FASB Exposure Draft

Proposed Accounting Standards Update (Revised)

Issued: May 16, 2013
Comments Due: September 13, 2013

Leases (Topic 842)

a revision of the 2010 proposed FASB Accounting Standards Update, *Leases (Topic 840)*

This Exposure Draft of a proposed Accounting Standards Update of Topic 842 is issued by the Board for public comment. Comments can be provided using the electronic feedback form available on the FASB website. Written comments should be addressed to:

Technical Director
File Reference No. 2013-270

Financial Accounting Standards Board
of the Financial Accounting Foundation

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft and is requesting comments by September 13, 2013. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing a written letter to director@fasb.org, File Reference No. 2013-270
- Sending written comments to “Technical Director, File Reference No. 2013-270, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116.”

Do not send responses by fax.

All comments received are part of the FASB’s public file. The FASB will make all comments publicly available by posting them to the online public reference room portion of its website.

An electronic copy of this Exposure Draft is available on the FASB’s website.

FASB

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7, PO Box 5116, Norwalk, Connecticut 06856-5116

Proposed Accounting Standards Update (Revised)

Leases (Topic 842)

a revision of the 2010 proposed FASB Accounting Standards Update, *Leases (Topic 840)*

May 16, 2013

Comment Deadline: September 13, 2013

CONTENTS

Page Numbers

Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

Leasing is an important activity for many entities. It is a means of gaining access to assets, of obtaining finance, and of reducing an entity's exposure to the risks of asset ownership. The prevalence of leasing, therefore, means that it is important that users of financial statements have a complete and understandable picture of an entity's leasing activities. The existing accounting models for leases require lessees and lessors to classify their leases as either capital leases or operating leases and account for those leases differently. Those models have been criticized for failing to meet the needs of users of financial statements because they do not always provide a faithful representation of leasing transactions. In particular, they do not require lessees to recognize assets and liabilities arising from operating leases. As a result, there has been a longstanding request from many users of financial statements and others to change the accounting requirements so that lessees would be required to recognize those assets and liabilities.

Accordingly, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) initiated a joint project to develop a new approach to lease accounting that would require assets and liabilities arising from leases to be recognized in the statement of financial position.

To meet that objective, the IASB and the FASB have jointly developed a revised draft standard on leases. The Boards developed the proposals in this revised Exposure Draft after considering responses to their Discussion Paper, *Leases: Preliminary Views*, which was issued in March 2009, and the IASB's initial Exposure Draft, *Leases*, and the proposed FASB Accounting Standards Update, *Leases (Topic 840)*, which were issued in August 2010.

Although many of the problems associated with existing leases requirements relate to the accounting for operating leases in the financial statements of lessees, retaining the existing lease accounting models for lessors would be inconsistent with the proposed approach to lessee accounting and would result in additional complexity in financial reporting. In addition, the Boards decided that it would be beneficial to consider lessor accounting at the same time they are developing proposals on revenue recognition. Consequently, this Exposure Draft proposes changes to both lessee accounting and lessor accounting.

Who Would Be Affected by the Amendments in This Proposed Update?

The proposed requirements would affect any entity that enters into a lease, with some specified scope exemptions. The proposed requirements would supersede IAS 17, *Leases* (and related Interpretations), in International Financial Reporting Standards (IFRSs) and the requirements in Topic 840, Leases (and related Subtopics), of the *FASB Accounting Standards Codification®.*

How Would the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

The core principle of the proposed requirements is that an entity should recognize assets and liabilities arising from a lease. This represents an improvement over existing leases requirements, which do not require lease assets and lease liabilities to be recognized by many lessees.

In accordance with that principle, a lessee would recognize assets and liabilities for leases with a maximum possible term of more than 12 months. A lessee would recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the leased asset (the underlying asset) for the lease term.

The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee would depend on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset. For practical purposes, this assessment would often depend on the nature of the underlying asset.

For most leases of assets other than property (for example, equipment, aircraft, cars, trucks), a lessee would classify the lease as a Type A lease and would do the following:

1. Recognize a right-of-use asset and a lease liability, initially measured at the present value of lease payments
2. Recognize the unwinding of the discount on the lease liability as interest separately from the amortization of the right-of-use asset.

For most leases of property (that is, land and/or a building or part of a building), a lessee would classify the lease as a Type B lease and would do the following:

1. Recognize a right-of-use asset and a lease liability, initially measured at the present value of lease payments

2. Recognize a single lease cost, combining the unwinding of the discount on the lease liability with the amortization of the right-of-use asset, on a straight-line basis.

Similarly, the accounting applied by a lessor would depend on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset. For practical purposes, this assessment often would depend on the nature of the underlying asset.

For most leases of assets other than property, a lessor would classify the lease as a Type A lease and would do the following:

1. Derecognize the underlying asset and recognize a right to receive lease payments (the lease receivable) and a residual asset (representing the rights the lessor retains relating to the underlying asset)
2. Recognize the unwinding of the discount on both the lease receivable and the residual asset as interest income over the lease term
3. Recognize any profit relating to the lease at the commencement date.

For most leases of property, a lessor would classify the lease as a Type B lease and would apply an approach similar to existing operating lease accounting in which the lessor would do the following:

1. Continue to recognize the underlying asset
2. Recognize lease income over the lease term typically on a straight-line basis.

When measuring assets and liabilities arising from a lease, a lessee and a lessor would exclude most variable lease payments. In addition, a lessee and a lessor would include payments to be made in optional periods only if the lessee has a significant economic incentive to exercise an option to extend the lease or not to exercise an option to terminate the lease.

The existing accounting model for leveraged leases would not be retained, and the proposals described above for lessors would be applied to all leases currently accounted for as leveraged leases.

For leases with a maximum possible term (including any options to extend) of 12 months or less, a lessee and a lessor would be permitted to make an accounting policy election, by class of underlying asset, to apply simplified requirements that would be similar to existing operating lease accounting.

An entity would provide disclosures to meet the objective of enabling users of financial statements to understand the amount, timing, and uncertainty of cash flows arising from leases.

On transition, a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach.

When Would the Amendments Be Effective?

The Boards will set the effective date for the proposed requirements when they consider interested parties' feedback on this revised Exposure Draft. The Boards are aware that the proposals affect almost every reporting entity. Some of those entities have many leases, and the proposed changes to accounting for leases are significant. The Boards will consider these and other relevant factors when setting the effective date.

How Do the Proposed Provisions Compare with International Financial Reporting Standards (IFRS)?

The leases project is a joint project with the IASB, and the requirements in this revised Exposure Draft are nearly identical to the requirements proposed by the IASB.

The following are the primary differences between the FASB's and the IASB's proposed requirements on leases:

1. Revaluations
    a. IFRS allows revaluation of the right-of-use asset (and related disclosure requirements).
2. Statement of cash flows
    a. U.S. GAAP requires interest to be classified as operating leases.
    b. IFRS allows interest to be classified as operating, investing, or financing leases.
3. Disclosure
    a. U.S. GAAP requires disclosure of a maturity analysis of nonlease components.
    b. U.S. GAAP does not require disclosure of a reconciliation of the opening and closing balances of the right-of-use asset.
4. Nonpublic entities
    a. U.S. GAAP permits a policy election to use a risk-free rate to discount the liability.
    b. U.S. GAAP permits an exemption from the liability balance reconciliation disclosure.
    c. The IASB will consider whether and, if so, how to incorporate this requirement into its *IFRS for Small and Medium-sized Entities* at a later date.

5. Existing differences in other areas of U.S. GAAP and IFRS that affect the accounting for leases:
   a. The key areas of difference are the existing requirements for impairment and the accounting for investment properties. There are also some minor differences in the accounting for foreign exchange, embedded derivatives, disclosure of transition, business combinations, and transfer/transition of secured lease receivables.

Questions for Respondents

The Boards invite individuals and organizations to comment on the proposals in this revised Exposure Draft and, in particular, on the questions below. Respondents need not comment on all of the questions.

Comments are requested from those who agree and those who disagree with the proposals. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with a proposal are asked to describe their suggested alternative(s), supported by specific reasoning and examples, if possible.

Respondents should submit one comment letter to either the IASB or the FASB. The Boards will jointly consider all comment letters received.

Scope

Question 1: Identifying a Lease

This revised Exposure Draft defines a lease as “a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.” An entity would determine whether a contract contains a lease by assessing whether:

1. Fulfillment of the contract depends on the use of an identified asset.
2. The contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.

Do you agree with the definition of a lease and the proposed requirements in paragraphs 842-10-15-2 through 15-16 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

The Accounting Model

This revised Exposure Draft would require an entity to recognize assets and liabilities arising from a lease.

When assessing how to account for a lease, a lessee and a lessor would classify a lease on the basis of whether a lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset.

This revised Exposure Draft would require an entity to apply that consumption principle by presuming that leases of property are Type B leases and leases of assets other than property are Type A leases, unless specified classification criteria are met. Those classification criteria are different for leases of property and leases of assets other than property to reflect the different natures of property (which often embeds a land element) and assets other than property.

The Boards acknowledge that, for some leases, the application of the classification criteria might result in different outcomes than if the consumption principle were to be applied without additional requirements. Nonetheless, this revised Exposure Draft would require an entity to classify leases by applying the classification criteria in paragraphs 842-10-25-5 through 25-8 to simplify the proposals.

