Boards continue their march towards new leases standard

What you need to know

- The Boards continued re-deliberating ways to clarify and simplify their 2013 joint proposal on leases at their June 2014 meeting.
- They reached converged decisions on how intermediate lessors would present subleases in the balance sheet and income statement. However, they reached different decisions about how such subleases would be classified.
- The Boards reached converged decisions on how lessees would present Type A right-of-use assets and lease liabilities in the balance sheet and lessors' presentation in the statement of cash flows. They also decided that lessees' presentation in the statement of cash flows would be consistent with what they proposed in 2013.

Highlights

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) (collectively, the Boards) met again in June 2014 to re-deliberate their 2013 proposal to put most leases on lessees’ balance sheets.

They focused on the accounting for subleases, lessee balance sheet presentation and the statement of cash flows presentation for lessees and lessors. By reaching converged decisions on the financial statement presentation of subleases, lessee balance sheet presentation for Type A leases and lessor presentation in the statement of cash flows, the Boards again looked to minimise differences in any final standards they issue for IFRS and US GAAP. However, a fundamental difference that arose earlier in re-deliberations on the proposed lessee accounting model led the Boards to reach different decisions on how intermediate lessors would classify subleases. As a reminder of those earlier discussions, the IASB is pursuing a single lessee model (i.e., Type A leases) with an exemption for leases of small-ticket assets while the FASB is pursuing a dual approach to lessee accounting (i.e., there would be two types of leases, Type A and Type B). The latest decisions, like all decisions to date, are tentative.

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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 (AU2269).
Key decisions

Subleases

The Boards decided that an intermediate lessor (i.e., the entity that is a lessee in the head lease and the lessor in the sublease) would account for a head lease (as a lessee) and a sublease (as a lessor) as two separate lease contracts, as they had proposed in 2013. However, the Boards clarified that when contracts are entered into at or near the same time, an intermediate lessor would be required to consider the criteria for combining contracts (i.e., whether the contracts are negotiated as a package with a single commercial objective or the consideration to be paid in one contract depends on the price or performance of the other contract). If either criterion is met, the intermediate lessor would account for the head lease and sublease as a single combined transaction.

The Boards reached different decisions on how an intermediate lessor would classify a sublease as Type A (similar to a finance lease today) or Type B (similar to an operating lease today). The FASB decided that an intermediate lessor would consider the lease classification criteria with reference to the underlying asset. The IASB, however, decided that an intermediate lessor would consider the lease classification criteria with reference to the remaining right-of-use asset from the head lease. The IASB's decision was driven primarily by its previous decision to only permit Type A leases for lessees (with certain exceptions). The IASB expects its decision to result in Type A classification for the sublease more often than if the lease classification were to be made with reference to the underlying asset (i.e., consistent with the Type A classification of the related head lease).

The Boards agreed on an intermediate lessor’s presentation of subleases in the balance sheet and income statement. Specifically, an intermediate lessor would not be permitted to offset lease liabilities and lease assets that arise from a head lease and a sublease, respectively, unless those liabilities and assets meet the applicable requirements for offsetting financial instruments. The Boards also agreed that an intermediate lessor would apply the principal-agent guidance from the new revenue recognition standard to determine whether sublease revenue should be presented on a gross or net (i.e., reduced for head-lease expenses) basis. The Boards expect that intermediate lessors would generally present sublease revenue on a gross basis.

How we see it

The Boards are trying to align various aspects of the proposed leases standard (e.g., the principal-agent considerations for sublease revenue) with the new joint revenue recognition standard. Lessors should familiarise themselves with the new revenue standard because it will also influence their accounting for leases under a final leases standard.

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4 See IFRS 15 Revenue from Contracts with Customers, IFRS 15.B34-B38 (Accounting Standards Update 2014-09, Revenue from Contracts with Customers (Topic 606), ASC 606-10-55-36 through 606-10-55-40).

5 See IFRS 15 (ASC Topic 606).
Lessee balance sheet presentation

Consistent with their 2013 proposal, the Boards decided that lessees’ Type A right-of-use assets would be presented in the balance sheet in either of the following ways:

- Separately from other assets (e.g., owned assets)
- Together with the corresponding underlying assets as if they were owned, with disclosure of the balance sheet line items that include Type A right-of-use assets and the amounts of those assets

The FASB decided that lessees’ Type B right-of-use assets would be presented in the balance sheet separately from Type A right-of-use assets with disclosure of the balance sheet line items that include Type B right-of-use assets. The FASB decided not to specify how lessees would separately present Type B right-of-use assets in the balance sheet except to say that the presentation should be rational and consistent for similar leases.

The Boards also decided that lessees’ Type A lease liabilities would be presented in the balance sheet in either of the following ways:

- Separately from other liabilities
- Together with other liabilities with disclosure of the balance sheet line items that include Type A lease liabilities and the amounts of those liabilities

In addition, the FASB decided that lessees’ Type B lease liabilities would be presented in the balance sheet separately from Type A lease liabilities (similar to Type B right-of-use asset presentation and disclosure). The FASB did not specify how lessees would separately present Type B lease liabilities in the balance sheet. The FASB wants lessees to present Type B lease liabilities in a manner that is most appropriate based on the facts and circumstances. Furthermore, the FASB noted that this decision does not call into question the Boards’ previous determination that lease liabilities are financial liabilities.

Presentation of leases in the statement of cash flows

Consistent with the 2013 proposal, the Boards agreed that lessors would present cash receipts from leases within operating activities in the statement of cash flows.

The Boards also decided to retain the requirements they proposed in 2013 for lessees’ presentation in the statement of cash flows.

Lessees applying IFRS would present cash payments for the principal portion of Type A lease liabilities within financing activities and would present cash payments for the interest portion within operating or financing activities (based on an accounting policy election under IAS 7\(^6\)).

Under the 2013 proposal, lessees applying US GAAP would present the following in the statement of cash flows:

- Cash payments for the principal portion of Type A lease liabilities within financing activities
- Cash payments for the interest portion of Type A lease liabilities within operating activities
- Cash payments for Type B leases within operating activities

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\(^6\) IAS 7, Statement of Cash Flows.
**What's next**

Before issuing a final standard, the Boards will re-deliberate several remaining issues, including the definition of a lease, leases of small assets (i.e., the IASB’s recognition and measurement exemption for leases of small-ticket assets), sale and leaseback transactions, disclosures and transition. The FASB will separately discuss leveraged leases and private company and not-for-profit issues (e.g., use of a risk-free discount rate as a policy election).