Boards complete redeliberations of the definition of a lease

What you need to know

➤ The Boards decided against adding an additional requirement to their proposed definition of a lease.
➤ With this decision, the Boards completed their redeliberations of the definition of a lease and left in place the converged decisions they had reached earlier on how the definition would be applied.
➤ A standard on accounting for leases is not expected before the third quarter of 2015.

Highlights

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) (collectively, the Boards) decided against adding an additional requirement to their proposed definition of a lease, leaving in place the converged decisions they previously reached in their redeliberations on their 2013 proposal¹ to put most leases on lessees’ balance sheets.

With this decision, the Boards completed their redeliberations of the definition of a lease and how the definition would be applied. The Boards’ decisions, like all decisions to date, are tentative.

Definition of a lease

At their October 2014 meeting, the Boards reaffirmed that a lease would be defined as a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration and that entities would determine whether a contract contains a lease by assessing whether: (1) the use of an identified asset is either explicitly or implicitly specified; and (2) the contract conveys to the customer the right to control the use of the identified asset throughout the period of use.

A contract would not involve the use of an identified asset if a supplier has the substantive right to substitute the asset used to fulfill the contract. A substitution right would be substantive if the supplier has the practical ability to substitute the asset and can benefit from exercising that right.

A contract would convey the right to control the use of an identified asset if, throughout the period of use, the customer has the right to both direct the use of the identified asset (i.e., by having the right to direct how and for what purpose the asset is used, including the right to change how and for what purpose the asset is used) and obtain substantially all of the economic benefits from directing the use of the identified asset.

¹ See the Exposure Draft: Leases on the IASB’s website.
If neither the customer nor the supplier controls how and for what purpose the asset is used throughout the period of use, the customer would have the right to direct the use of the identified asset if it either:

- Has the right to operate the asset or direct others to operate the asset in a manner that it determines (with the supplier having no right to change those operating instructions)
- Or
- Designed the asset, or caused the asset to be designed, in a way that predetermines how and for what purpose the asset will be used or operated

A supplier’s protective rights, in isolation, would not prevent the customer from having the right to direct the use of an identified asset. Protective rights are intended to protect a supplier’s interests (e.g., interests in the asset, its personnel, compliance with laws and regulations) and might take the form of a specified maximum amount of asset use or a requirement to follow specific operating instructions.

At their December 2014 meeting, the Boards decided against adding an additional requirement that, for a contract to contain a lease, a customer must have the ability to derive benefits from directing the use of an identified asset on its own or together with other resources (e.g., goods or services) that are either sold separately (by the supplier or any other supplier) or can be sourced in a reasonable period of time. Some members of the Boards said such a requirement would have added complexity to the application of the proposed definition and the costs would have outweighed the benefits. They also noted that the Boards’ staffs were unable to identify arrangements in which the lease conclusion would change as a result of the additional requirement.

How we see it

While the Boards have concluded their redeliberations on the definition of a lease, there are still questions related to how the definition would be applied to certain arrangements. For example, arrangements that include significant services may require judgement to determine whether the contract conveys the right to control the use of an identified asset.

Next steps

Before issuing a standard, the Boards will redeliberate several remaining issues, including lessee disclosures, transition and an effective date. A standard is not expected before the third quarter of 2015.