Lessee Accounting

A lessee would do the following:

1. For all leases, recognize a right-of-use asset and a lease liability, initially measured at the present value of lease payments (except if a lessee elects to apply the recognition exemption for short-term leases).
2. For Type A leases, subsequently measure the lease liability on an amortized cost basis and amortize the right-of-use asset on a systematic basis that reflects the pattern in which the lessee expects to consume the right-of-use asset's future economic benefits. The lessee would present the unwinding of the discount on the lease liability as interest separately from the amortization of the right-of-use asset.
3. For Type B leases, subsequently measure the lease liability on an amortized cost basis and amortize the right-of-use asset in each period so that the lessee would recognize the total lease cost on a straight-line basis over the lease term. In each period, the lessee would present a single lease cost combining the unwinding of the discount on the lease liability with the amortization of the right of use asset.

Lessor Accounting

A lessor would do the following:

1. For Type A leases, derecognize the underlying asset and recognize a lease receivable and a residual asset. The lessor would recognize both of the following:
   a. The unwinding of the discount on both the lease receivable and the residual asset as interest income over the lease term
   b. Any profit relating to the lease (as described in paragraph 842-30-30-7) at the commencement date.
2. For Type B leases (and any short-term leases if the lessor elects to apply the exemption for short-term leases), continue to recognize the underlying asset and recognize lease income over the lease term, typically on a straight-line basis.

Question 2: Lessee Accounting

Do you agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Question 3: Lessor Accounting

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Question 4: Classification of Leases

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 842-10-25-5 through 25-8, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

Measurement

This revised Exposure Draft would require that a lessee and a lessor measure assets and liabilities arising from a lease on a basis that:

1. Reflects a lease term determined as the noncancellable period, together with both of the following:
   a. Periods covered by an option to extend the lease if the lessee has a significant economic incentive to exercise that option
   b. Periods covered by an option to terminate the lease if the lessee has a significant economic incentive not to exercise that option.
2. Includes fixed lease payments and variable lease payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate) but excludes other variable lease payments unless those payments are in-substance fixed payments. The lessee and lessor would measure variable lease payments that depend on an index or a rate using the index or rate at the commencement date.

A lessee would reassess the measurement of the lease liability, and a lessor would reassess the measurement of the lease receivable, if either of the following occurs:

1. There is a change in relevant factors that would result in a change in the lease term (as described in paragraph 842-10-55-5).
2. There is a change in an index or a rate used to determine lease payments.

Question 5: Lease Term

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

Question 6: Variable Lease Payments

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

Question 7: Transition

Subparagraphs 842-10-65-1(b) through (h) and (k) through (y) state that a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?

Are there any additional transition issues the Boards should consider? If yes, what are they and why?

Question 8: Disclosure

Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1 through 50-13 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

Question 9: Nonpublic Entities (FASB Only)

To strive for a reasonable balance between the costs and benefits of information, the FASB decided to provide the following specified reliefs for nonpublic entities:

1. To permit a nonpublic entity to make an accounting policy election to use a risk-free discount rate to measure the lease liability. If an entity elects to use a risk-free discount rate, that fact should be disclosed.
2. To exempt a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability.

Will these specified reliefs for nonpublic entities help reduce the cost of implementing the new lease accounting requirements without unduly sacrificing information necessary for users of their financial statements? If not, what changes do you propose and why?

Related Party Leases (FASB Only)

The FASB decided that the recognition and measurement requirements for all leases should be applied by lessees and lessors that are related parties based on the legally enforceable terms and conditions of the lease, acknowledging that some related party transactions are not documented and/or the terms and conditions are not at arm's length. In addition, lessees and lessors would be required to apply the disclosure requirements for related party transactions in

Topic 850, Related Party Disclosures. Under existing U.S. GAAP, entities are required to account for leases with related parties on the basis of their economic substance, which may be difficult when there are no legally enforceable terms and conditions of the agreement.

Question 10: (FASB Only)

Do you agree that it is not necessary to provide different recognition and measurement requirements for related party leases (for example, to require the lease to be accounted for based on the economic substance of the lease rather than the legally enforceable terms and conditions)? If not, what different recognition and measurement requirements do you propose and why?

Question 11: (FASB Only)

Do you agree that it is not necessary to provide additional disclosures (beyond those required by Topic 850) for related party leases? If not, what additional disclosure requirements would you propose and why?

Question 12: Consequential Amendments to IAS 40 (IASB Only)

The IASB is proposing amendments to other IFRSs as a result of the proposals in this revised Exposure Draft, including amendments to IAS 40, *Investment Property*. The amendments to IAS 40 propose that a right-of-use asset arising from a lease of property would be within the scope of IAS 40 if the leased property meets the definition of investment property. This would represent a change from the current scope of IAS 40, which permits, but does not require, property held under an operating lease to be accounted for as investment property using the fair value model in IAS 40 if it meets the definition of investment property.

Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

Amendments to the *FASB Accounting Standards Codification*®

[Note: These proposed amendments are based on the Accounting Standards Codification as of the date of this proposal and do not include, for example, potential amendments from the proposed FASB Accounting Standards Update*, Revenue Recognition (Topic 605): Revenue from Contracts with Customers*. These proposed amendments do not replace or affect guidance issued by the SEC or its staff for public companies in their filings with the SEC.]

Summary of Proposed Amendments to the Accounting Standards Codification

1. This proposed Accounting Standards Update describes a lease model applicable to a wide range of industries and transactions. Consequently, the Board proposes to supersede or amend various Subtopics of the Accounting Standards Codification. Those proposed amendments are summarized below.

2. The following Topic would be superseded:

- 840 Leases

3. The following Subtopics would be superseded:

- 958-840 Not-for-Profit Entities—Leases
- 974-840 Real Estate—Real Estate Investment Trusts—Leases
- 978-840 Real Estate—Time-Sharing Activities—Leases
- 980-840 Regulated Operations—Leases

4. The following Topic would be added:

- 842 Leases

5. The following Subtopics would be amended as described.

Codification Subtopic	Description of Proposed Amendments
205-20 Presentation of Financial Statements—Discontinued Operations	Amended to include cross-reference to Subtopic 842-10 to determine whether a lease exists.
210-20 Balance Sheet—Offsetting	Removed cross-references to Topic 840 for guidance on leveraged lease offsetting.
230-10 Statement of Cash Flows—Overall	Amended examples of noncash investing and financing activities to include exchanging a right-of-use asset for a lease liability. Amended illustration of the statement of cash flows to include a Type A lease.
255-10 Changing Prices—Overall	Amended implementation guidance to determine whether lease assets and liabilities are monetary or nonmonetary.
270-10 Interim Reporting—Overall	Added interim disclosure requirements for lessors about lease-related income.
274-10 Personal Financial Statements—Overall	Removed example of an operating lease as a noncancellable commitment.
310-10 Receivables—Overall	Removed receivables guidance related to leveraged leases, direct financing leases, and sales-type leases. Amended receivables guidance for Type A leases.
310-20 Receivables—Nonrefundable Fees and Other Costs	Amended to include cross-reference to Topic 842 to determine initial direct costs.

Codification Subtopic	Description of Proposed Amendments
310-30, Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality	Amended to include cross-reference to Topic 842 to determine whether a lease exists.
310-40 Receivables—Troubled Debt Restructurings by Creditors	Amended to include cross-reference to Topic 842 to determine whether a change in a lease arrangement creates a scope exception.
323-740 Investments—Equity Method and Joint Ventures—Income Taxes	Removed cross-references to delayed equity contributions guidance in Topic 840.
350-40 Intangibles—Goodwill and Other—Internal-Use Software	Removed analogy to Subtopic 840-10 to determine the asset acquired in a software licensing arrangement.
360-10 Property, Plant, and Equipment—Overall	Amended to include the list of assets within the scope of Subtopic 360-10 for impairment and disposal of long-lived assets. Amended to include cross-references to Topic 842 to measure assets acquired under a lease. Amended to include cross-references to Topic 605 for sales guidance and Topic 842 for sale and leaseback transaction guidance. Removed cross-reference to Topic 840 and amended example of sale and leaseback transaction.
360-20 Property, Plant, and Equipment—Real	Removed real estate sales derecognition guidance and illustrations for interdependent sales of property improvements and leases of underlying land.

Codification Subtopic	Description of Proposed Amendments
Estate Sales	Amended to include cross-reference to Topic 842 to account for sale and leaseback transactions. Removed cross-reference to Topic 840 to determine if lease meets transfer of ownership criteria.
410-20 Asset Retirement and Environmental Obligations—Asset Retirement Obligations	Removed cross-reference to Topic 840 that required lease classification test to incorporate the requirements of Subtopic 410-20 to the extent applicable. Amended to include cross-references for terms defined in Topic 842. Amended to include cross-reference to Topic 842 to determine whether lease exists.
420-10 Exit or Disposal Cost Obligations—Overall	Amended to include cross-references to Topic 842 to determine lease termination costs. Removed operating lease termination measurement guidance and illustrations.
440-10 Commitments—Overall	Amended to include cross-references to Topic 842 to determine whether unconditional purchase option arising from a lease is outside the scope of the leases guidance.
450-10 Contingencies—Overall	Amended to include cross-reference to Topic 842, which defines variable lease payments.
450-20 Contingencies—Loss Contingencies	Amended to include cross-reference to Topic 842, which defines variable lease payments. Removed reference to Topic 840 to determine classification effects of a provision in a lease that requires lessee indemnifications for environmental contamination caused by the lessee during its use of the property.

