC 360-10 *Property, Plant and Equipment – Overall*. 