**IASB substantially completes redeliberations on leases**

**What you need to know**

- The IASB held a meeting in February 2015 to redeliberate the transition and other requirements of its proposed new leases standard.
- The IASB decided to simplify the transition to its new standard; this includes changing the modified retrospective approach, and not requiring entities to reassess the definition of a lease for existing contracts nor to apply the new standard to leases with remaining terms of less than 12 months.
- The IASB reaffirmed that its standard will include a recognition and measurement exemption for leases of small assets.
- A standard on accounting for leases is expected in the second half of 2015.

**Highlights**

The International Accounting Standards Board (IASB) held a meeting in February 2015 to substantially complete the redeliberations of the 2013 proposal to put most leases on lessees' balance sheets.

The IASB reaffirmed that a lessee that has leases classified as operating leases under IAS 17 Leases can choose a fully retrospective or a modified retrospective approach on transition to the new standard. The IASB decided to permit additional transition reliefs associated with existing operating leases. The IASB also decided to not require entities to reassess whether arrangements existing at transition meet the definition of a lease under the new standard. The IASB also made decisions about the transition requirements for sale and leaseback transactions and subleases; an exemption for leases of small assets; and the discount rate for subleases. Like all decisions to date, these decisions are tentative.

The FASB will hold its own meeting in February 2015 but after the date of this publication. At its meeting, the FASB plans to discuss various transition items and reassessment of variable lease payments that depend on an index or rate. Our forthcoming To the Point publication will summarise the decisions made at the FASB’s meeting.

Both the IASB and the FASB are expected to issue separate standards in the second half of 2015.

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1 See the Exposure Draft: Leases on the IASB’s website.
Key decisions on transition requirements

Leases previously classified as finance leases
The IASB did not redeliberate the transition requirements in the 2013 proposal for finance leases. Therefore, an entity would not change its accounting for finance leases existing at the date of initial application of the new standard. The term ‘date of initial application’ describes the first day of the annual reporting period in which an entity first applies the requirements of the new standard.

Lessees - Leases previously classified as operating leases
For leases previously classified as operating leases, the IASB decided to permit lessees to choose either a fully retrospective approach or a modified retrospective approach on initial application of the new standard. The approach must be applied consistently across a lessee’s entire operating lease portfolio.

Under the modified retrospective approach, the lessee would:
- Not restate comparative figures
- Recognise the cumulative effect of initially applying the new standard as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application
- Measure the lease liability at the present value of the remaining lease payments, discounted using the lessee’s incremental borrowing rate at the date of initial application
- Measure the right-of-use asset on transition in one of two ways, chosen on a lease-by-lease basis:
  - As if the new standard had always been applied, but using a discount rate based on the lessee’s incremental borrowing rate at the date of initial application
  - At an amount equal to the lease liability, adjusted for previously recognised prepaid or accrued lease payments
- Be permitted to apply a single discount rate to a portfolio of leases with similar characteristics
- Be permitted to adjust the right-of-use asset for any previously recognised onerous lease provisions
- Be permitted to apply a recognition and measurement exemption for leases for which the term ends within 12 months or less of the date of initial application
- Be permitted to exclude initial direct costs in the measurement of the right-of-use asset
- Be permitted to use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease

The IASB discussed specific disclosure requirements to help users understand the effect of the new standard, on both the statement of financial position and the statement of financial performance, compared to IAS 17 Leases. No decision was reached, therefore, the IASB will continue this discussion at a future meeting.

First-time adopters of IFRS would also be able to use a modified retrospective approach, but with some exceptions to the approach described above.

How we see it
The additional transition reliefs for lessees with existing operating leases address many of the concerns constituents raised about the cost and complexity of applying the transition provisions contained in the 2013 proposal.