Codification Subtopic	Description of Proposed Amendments
450-30 Contingencies—Gain Contingencies	Amended to include cross-reference to Topic 842, which defines variable lease payments.
460-10 Guarantees—Overall	Amended to include cross-reference to Topic 842, which defines lease term. Amended to include cross-reference to Topic 842, which defines variable lease payments. Removed cross-reference to Topic 840, which describes accounting for lease guarantees. Removed operating lease guarantee from examples of guarantees that have an initial measurement objective of fair value. Amended to include cross-reference to Topic 842 for relationships with proposed leases standard.
470-10 Debt—Overall	Amended to include cross-reference to Topic 842 to determine classification of obligations under leases.
470-60 Debt—Troubled Debt Restructurings by Debtors	Amended to include cross-reference to Topic 842 to determine impact of a change in a lease arrangement.
605-10 Revenue Recognition—Overall	Removed references to operating lease from sale and repurchase guidance and expanded scope to include all leases.
605-15 Revenue Recognition—Products	Removed references to operating lease from sale and repurchase guidance and expanded scope to include all leases.
605-25 Revenue Recognition—Multiple-Element Arrangements	Amended to include cross-reference to Topic 842 to determine if component of multiple-element arrangement is within the scope of leases guidance. Removed example of multiple deliverables in an arrangement that includes leased equipment.

Codification Subtopic	Description of Proposed Amendments
605-30 Revenue Recognition—Rights to Use	Amended to include cross-reference to Topic 842 to determine whether a lease exists.
605-50 Revenue Recognition—Customer Payments and Incentives	Removed cross-reference to Topic 840 for examples on the effect on revenue recognition of a manufacturer selling equipment.
740-10 Income Taxes—Overall	Removed cross-references to leveraged leases guidance. Removed direct financing and sales-type lease examples. Removed sale and leaseback transaction income tax example.
740-270 Income Taxes—Interim Reporting	Removed cross-reference to Topic 840 income tax interim reporting guidance for leveraged leases.
805-10 Business Combinations—Overall	Amended fair value disclosure example of a capital lease receivable to reflect a Type A lease.
805-20 Business Combinations—Identifiable Assets and Liabilities, and Any Noncontrolling Interest	Amended exception for the date to classify identifiable assets acquired and liabilities assumed in a business combination for leases. Added recognition exception for leases that, at the acquisition date, have a remaining maximum possible term under the contract of 12 months or less. Amended recognition and measurement guidance for assets and liabilities arising from leases acquired in a business combination. Amended disclosure requirements to specify which lease receivables are not subject to the requirements of Subtopic 310-30. Removed example of lease from list of contract-

Codification Subtopic	**Description of Proposed Amendments**
	based intangibles.
805-740 Business Combinations—Income Taxes	Removed cross-references to Topic 842 leveraged lease income tax guidance.
810-10 Consolidation—Overall	Removed cross-references to lease classification. Removed cross-references to other Topic 840 guidance.
815-10 Derivatives and Hedging—Overall	Removed example of operating lease that is outside the scope of Topic 815. Amended to include cross-references to Topic 842 to determine whether a lease exists. Amended to include cross-reference to Topic 842 to determine whether guarantee is in or outside the scope.
815-15 Derivatives and Hedging—Embedded Derivatives	Amended to include cross-references to Topic 842, which defines variable lease payments. Removed example of operating lease that is similar to an insurance contract.
815-20 Derivatives and Hedging—Hedging—General	Amended list of assets of a lessor that are a specific portion of an asset or liability (or of a portfolio of similar assets or a portfolio of similar liabilities) of a hedged item. Removed firm commitment example of a noncancellable operating lease.
820-10 Fair Value Measurement—Overall	Amended to include cross-references to Topic 842 for accounting principles related to lease classification and measurement.
825-10 Financial Instruments—Overall	Amended to include cross-references to Topic 842 to determine assets and liabilities arising from leases.

Codification Subtopic	Description of Proposed Amendments
845-10 Nonmonetary Transactions—Overall	Removed guidance for transfers of operating lease for barter credits.
860-10 Transfers and Servicing—Overall	Amended example of leases that are commonly securitized. Amended to include cross-reference to Subtopic 842-40 for sale and leaseback transaction guidance. Removed cross-reference to Topic 840 for leveraged leases, money-over-money leases, and wrap leases. Amended implementation guidance to include lease payments as financial assets.
860-20 Transfers and Servicing—Sales of Financial Assets	Amended implementation guidance to cross-reference guidance that indicates Type A lease payments are financial assets. Removed example of a transfer of lease financial receivables with residual values.
908-360 Airlines—Property, Plant, and Equipment	Amended purchase incentive measurement guidance for assets and liabilities arising from leases.
942-230 Financial Services—Depository and Lending—Statement of Cash Flows	Removed leveraged lease facts and financial statements illustrated. Amended facts and financial statements to illustrate a Type A lease.
954-470 Health Care Entities—Debt	Amended guidance to clarify the types of leases that create liabilities. Moved link to the definition of advanced refunding to Subtopic 954-470.
958-805 Not-for-Profit Entities—	Amended to include cross-reference to Topic 842 to determine when a revised lease agreement is

Codification Subtopic	Description of Proposed Amendments
Business Combinations	considered a new agreement.
958-810 Not-for-Profit Entities—Consolidation	Removed cross-references to Subtopic 958-840 for industry-specific accounting of interest-only payments of special-purpose-entity lessors. Removed cross-references to Topic 840, but guidance retained to determine when the fees paid by the lessee to the owners of the special-purpose entity are considered a return of the owners' initial equity capital investment. Removed link to the definition of lease inception but retained guidance for leases of assets under construction.
970-10 Real Estate—General—Overall	Amended to include cross-reference to Topic 842 to determine initial direct costs.
970-340 Real Estate—General—Other Assets and Deferred Costs	Amended to retain guidance for the capitalization of real estate rental costs other than initial direct costs. Amended to include cross-reference to Topic 842 to account for initial direct costs.
978-330 Real Estate—Time-Sharing Activities—Inventory	Amended to include cross-reference to Topic 842 to determine how to account for leases of real estate.
978-605 Real Estate—Time-Sharing Activities—Revenue Recognition	Removed cross-reference to Topic 840 that required title be transferred to recognize a sale of real estate, but guidance retained.
980-250 Regulated Operations—Accounting Changes and Error Corrections	Removed cross-reference to industry-specific example in Subtopic 980-840 of capitalization of leases with no income statement effect.

Codification Subtopic	Description of Proposed Amendments
980-340 Regulated Operations—Other Assets and Deferred Costs	Removed industry-specific sale and leaseback transaction examples.
980-605 Regulated Operations—Revenue Recognition	Amended to include cross-reference to Topic 842 to determine whether a lease exists.
985-605 Software—Revenue Recognition	Moved link to the definition of fiscal funding clause to Subtopic 985-605. Removed cross-reference to Topic 840 but retained fiscal funding clause guidance.

Introduction

6. The Accounting Standards Codification is amended as described in paragraphs 7–116. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Master Glossary

7. Supersede the following Master Glossary terms, with a link to transition paragraph 842-10-65-1, as follows:

- Active Use of the Property
- Bargain Purchase Option
- Bargain Renewal Option
- Capital Lease
- Construction Period Lease Payments
- Contingent Rentals
- Delayed Equity Investment
- Direct Financing Lease
- Estimated Residual Value
- Fair Value of Leased Property
- Heat Supply (or Burn-Up) Contracts
- Lease Incentive

- Lease Inception
- Leveraged Lease
- Minimum Lease Payments
- Minor
- Money-Over-Money Lease
- Noncancelable Lease Term
- Normal Leaseback
- Operating Lease
- Original Lessee
- Penalty
- Profit or Loss on Sale
- Sale-Leaseback Accounting
- Sales-Type Lease
- Substantially All
- Wrap Lease Transaction.

8. Add the following Master Glossary term to Subtopic 954-10 as follows:

Advance Refunding

A transaction involving the issuance of new debt to replace existing debt with the proceeds from the new debt placed in trust or otherwise restricted to retire the existing debt at a determinable future date or dates.

9. Add the following Master Glossary term to Subtopic 985-10 as follows:

Fiscal Funding Clause

A provision by which the lease is cancelable if the legislature or other funding authority does not appropriate the funds necessary for the governmental unit to fulfill its obligations under the lease agreement.

10. Add the following new terms to the Master Glossary, with a link to transition paragraph 842-10-65-1, as follows:

Commencement Date of the Lease (Commencement Date)

The date on which a **lessor** makes an **underlying asset** available for use by a **lessee**.

Contract

An agreement between two or more parties that creates enforceable rights and obligations.

Gross Residual Asset

The amount a **lessor** expects to derive from an **underlying asset** following the end of the **lease term**, measured on a discounted basis.

Initial Direct Costs

Costs that are directly attributable to negotiating and arranging a **lease** and would not have been incurred without entering into the lease.

Lease Liability

A **lessee**'s obligation to make lease payments arising from a **lease**, measured on a discounted basis.

Lease Payments

Payments made by a **lessee** to a **lessor** relating to the right to use an **underlying asset** during the **lease term**, consisting of the following:

a. Fixed payments, less any **lease** incentives received or receivable from the lessor
b. **Variable lease payments** that depend on an index or a rate or are in-substance fixed payments
c. The exercise price of a purchase option if the lessee has a significant economic incentive to exercise that option
d. Payments for penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

For the lessee, lease payments also include amounts expected to be payable by the lessee under **residual value guarantees**. Lease payments do not include payments allocated to nonlease components of a **contract** except when the lessee is required to combine nonlease and lease components and account for them as a single lease component.

For the lessor, lease payments also include lease payments structured as residual value guarantees. Lease payments do not include payments allocated to nonlease components.

Lease Receivable

A **lessor**'s right to receive **lease payments** arising from a **lease**, measured on a discounted basis.

Lessee

An entity that enters into a **contract** to obtain the right to use an **underlying asset** for a period of time in exchange for consideration.

Lessor

An entity that enters into a **contract** to provide the right to use an **underlying asset** for a period of time in exchange for consideration.

Property

Land or a building, or part of a building, or both.

Rate the Lessor Charges the Lessee

A discount rate that takes into account the nature of the transaction as well as the terms and conditions of the **lease**. The rate the lessor charges the lessee could be, for example, the **rate implicit in the lease** or the property yield.

Residual Asset

An asset representing the rights to an **underlying asset** retained by a **lessor** during a **lease**.

Residual Value Guarantee

A guarantee made to a **lessor** that the value of an **underlying asset** returned to the lessor at the end of a **lease** will be at least a specified amount.

Right-of-Use Asset

An asset that represents a **lessee**'s right to use an **underlying asset** for the **lease term**.

Short-Term Lease

A **lease** that, at the **commencement date**, has a maximum possible term under the **contract**, including any options to extend, of 12 months or less. Any lease that contains a purchase option is not a short-term lease.

Standalone Price

The price at which a **lessee** would purchase a component of a **contract** separately.

Underlying Asset

An asset that is the subject of a **lease** for which a right to use that asset has been conveyed to a **lessee**. The underlying asset could be a physically distinct portion of a single asset.

Variable Lease Payments

Payments made by a **lessee** to a **lessor** for the right to use an **underlying asset** that vary because of changes in facts or circumstances occurring after the **commencement date**, other than the passage of time.

11. Amend the following Master Glossary terms, with a link to transition paragraph 842-10-65-1, as follows:

~~Estimated~~ Economic Life

~~The estimated remaining~~ Either the period ~~during which the property~~ over which an asset is expected to be economically usable by one or more users or the number of production or similar units expected to be obtained from an asset by one or more users. ~~users, with normal repairs and maintenance, for the purpose for which it was intended at lease inception, without limitation by the lease term.~~

Interest Cost

Interest cost includes interest recognized on obligations having explicit interest rates, interest imputed on certain types of payables in accordance with Subtopic 835-30, and interest related to a ~~capital~~Type A **{add glossary link}**lease**{add glossary link}** determined in accordance with Topic 842. ~~Subtopic 840–30.~~ With respect to obligations having explicit interest rates, interest cost includes amounts resulting from periodic amortization of discount or premium and issue costs on debt.

Lease

~~An agreement conveying~~ A **contract** that conveys the right to use an asset (the **underlying asset**) ~~property, plant, or equipment (land and/or depreciable assets) usually~~ for a ~~stated~~ period of time in exchange for consideration.

Lease Term

The ~~fixed~~ noncancellable period for which a **lessee** has the right to use an **underlying asset**, together with both of the following: ~~**noncancelable lease term** plus all of the following, except as noted in the following paragraph:~~

- a. Periods covered by an option to extend the **lease** if the lessee has a significant economic incentive to exercise that option ~~All periods, if any, covered by **bargain renewal options**.~~
- b. Periods covered by an option to terminate the lease if the lessee has a significant economic incentive not to exercise that option. ~~All periods, if any, for which failure to renew the lease imposes a **penalty** on the lessee in such amount that a renewal appears, at lease inception, to be reasonably assured~~
- ~~c. All periods, if any, covered by ordinary renewal options during which any of the following conditions exist:~~
  - ~~1. A guarantee by the lessee of the lessor's debt directly or **indirectly related to the leased property** is expected to be in effect.~~
  - ~~2. A loan from the lessee to the lessor directly or indirectly related to the leased property is expected to be outstanding.~~

~~d. All periods, if any, covered by ordinary renewal options preceding the date as of which a **bargain purchase option** is exercisable~~

~~e. All periods, if any, representing renewals or extensions of the lease at the lessor's option.~~

~~The lease term shall not be assumed to extend beyond the date a bargain purchase option becomes exercisable.~~

Lessee's Incremental Borrowing Rate

The rate of interest that ~~that, at lease inception, the~~a **{add glossary link}**lessee**{add glossary link}** would have ~~incurred~~ to pay to borrow over a similar ~~term~~term, and with a similar security, the funds necessary to ~~purchase~~ obtain an asset of a similar value to the **right-of-use asset** in a similar economic environment. ~~the leased asset. This definition does not proscribe the lessee's use of a secured borrowing rate as its incremental borrowing rate if that rate is determinable, reasonable, and consistent with the financing that would have been used in the particular circumstances.~~

~~Interest~~ Rate Implicit in the Lease

The ~~discount~~ rate of interest that, at a given date, ~~that~~ causes the sum of the ~~aggregate~~ present value of payments made by a **lessee** for the right to use an **underlying asset** and the present value of the amount a lessor expects to derive from the underlying asset following the end of the **lease term** ~~at the beginning of the lease term of the minimum lease payments (as described in paragraph 840-10-25-4), excluding that portion of the payments representing executory costs to be paid by the lessor, together with any profit thereon and the unguaranteed residual value, accruing to the benefit of the lessor to be~~ to equal ~~to~~ the fair value of the underlying asset. ~~leased property to the lessor at lease inception, minus any investment tax credit retained by the lessor and expected to be realized by him. If the lessor is not entitled to any excess of the amount realized on disposition of the property over a guaranteed amount, no unguaranteed residual value would accrue to its benefit.~~

Sublease

A transaction in which an **underlying asset** ~~a leased property~~ is re-leased by the original **{add glossary link}**lessee**{add glossary link}** (or intermediate lessor) to a third party, and the **lease** (or head lease) ~~lease agreement~~ between the original **lessor** and lessee ~~two original parties~~ remains in effect.

Addition of Topic 842

[Note: For ease of readability, the new Topic is not underlined.]

12. Add Subtopic 842-10, with a link to transition paragraph 842-10-65-1, as follows:

Leases—Overall

Overview and Background

General

842-10-05-1 The **Leases** Topic includes the following Subtopics:

a. Overall
b. **Lessee**
c. **Lessor**
d. Sale and Leaseback Transactions.

842-10-05-2 Those Subtopics establish requirements of financial accounting and reporting for lessees and lessors.

842-10-05-3 Paragraphs presented in **bold** type in this Topic state the main principles. All paragraphs have equal authority.

Objectives

General

842-10-10-1 This Topic specifies the accounting for {add glossary link}leases{add glossary link}. The core principle of this Topic is that an entity should recognize assets and liabilities arising from a lease.

842-10-10-2 An entity should consider the terms and conditions of the **contract** and all related facts and circumstances when applying this Topic. An entity should apply this Topic consistently to leases with similar characteristics and in similar circumstances.

842-10-10-3 The objective of this Topic is to establish the principles that **lessees** and **lessors** should apply to report useful information to users of financial statements about the amount, timing, and uncertainty of cash flows arising from a lease.

Scope and Scope Exceptions

General

842-10-15-1 An entity shall apply this Topic to all **leases** as defined in the following paragraph, including leases of **right-of-use assets** in a **sublease**, except for the following:

a. Leases of intangible assets (see Topic 350)
b. Leases to explore for or use minerals, oil, natural gas, and similar nonregenerative resources (see Topics 930 and 932)

c. Leases of biological assets, including timber (see Topic 905).

> Identifying a Lease

842-10-15-2 A lease is a **contract** that conveys the right to use an asset (the **underlying asset**) for a period of time in exchange for consideration.

842-10-15-3 At inception of a contract, an entity shall determine whether that contract is or contains a lease by assessing both of the following:

- **a. Whether fulfillment of the contract depends on the use of an identified asset (as described in paragraphs 842-10-15-5 through 15-8)**
- **b. Whether the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration (as described in paragraphs 842-10-15-9 through 15-16).**

842-10-15-4 See Examples 1 through 5 (paragraphs 842-10-55-6 through 55-41) for illustrations of the requirements.

> > Fulfillment of the Contract Depends on the Use of an Identified Asset

842-10-15-5 An asset would typically be identified by being explicitly specified in a contract. However, even if an asset is explicitly specified, fulfillment of a contract does not depend on the use of an identified asset if the supplier (that is, the entity that provides the good or service under the contract) has the substantive right to substitute the asset throughout the term of the contract. In contrast, even if an asset is not explicitly specified in a contract, fulfillment of the contract can depend on the use of an identified asset if the supplier does not have a substantive right to substitute the asset.

842-10-15-6 A supplier's right to substitute an asset is substantive if both of the following conditions are met:

- a. The supplier can substitute alternative assets in place of the asset without requiring the consent of the customer (that is, the entity that receives the good or service under the contract).
- b. There are no barriers (economic or otherwise) that would prevent the supplier from substituting alternative assets in place of the asset during the term of the contract. Examples of such barriers include, but are not limited to, the following:
    1. Costs associated with substituting the asset that are so high that they create an economic disincentive to substituting alternative assets during the term of the contract
    2. Operational barriers that would prevent or deter the supplier from substituting the asset (for example, alternative assets are neither readily available to the supplier nor could they be sourced by the supplier within a reasonable time period or without incurring significant costs).

842-10-15-7 Fulfillment of a contract can depend on the use of an identified asset even if a supplier has the right or obligation to substitute other assets in place of the underlying asset if the asset is not operating properly or a technical upgrade becomes available. In addition, fulfillment of a contract can depend on the use of an identified asset even if a supplier has the right or obligation to substitute other assets for any reason only on or after a particular date. In this case, fulfillment of the contract can depend on the use of an identified asset until the date that the right or obligation to substitute becomes effective.