Lessors - Leases previously classified as operating leases
The IASB decided that, with the exception of subleases described below, lessors would continue to apply their current accounting for any operating leases that are ongoing at the date of initial application.
Subleases
The IASB decided that an intermediate lessor (an entity that is both the lessee and lessor of the same underlying asset) must reassess each existing operating sublease at the date of initial application to determine whether it is classified as an operating lease or a finance lease under the requirements of the new standard. This reassessment would be based on the remaining contractual terms of the head lease and the sublease with reference to the right-of-use asset associated with the head lease and not the underlying asset. If a sublease was classified as an operating lease under IAS 17 and is a finance lease under the new standard, the intermediate lessor would account for the sublease as a new finance lease entered into on the date of initial application. Any gain or loss arising on the sublease arrangement would be included in the cumulative catch-up adjustment to retained earnings (or other component of equity) at the date of initial application.

Sale and leaseback transactions
The IASB decided to prohibit reassessment of historical sale and leaseback transactions to determine whether a sale occurred in accordance with IFRS 15 Revenue from Contracts with Customers.

Seller-lessees would not perform any retrospective adjustments to sale and leaseback transactions on transition to the new standard. The leaseback would be accounted for on transition in the same way as any other operating or finance lease ongoing at the date of initial application, subject to the following:

- For sale and leaseback transactions previously classified as finance leases, any gain on the sale would continue to be amortised in the same way as under IAS 17.
- For sale and leaseback transactions previously classified as operating leases, any deferred losses or gains relating to off-market terms at the date of initial application would be adjusted against the right-of-use asset.

At its July 2014 meeting the IASB decided that the seller-lessee’s immediate gain on a sale and leaseback transaction would be limited to the portion related to the residual asset (i.e., the residual interest in the underlying asset transferred to the buyer-lessee). 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. In February 2015, the IASB decided that this partial gain recognition approach would only apply to new sale and leaseback transactions entered into after the date of initial application.

Definition of a lease
The IASB decided not to require entities to reassess existing contracts under the definition of a lease contained in the new standard. Instead, entities would be permitted to account for transactions that do not contain a lease under IAS 17 and IFRIC 4 Determining whether an Arrangement contains a Lease as they are today, i.e., generally as services. Likewise, an entity would be permitted to account for contracts that contain a lease under IAS 17 and IFRIC 4 as containing a lease when applying the new standard. The IASB believes the cost relief to preparers outweighs any benefit to be gained from reassessment.

If an entity chooses this option, it would be applied to all contracts that are ongoing at the date of initial application (i.e., an entity would not be permitted to apply the option on a lease-by-lease basis) and that fact would be disclosed.

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2 See our IFRS Developments 88: Boards address sale and leaseback transactions, lessor disclosures (AU2546).
Leases of small assets

The IASB reaffirmed its March 2014\(^3\) decision to include a lessee recognition and measurement exemption for leases of small assets. At that meeting, the IASB asked its staff to perform outreach to assess whether the scope of the proposed exemption was clear and whether it would be likely to result in leases that are material in aggregate being exempt from the new standard.

Based on the results of the outreach, the IASB concluded that it does not expect the application of the exemption for leases of small assets to give rise to the omission of material assets and liabilities when a quantitative threshold is used. Therefore, the Basis for Conclusions to the new standard will include a discussion of the quantitative threshold the IASB considers appropriate in applying the exemption. In their redeliberations, the IASB discussed a threshold of $5,000. This is intended to help preparers determine what is meant by ‘small’ and will be expressed in terms of the underlying value of the asset when new. The new standard will specify that the exemption only applies to leases of assets that are not dependent on, or highly interrelated with, other leased assets.

Discount rate used for subleases

The IASB decided to allow an intermediate lessor to use the discount rate used to account for the head lease when accounting for a sublease classified as a finance lease if the rate implicit in the sublease cannot be readily determined. This changes the Board’s tentative decision in June 2014\(^4\) that would have required the use of the rate implicit in the sublease.

Next steps

The IASB has substantially completed its redeliberations on leases. Before issuing a new standard, the IASB will discuss certain transition-related disclosures, the effective date of the standard and any sweep issues that arise during the drafting process. The new standard is expected in the second half of 2015.

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\(^3\) See our IFRS Developments 75: Boards back away from some key aspects of leases proposal (AU2269).

\(^4\) See our IFRS Developments 83: Boards continue their march towards new leases standard (AU2500).