842-10-15-8 A physically distinct portion of an asset (for example, a floor of a building) can be an identified asset. However, a capacity portion of an asset (for example, a capacity portion of a fiber-optic cable that is less than substantially all of the capacity of the cable) cannot be an identified asset because it is not physically distinct from the remaining capacity of the asset.

> > Contract Conveys the Right to Control the Use of an Identified Asset

842-10-15-9 A contract conveys the right to control the use of an identified asset if, throughout the term of the contract, the customer has the ability to do both of the following:

a. Direct the use of the identified asset (as described in paragraphs 842-10-15-10 through 15-14)
b. Derive the benefits from use of the identified asset (as described in paragraphs 842-10-15-15 through 15-16).

> > > Ability to Direct the Use

842-10-15-10 A customer has the ability to direct the use of an asset when the contract conveys rights that give the customer the ability to make decisions about the use of the asset that most significantly affect the economic benefits to be derived from use of the asset throughout the term of the contract.

842-10-15-11 Examples of decisions that could most significantly affect the economic benefits to be derived from use of an asset include, but are not limited to, determining or being able to change any of the following:

a. How and for what purpose the asset is employed during the term of the contract
b. How the asset is operated during the term of the contract
c. The operator of the asset.

842-10-15-12 In some contracts for which there are few, if any, substantive decisions to be made about the use of an asset after the **commencement date**, a customer's ability to direct the use of the asset may be obtained at or before that date. For example, a customer may be involved in designing the asset for its use or in determining the terms and conditions of the contract, so that the decisions about the use of the asset that most significantly affect the economic benefits to be derived from use are predetermined. In those cases, the customer has the ability to direct the use of the asset throughout the term of the contract as a result of the decisions that it made at or before the commencement of the contract.

842-10-15-13 A contract may include clauses that restrict a customer's use of an asset; for example, a contract may specify the maximum amount of use of an asset to protect the supplier's interest in the asset. Such protective rights that restrict a customer's use of an asset would not, in isolation, prevent the customer from having the ability to direct the use of the asset.

842-10-15-14 Rights that give a customer the ability to specify the output of an asset (for example, the quantity and description of goods or services produced by the asset) would not, in isolation, mean that a customer has the ability to direct the use of that asset. The ability to specify the output, without any other decision-making rights relating to the use of the asset, gives a customer the same rights as any customer that purchases services.

> > > Ability to Derive the Benefits from Use

842-10-15-15 A customer's ability to derive the benefits from use of an asset refers to its right to obtain substantially all of the potential economic benefits from use of the asset throughout the term of the contract. A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, consuming, holding, or subleasing the asset. The economic benefits from use of an asset include its primary output and by-products in the form of products and services. Those economic benefits also include other economic benefits from use of the asset that could be realized from a commercial transaction with a third party.

842-10-15-16 A customer does not have the ability to derive the benefits from use of an asset if both of the following occur:

a. The customer can obtain the benefits from use of the asset only in conjunction with additional goods or services that are provided by the supplier and not sold separately by the supplier or other suppliers.
b. The asset is incidental to the delivery of services because the asset has been designed to function only with the additional goods or services provided by the supplier. In such cases, the customer receives a bundle of goods or services that combine to deliver an overall service for which the customer has contracted.

> Separating Components of a Contract

842-10-15-17 After determining that a contract contains a lease in accordance with paragraphs 842-10-15-2 through 15-16, an entity shall identify each separate lease component within the contract. An entity shall consider the right to use an asset to be a separate lease component if both of the following criteria are met:

a. The **lessee** can benefit from use of the asset either on its own or together with other resources that are readily available to the lessee. Readily available resources are goods or services that are sold or leased separately (by the **lessor** or other suppliers) or resources that the lessee has already obtained (from the lessor or from other transactions or events).
b. The underlying asset is neither dependent on nor highly interrelated with the other underlying assets in the contract.

842-10-15-18 An entity shall account for each lease component as a separate lease, separately from nonlease components of a contract, except as described in paragraph 842-10-15-20(b)(2) through (c). An entity shall allocate the consideration in the contract to each separate lease component that has been identified in accordance with paragraphs 842-10-15-20 through 15-22.

842-10-15-19 See Examples 6 through 10 (paragraphs 842-10-55-42 through 55-60) for an illustration of the requirements.

> > Lessee

842-10-15-20 After identifying the lease components in a contract in accordance with paragraph 842-10-15-17, a lessee shall allocate the consideration in the contract as follows:

a. If there are observable **standalone prices** for each component of the contract, a lessee shall allocate the consideration to each component on the basis of the relative standalone price of each component.
b. If there are observable standalone prices for one or more, but not all, of the components of the contract, a lessee shall allocate both of the following:
    1. The standalone price of each component to the components of the contract with observable prices
    2. The remaining consideration in the contract to the components of the contract without observable prices. If one or more of the components without observable prices is a lease component, the lessee shall combine those components and account for them as a single lease component.
c. If there are no observable standalone prices for any components of the contract, a lessee shall combine the components and account for them as a single lease component.

842-10-15-21 A price is observable if it is the price that either the lessor or similar suppliers charge for similar lease, good, or service components on a standalone basis.

> > Lessor

842-10-15-22 After identifying the lease components in a contract in accordance with paragraph 842-10-15-17, a lessor shall allocate the consideration in the contract using the requirements in paragraphs 70–76 of proposed Accounting Standards Update, *Revenue Recognition (Topic 605): Revenue from Contracts with Customers*.

Glossary

Commencement Date of the Lease (Commencement Date)

The date on which a **lessor** makes an **underlying asset** available for use by a **lessee**.

Contract

An agreement between two or more parties that creates enforceable rights and obligations.

Economic Life

Either the period over which an asset is expected to be economically usable by one or more users or the number of production or similar units expected to be obtained from an asset by one or more users.

Gross Residual Asset

The amount a **lessor** expects to derive from an **underlying asset** following the end of the **lease term**, measured on a discounted basis.

Initial Direct Costs

Costs that are directly attributable to negotiating and arranging a **lease** and would not have been incurred without entering into the lease.

Lease

A **contract** that conveys the right to use an asset (the **underlying asset**) for a period of time in exchange for consideration.

Lease Liability

A **lessee**'s obligation to make lease payments arising from a **lease**, measured on a discounted basis.

Lease Payments

Payments made by a **lessee** to a **lessor** relating to the right to use an **underlying asset** during the **lease term**, consisting of the following:

a. Fixed payments, less any **lease** incentives received or receivable from the lessor

b. **Variable lease payments** that depend on an index or a rate or are in-substance fixed payments
c. The exercise price of a purchase option if the lessee has a significant economic incentive to exercise that option
d. Payments for penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

For the lessee, lease payments also include amounts expected to be payable by the lessee under **residual value guarantees**. Lease payments do not include payments allocated to nonlease components of a **contract** except when the lessee is required to combine nonlease and lease components and account for them as a single lease component.

For the lessor, lease payments also include lease payments structured as residual value guarantees. Lease payments do not include payments allocated to nonlease components.

Lease Receivable

A **lessor**'s right to receive **lease payments** arising from a **lease**, measured on a discounted basis.

Lease Term

The noncancellable period for which a **lessee** has the right to use an **underlying asset**, together with both of the following:

a. Periods covered by an option to extend the **lease** if the lessee has a significant economic incentive to exercise that option
b. Periods covered by an option to terminate the lease if the lessee has a significant economic incentive not to exercise that option.

Lessee

An entity that enters into a **contract** to obtain the right to use an **underlying asset** for a period of time in exchange for consideration.

Lessee's Incremental Borrowing Rate

The rate of interest that a **lessee** would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the **right-of-use asset** in a similar economic environment.

Lessor

An entity that enters into a **contract** to provide the right to use an **underlying asset** for a period of time in exchange for consideration.

Property

Land or a building, or part of a building, or both.

Rate Implicit in the Lease

The rate of interest that, at a given date, causes the sum of the present value of payments made by a **lessee** for the right to use an **underlying asset** and the present value of the amount a lessor expects to derive from the underlying asset following the end of the **lease term** to equal the fair value of the underlying asset.

Rate the Lessor Charges the Lessee

A discount rate that takes into account the nature of the transaction as well as the terms and conditions of the **lease**. The rate the lessor charges the lessee could be, for example, the **rate implicit in the lease,** or the property yield.

Residual Asset

An asset representing the rights to an **underlying asset** retained by a **lessor** during a **lease**.

Residual Value Guarantee

A guarantee made to a **lessor** that the value of an **underlying asset** returned to the lessor at the end of a **lease** will be at least a specified amount.

Right-of-Use Asset

An asset that represents a **lessee**'s right to use an **underlying asset** for the **lease term**.

Short-Term Lease

A **lease** that, at the **commencement date**, has a maximum possible term under the **contract**, including any options to extend, of 12 months or less. Any lease that contains a purchase option is not a short-term lease.

Standalone Price

The price at which a **lessee** would purchase a component of a **contract** separately.

Sublease

A transaction in which an **underlying asset** is re-leased by the original **lessee** (or intermediate lessor) to a third party, and the **lease** (or head lease) between the original **lessor** and lessee remains in effect.

Underlying Asset

An asset that is the subject of a **lease** for which a right to use that asset has been conveyed to a **lessee**. The underlying asset could be a physically distinct portion of a single asset.

Useful Life

The period over which an asset is expected to contribute directly or indirectly to future cash flows.

Variable Lease Payments

Payments made by a **lessee** to a **lessor** for the right to use an underlying asset that vary because of changes in facts or circumstances occurring after the **commencement date**, other than the passage of time.

Recognition

General

> Lease Term

842-10-25-1 An entity shall determine the **lease term** as the noncancellable period of the **lease**, together with both of the following:

a. Periods covered by an option to extend the lease if the **lessee** has a significant economic incentive to exercise that option
b. Periods covered by an option to terminate the lease if the lessee has a significant economic incentive not to exercise that option.

842-10-25-2 At the **commencement date**, an entity shall consider contract-based, asset-based, entity-based, and market-based factors when assessing whether a lessee has a significant economic incentive either to exercise an option to extend a lease or not to exercise an option to terminate a lease, as described in paragraph 842-10-55-4. Those factors shall be considered together, and the existence of any one factor does not necessarily signify that a lessee has a significant economic incentive to exercise, or not to exercise, the option.

842-10-25-3 An entity shall reassess the lease term only if either of the following occurs:

a. There is a change in relevant factors, as described in paragraph 842-10-55-5, that would result in the lessee having or no longer having a significant economic incentive either to exercise an option to extend the lease or not to exercise an option to terminate the lease. A change in market-based factors (such as market rates to lease a comparable asset) shall not, in isolation, trigger reassessment of the lease term.
b. The lessee does either of the following:
    1. Elects to exercise an option even though the entity had previously determined that the lessee did not have a significant economic incentive to do so

2. Does not elect to exercise an option even though the entity had previously determined that the lessee had a significant economic incentive to do so.

842-10-25-4 See paragraphs 842-10-55-1 through 55-5 for implementation guidance on lease term and significant economic incentive.

> Classification of Leases

842-10-25-5 At the commencement date, an entity shall classify a lease as either a Type A lease or a Type B lease. An entity shall not reassess the classification after the commencement date.

842-10-25-6 If the **underlying asset** is not **property**, an entity shall classify a lease as a Type A lease unless one of the following two criteria is met:

a. The lease term is for an insignificant part of the total **economic life** of the underlying asset.
b. The present value of the **lease payments** is insignificant relative to the fair value of the underlying asset at the commencement date.

If either criterion above is met, the lease is classified as a Type B lease.

842-10-25-7 If the underlying asset is property, an entity shall classify a lease as a Type B lease unless one of the following two criteria is met:

a. The lease term is for the major part of the remaining economic life of the underlying asset.
b. The present value of the lease payments accounts for substantially all of the fair value of the underlying asset at the commencement date.

If either criterion above is met, the lease is classified as a Type A lease.

842-10-25-8 Notwithstanding the requirements in paragraphs 842-10-25-6 through 25-7, a lease is classified as a Type A lease if a lessee has a significant economic incentive to exercise an option to purchase the underlying asset.

842-10-25-9 If a lease component contains the right to use more than one asset, an entity shall determine the nature of the underlying asset on the basis of the nature of the primary asset within the lease component. An entity shall regard the economic life of the primary asset to be the economic life of the underlying asset when applying the classification criteria in paragraphs 842-10-25-6 through 25-7.

842-10-25-10 Notwithstanding the requirements in the preceding paragraph, if a lease component contains both land and a building, an entity shall regard the economic life of the building to be the economic life of the underlying asset when applying the classification criteria in paragraph 842-10-25-7.

842-10-25-11 When classifying a **sublease**, an entity shall evaluate the sublease with reference to the underlying asset (for example, the item of property, plant, or equipment that is the subject of the lease), rather than with reference to the **right-of-use asset**.

842-10-25-12 See Examples 11 and 12 (paragraphs 842-10-55-61 through 55-65) for illustrations of the requirements.

> > Contract Modifications

842-10-25-13 If the contractual terms and conditions of a lease are modified, resulting in a substantive change to the existing lease, an entity shall account for the modified **contract** as a new contract at the date that the modifications become effective. An entity shall recognize any difference between the carrying amounts of the assets and liabilities arising from the previous lease and those arising from any new lease in profit or loss. Examples of a substantive change arising from a contract modification include changes to the contractual lease term or to the amount of contractual lease payments that were not part of the original terms and conditions of the lease.

> Short-Term Leases

842-10-25-14 A lessee may elect, as an accounting policy, not to apply the requirements in Subtopic 842-20 to **short-term leases**. Instead, a lessee may recognize the lease payments in profit or loss on a straight-line basis over the lease term. The accounting policy election for short-term leases shall be made by class of underlying asset to which the right of use relates.

842-10-25-15 A **lessor** may elect, as an accounting policy, not to apply the requirements in Subtopic 842-30, except for the requirements in paragraph 842-30-50-5(d), to short-term leases. Instead, a lessor may recognize the lease payments in profit or loss over the lease term on either a straight-line basis or another systematic basis, if that basis is more representative of the pattern in which income is earned from the underlying asset. The accounting policy election for short-term leases shall be made by class of underlying asset to which the right of use relates.

842-10-25-16 See Example 13 (paragraphs 842-10-55-66 through 55-69) for an illustration of the requirements.

Disclosure

General

> Short-Term Leases

842-10-50-1 An entity that accounts for **short-term leases** in accordance with paragraph 842-10-25-14 or 842-10-25-15 shall disclose that fact.

Implementation Guidance and Illustrations

General

> Implementation Guidance

> > Application of Lease Term

842-10-55-1 An entity should determine the noncancellable period of a **lease** when determining the **lease term**. When assessing the length of the noncancellable period of a lease, an entity should apply the definition of a **contract** and determine the period for which the contract is enforceable. A lease is no longer enforceable when both the **lessee** and the **lessor** each have the right to terminate the lease without permission from the other party with no more than an insignificant penalty.

842-10-55-2 If only a lessee has the right to terminate a lease, that right is considered to be an option to terminate the lease available to the lessee that an entity considers when determining the lease term, as described in paragraph 842-10-25-1.

842-10-55-3 The lease term begins at the **commencement date** and includes any rent-free periods provided to the lessee by the lessor.

> > Application of Significant Economic Incentive

842-10-55-4 At the commencement date, an entity assesses whether the lessee has a significant economic incentive to exercise, or not to exercise, an option by considering all factors relevant to that assessment—contract-based, asset-based, market-based, and entity-based factors. An entity's assessment will often require the consideration of a combination of those factors because they are interrelated. Examples of factors to consider include, but are not limited to, any of the following:

a. Contractual terms and conditions for the optional periods compared with current market rates, such as:
    1. The amount of **lease payments** in any optional period
    2. The amount of any **variable lease payments** or other contingent payments, such as payments under termination penalties and **residual value guarantees**
    3. The terms and conditions of any options that are exercisable after initial optional periods (for example, the terms and conditions of a purchase option that is exercisable at the end of an extension period at a rate that is currently below market rates).
b. Significant leasehold improvements that are expected to have significant economic value for the lessee when the option to extend or terminate the lease or to purchase the asset becomes exercisable.

c. Costs relating to the termination of the lease and the signing of a new lease, such as negotiation costs, relocation costs, costs of identifying another **underlying asset** suitable for the lessee's operations, or costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location.
d. The importance of that underlying asset to the lessee's operations, considering, for example, whether the underlying asset is a specialized asset and the location of the underlying asset.

842-10-55-5 An entity should reassess whether the lessee has, or does not have, a significant economic incentive to exercise, or not to exercise, an option if there is a change in relevant factors as described in the preceding paragraph. However, a change in market-based factors (such as market rates to lease a comparable asset) should not, in isolation, trigger reassessment.

> Illustrations

> > Illustrations of Identifying a Lease

842-10-55-6 The following Examples illustrate how an entity determines whether a contract is, or contains, a lease.

> > > Example 1—Contract for Rail Cars

> > > > Example 1A: Contract for Rail Cars—Part A

842-10-55-7 A contract between Customer and a freight carrier (Carrier) provides Customer with the use of 10 rail cars of a particular specification owned by Carrier for 5 years. The contract specifies the type of car. Customer determines when, where, and which goods are to be transported using the cars. When the cars are not in use, they are kept at Customer's premises. Customer can use the cars for another purpose (for example, storage) if it so chooses. If a particular car needs to be serviced or repaired, Carrier is required to substitute an equivalent car of the same type. Otherwise, and other than on default by Customer, Carrier cannot retrieve the cars during the five-year period.

842-10-55-8 The contract also requires Carrier to provide an engine and a driver when requested by Customer and stipulates that, if Carrier is unable to do so, Customer has the right to hire an engine and a driver from other suppliers. Carrier keeps the engines at its premises and provides instructions to the driver detailing Customer's requests to transport goods. Carrier can choose to use any one of a number of engines to fulfill each of Customer's requests, and one engine could be used to transport not only Customer's goods but also the goods of other customers (that is, if other customers require the transportation of goods to destinations close to the destination requested by Customer and within a similar time frame, Carrier can choose to attach up to 100 rail cars to the engine).

842-10-55-9 The contract contains a lease of rail cars. Customer has the right to use 10 rail cars for 5 years.

842-10-55-10 Fulfillment of the contract depends on the use of 10 identified cars. Once delivered to Customer, Carrier can substitute the cars only when they are not operating properly.

842-10-55-11 Customer has the right to control the use of the cars because of both of the following:

a. Customer has the ability to direct the use of the cars. Customer determines how, when, and for what purpose the cars are used, not only when they are being used to transport Customer's goods but throughout the term of the contract.
b. Customer has the ability to derive the benefits from use of the cars. The cars are available for Customer's use throughout the term of the contract, including when they are not being used to transport Customer's goods.

842-10-55-12 The contract also contains a nonlease (service) component that relates to the use of an engine and a driver. The contract does not convey the right to use an identified engine (see analysis in Example 1B).

> > > > Example 1B: Contract for Rail Cars—Part B

842-10-55-13 The contract between Customer and Carrier requires Carrier to transport a specified quantity of goods in accordance with a stated timetable for a period of five years. The timetable and quantity of goods specified is equivalent to Customer having the use of 10 rail cars for 5 years. Carrier provides the rail cars, driver, and engine as part of the contract. The contract states the nature and quantity of the goods to be transported but does not include specific details about the cars or engine to be used to transport Customer's goods. Although transporting the goods identified in the contract requires cars similar to those identified in Example 1A, Carrier has a large pool of similar cars that can be used to transport Customer's goods. Similarly, Carrier can choose to use any one of a number of engines to fulfill each of Customer's requests, and one engine could be used to transport not only Customer's goods, but also the goods of other customers. The cars and engines are stored in Carrier's premises when not being used to transport goods.

842-10-55-14 The contract does not contain a lease.

842-10-55-15 Fulfillment of the contract does not depend on the use of 10 identified rail cars or an identified engine because Carrier has substantive substitution rights. Carrier can choose the cars and engine without Customer's consent. There also are no economic barriers that prevent Carrier from using any car within the pool of cars of a particular specification, and any one of a number of engines, for each delivery of Customer's goods.

> > > > Example 1C: Contract for Rail Cars—Part C

842-10-55-16 Assume the same facts as in Example 1B except that Carrier has only 10 rail cars of the specification required to transport Customer's goods. Carrier also can use those cars to fulfill other contracts if those cars are not being used to transport Customer's goods, and Carrier could decide to expand its fleet of cars during the term of the contract. Cars of the specification required to transport Customer's goods can be purchased from rail car suppliers and are readily available to Carrier.

842-10-55-17 The contract does not contain a lease.

842-10-55-18 Although the 10 rail cars owned by Carrier are identified at the commencement of the contract, Customer does not have the right to control their use throughout the term of the contract. Carrier controls the use of the rail cars. Carrier makes the substantive decisions about how the rail cars are used to deliver goods including, for example, whether to use the rail cars to fulfill other contracts. Carrier could fulfill the contract with Customer using rail cars other than those owned at the commencement of the contract if, for example, Carrier were to decide to expand its fleet of rail cars during the term of the contract.

842-10-55-19 Specifying the quantity of goods to be transported and the timetable for delivery, means, in effect, that Customer specifies the output from the use of rail cars but it does not give Customer the right to use the 10 rail cars for 5 years.

> > > Example 2—Contract for Coffee Services

842-10-55-20 Customer enters into a contract for coffee services for two years. Supplier puts 25 coffee machines in Customer's premises that are tailored for use with coffee consumables provided by Supplier. The coffee machines function only with the consumables provided by Supplier and have no use to Customer other than when they are used in conjunction with those consumables. Supplier is responsible for repairs and maintenance of the coffee machines. Customer's staff operate the machines (that is, they select the coffee they wish to drink, and the machines deliver the coffee).

842-10-55-21 The contract does not contain a lease.

842-10-55-22 Although fulfillment of the contract may depend on the use of the machines, the contract does not give Customer the right to control the use of those machines. That is because Customer does not have the ability to derive the benefits from use of the machines on their own; the machines function only with the consumables that are supplied by Supplier. Accordingly, the machines have no use or value to Customer without the consumables. The machines are incidental to the delivery of the coffee services. The machines and the consumables combine to deliver coffee services to Customer over the two-year term of the contract.

> > > Example 3—Contract for Medical Equipment

842-10-55-23 Customer enters into a contract for medical equipment for three years. Supplier puts 10 items of patient-monitoring equipment in Customer's premises that require the use of disposable consumables that connect the monitoring equipment to the patient. Although the contract requires Customer to purchase the consumables from Supplier, consumables that function with the monitoring equipment are readily available from other suppliers. Supplier carries out repairs and maintenance of the monitoring equipment when needed and can replace the equipment without the consent of Customer (although, because of the costs associated with replacing the equipment, Supplier would replace the equipment only if it is not operating properly). Customer determines how and when the equipment is used and operates the equipment to monitor patients.

842-10-55-24 The contract contains a lease of the patient-monitoring equipment.

842-10-55-25 Although the terms of the contract require Customer to use Supplier's consumables, consumables that function with the patient-monitoring equipment are readily available from other suppliers. Accordingly, Customer would be able to derive the benefits from use of the monitoring equipment on its own without Supplier's consumables. In addition, although the terms of the contract require Customer to use Supplier for repairs and maintenance, this is a nonlease (service) component of the contract that does not change the conclusion that Customer has the right to use the equipment. Consequently, the contract has three separate components: the right to use the equipment, the supply of consumables, and the maintenance of the equipment.

842-10-55-26 The contract conveys the right to use the patient-monitoring equipment to Customer for the following reasons:

a. Fulfillment of the contract depends on the use of the equipment. Supplier's substitution rights are not substantive because the costs of replacing the equipment create an economic barrier that prevents Supplier from replacing the equipment other than when it is not operating properly.
b. Customer has the right to control the use of the equipment because of the following:
    1. Customer has the ability to direct the use of the equipment. Customer determines how and when the equipment is used and it operates the equipment. Accordingly, Customer makes decisions about the use of the equipment that most significantly affect the economic benefits derived from use throughout the term of the contract.
    2. Customer has the ability to derive the benefits from use of the equipment. The equipment is available solely for Customer's use throughout the three-year term of the contract.

> > > Example 4—Contract for Fiber-Optic Cable

> > > > Example 4A: Contract for Fiber-Optic Cable—Part A

842-10-55-27 Customer enters into a 15-year contract for the right to use 3 specified, physically distinct dark fibers within a larger cable connecting Hong Kong to Tokyo. Customer makes all of the decisions about the use of the fibers by connecting each end of the fibers to its electronics equipment (that is, Customer "lights" the fibers). If the fibers are damaged, Supplier is responsible for the repairs and maintenance.

842-10-55-28 The contract contains a lease. Customer has the right to use the 3 dark fibers for 15 years.

842-10-55-29 Fulfillment of the contract depends on the use of the fibers. The fibers are explicitly specified in the contract and are physically distinct from other fibers within the cable.

842-10-55-30 Customer has the right to control the use of the dark fibers because of the following:

a. Customer has the ability to direct the use of the dark fibers. Customer determines how, when, and for what purpose the fibers are used. Accordingly, Customer makes decisions about the use of the fibers that most significantly affect the economic benefits derived from use throughout the term of the contract.
b. Customer has the ability to derive the benefits from use of the dark fibers. The fibers are available for Customer's use throughout the 15-year term of the contract; they cannot be used by any other party unless Customer agrees to such use.

842-10-55-31 The contract also contains a nonlease (service) component for repairs and maintenance of the fibers.

> > > > Example 4B: Contract for Fiber-Optic Cable—Part B

842-10-55-32 Customer enters into a 15-year contract for the right to use a specified amount of capacity within a cable connecting Hong Kong to Tokyo. The specified amount is equivalent to Customer having the use of the full capacity of 3 fiber strands within the cable (the cable contains 15 fibers with similar capacities). Supplier makes decisions about the transmission of data (that is, Supplier lights the fibers and makes decisions about which fibers are used to transmit Customer's traffic).

842-10-55-33 The contract does not contain a lease.

842-10-55-34 Supplier makes all decisions about the transmission of Customer's data, which requires the use of only a portion of the capacity of the cable. That capacity portion is not physically distinct from the remaining capacity of the cable.

Customer has contracted for the right to capacity within a cable. It does not have the right to use an identified asset.

> > > Example 5—Contract for Energy/Power

> > > > Example 5A: Contract for Energy/Power—Part A

842-10-55-35 Customer enters into a contract to purchase substantially all of the energy produced by a new power plant for 20 years. The power plant is owned by Supplier and the energy cannot be provided from another plant. Supplier and Customer were both involved in designing the plant before it was constructed. Customer has the right to either operate and maintain the plant itself or appoint another party to operate and maintain the plant, in accordance with industry-approved operating practices.

842-10-55-36 The contract contains a lease. Customer has the right to use the power plant for 20 years.

842-10-55-37 Fulfillment of the contract depends on the use of the power plant. The energy cannot be supplied from another plant.

842-10-55-38 Customer has the right to control the use of the power plant because of the following:

a. Customer has the ability to direct the use of the power plant. Customer has determined how the plant will be operated by both being involved in designing the plant and appointing the party that operates and maintains the plant. Customer's decision-making rights about the design and maintenance of the plant have given it the ability to make decisions about the use of the plant that most significantly affect the economic benefits derived from use throughout the term of the contract. Although another party might operate the plant on a daily basis, that party would be implementing decisions made by Customer about the use of the plant.
b. Customer has the ability to derive the benefits from use of the plant. Customer has the right to obtain substantially all of the energy produced by the plant throughout the 20-year term of the contract.

> > > > Example 5B: Contract for Energy/Power—Part B

842-10-55-39 An electricity provider (Customer) enters into a contract to purchase substantially all of the power produced by a power plant for three years. The power plant is owned and operated by a utility company (Supplier). Supplier cannot provide power from another plant. Supplier designed the power plant when it was constructed some years before entering into the contract with Customer. Customer had no involvement in that design. Customer issues dispatch instructions to Supplier. Those instructions detail the quantity and timing of delivery of power to Customer. Supplier operates and maintains the plant on a daily basis in accordance with industry-approved operating practices. Customer and Supplier agree to the plant's maintenance plan at the start of the contract. Customer's only decision-making authority relates to the dispatch instructions. Supplier is able to sell the power not taken by Customer to other customers.

842-10-55-40 The contract does not contain a lease.

842-10-55-41 Although fulfillment of the contract depends on the use of the power plant, Customer does not have the right to control its use because it does not have the ability to direct the use of the plant. Supplier has that ability. Supplier has made (and will make) all decisions about how the plant operates. Customer's ability to determine when power is produced, in effect, gives it the ability to specify the output from the plant. However, without any other decision-making authority, Customer has no ability to direct the use of the plant that is used to make the power.

> > Illustration of Allocating Consideration to Components of a Contract

842-10-55-42 The following Example illustrates the allocation of consideration in a contract to lease and nonlease components by a lessee.

> > > Example 6—Lessee Allocation of Consideration to Lease and Nonlease Components of a Contract

842-10-55-43 Customer enters into a 5-year contract with Supplier for a total consideration of CU200,000, payable annually in 5 amounts of CU40,000. The contract has two components:

a. Component 1—lease of equipment for five years
b. Component 2—maintenance of the equipment by Supplier for five years.

842-10-55-44 The contract does not specify prices for the individual components.

842-10-55-45 The manufacturer of the equipment requires that all lessors of the equipment include maintenance services as part of the contract with the lessee. Accordingly, Supplier cannot lease the equipment without also requiring the lessee to purchase maintenance services that relate to the equipment. The contract is priced as a package, and Customer is unable to obtain an observable **standalone price** for the lease component.

842-10-55-46 Customer, however, is able to obtain an observable standalone price for the service component on the basis of information that is available from other suppliers. Several other suppliers provide maintenance services that relate to similar equipment over a 5-year period at a standalone price of CU10,000 per year.

842-10-55-47 Because Customer has an observable standalone price for one component, but not both, it first allocates consideration to the component with an observable price and then allocates the remaining consideration to the component without an observable price. Customer concludes that the consideration for the lease component is CU30,000 per year (CU40,000 per year – CU10,000 per year allocated to the service component of the contract).

> > Illustrations of Lease Components and Identifying the Primary Asset

842-10-55-48 The following Examples illustrate how an entity would identify separate lease components in a contract and the primary asset within one lease component that conveys the right to use more than one asset to the lessee.

> > > Example 7—Lease of Retail Space

842-10-55-49 A lessee enters into a lease of retail space together with the surrounding land that is used for parking and deliveries. Because of the location of the retail space, a retailer would not lease the building without the surrounding land. The lessee is a retailer that intends to use the building for its retail operations.

842-10-55-50 The contract contains one lease component. The retail space is dependent on the land for parking and deliveries. The lessee would be unable to access the benefits from use of the retail space without the surrounding land for parking and deliveries. Accordingly, the lessee cannot benefit from use of the retail space without also using the surrounding land that is part of the contract.

842-10-55-51 The primary asset is the retail building because it is the predominant asset for which the lessee has contracted for the right to use. The main purpose of the surrounding land for parking and deliveries is to facilitate the lessee obtaining benefits from use of the retail space.

> > > Example 8—Lease of Retail Space plus an Additional Plot of Land

842-10-55-52 Assume the same facts as Example 7, except that the contract also conveys the right to use an additional plot of land that is located adjacent to the retail space. The additional plot of land could, for example, be redeveloped independently of the retail space.

842-10-55-53 The contract contains two lease components—a lease of the retail space (together with the surrounding land for parking and deliveries) and a lease of a plot of land.

842-10-55-54 The plot of land is neither dependent on, nor highly interrelated with, the retail space and vice versa. Accordingly, the lessee can benefit from use of the plot of land on its own and, as described in Example 7, the lessee can benefit from use of the retail space (together with the surrounding land for parking and deliveries) on its own.

> > > Example 9—Lease of a Manufacturing Plant

842-10-55-55 A lessee leases a manufacturing plant together with a large item of equipment that is installed within the plant. The lessor does not lease or sell the equipment separately, but other suppliers do. The plant is not tailored for use only with that item of equipment, and the equipment could be used for a different manufacturing process within another plant.

842-10-55-56 The contract contains two lease components—a lease of the manufacturing building (together with the land on which the building is situated) and a lease of an item of manufacturing equipment.

842-10-55-57 The item of equipment is neither dependent on, nor highly interrelated with, the plant and vice versa; that is, both the plant and the equipment could be used for other purposes together with other assets. Accordingly, the lessee can benefit from use of the plant together with other resources that are readily available to it. The lessee also can benefit from use of the equipment together with other resources that are readily available to it.

> > > Example 10—Lease of a Turbine Plant

842-10-55-58 A lessee leases a turbine plant, which consists of a large turbine housed within a building, together with the land on which the turbine is situated. The building was designed specifically to house the turbine, and the life of the building is directly linked to the life of the turbine (that is, when the turbine can no longer be used and is dismantled, the building will be demolished or substantially rebuilt).

842-10-55-59 The contract contains one lease component. The building and the land on which the turbine is situated are highly interrelated with the turbine. Accordingly, the lessee cannot benefit from use of the building or the land without also using the turbine. Similarly, the lessee could not benefit from use of the turbine if it were not housed within the building.

842-10-55-60 The primary asset is the turbine because it is the predominant asset for which the lessee has contracted for the right to use. The main purpose of the building (and the land on which the turbine is situated) is to facilitate the lessee obtaining benefits from use of the turbine. The land and building would have little, if any, use or value to the lessee without the turbine.

> > Illustrations of Lease Classification

842-10-55-61 The following Examples illustrate lease classification.

> > > Example 11—Equipment Lease Classification

842-10-55-62 A lessee enters into a 2-year lease of an item of equipment, which has a total **economic life** of 12 years. The lease payments are CU9,000 per year, the present value of which is CU16,700, calculated using the **rate the lessor charges the lessee**. The fair value of the equipment at the commencement date is CU60,000.

842-10-55-63 The lessee determines that the lease is a Type A lease because of the following:

a. The underlying asset is not **property**.
b. The lease term is for more than an insignificant part of the total economic life of the equipment.
c. The present value of the lease payments is more than insignificant relative to the fair value of the equipment at the commencement date.

> > > Example 12—Commercial Property Lease Classification

842-10-55-64 A lessee enters into a 15-year lease of an office building, which has a remaining economic life of 40 years at the commencement date. The lease payments are CU30,000 per year, the present value of which is CU300,000, calculated using the **lessee's incremental borrowing rate** (that is, the rate the lessor charges the lessee is not readily determinable to the lessee). The fair value of the property at the commencement date is CU400,000.

842-10-55-65 The lessee determines that the lease is a Type B lease because of the following:

a. The underlying asset is property.
b. The lease term is not for a major part of the remaining economic life of the property.
c. The present value of the lease payments does not account for substantially all of the fair value of the property.

> > Illustration of a Short-Term Lease

842-10-55-66 The following Example illustrates the assessment of whether a lease is a **short-term lease**.

> > > Example 13—Short-Term Lease

842-10-55-67 A lessee has made an accounting policy election not to recognize a **right-of-use asset** and a **lease liability** that arise from short-term leases for any class of underlying asset.

842-10-55-68 The lessee enters into a 12-month lease of a vehicle, with an option to extend for another 12 months. The lessee does not have a significant economic incentive to exercise the option to extend.

842-10-55-69 The lease does not meet the definition of a short-term lease because the maximum possible term under the contract is longer than 12 months (that is, the maximum possible term under the contract is 2 years). Consequently, the lessee recognizes a right-of-use asset and a lease liability. Because there is no significant economic incentive to exercise the option to extend, the lessee determines the lease term to be 12 months and measures the right-of-use asset and the lease liability accordingly.

> > Illustrations of Transition

> > > Illustration of Lessee Transition—Operating Lease to Type A Lease

842-10-55-70 The following Example illustrates how a lessee would account for the transition of existing operating leases to Type A leases when applying the permitted alternative to a full retrospective transition approach.

> > > > Example 14—Lessee Transition—Operating Lease to Type A Lease

842-10-55-71 A lessee enters into a five-year lease of a vehicle on January 1, 20X1, with annual lease payments payable at the end of each year. The lessee originally accounts for the lease as an operating lease. On January 1, 20X2 (and before transition adjustments), the lessee has an accrued rent liability of CU1,200 for the lease, reflecting rent that was previously recognized as an expense but was not paid at that date. Four lease payments remain: 1 payment of CU31,000 followed by 3 payments of CU33,000.

842-10-55-72 January 1, 20X2, is the beginning of the earliest comparative period presented in the financial statements in which the lessee first applies the requirements in this Subtopic. At the effective date, the lessee's incremental borrowing rate is 6 percent. The lessee classifies the lease of the vehicle as a Type A lease.

842-10-55-73 On January 1, 20X2, the lessee measures the lease liability at CU112,462, the present value of 1 payment of CU31,000 and 3 payments of CU33,000, discounted at 6 percent.

842-10-55-74 The lessee determines the carrying amount of the right-of-use asset at the date of initial application in two steps: the lessee estimates the commencement-date lease liability and it calculates the right-of-use asset (before adjustment for accrued rent) on the basis of the proportion of the commencement-date lease liability that relates to the remaining lease term. The lessee elects not to include **initial direct costs** in determining the right-of-use asset as permitted by paragraph 842-10-65-1(g)(1).

842-10-55-75 The lessee estimates the commencement-date lease liability on the basis of the average remaining lease payments. The average lease payment for the remaining 4 years of the lease is CU32,500. The lessee estimates the commencement-date lease liability at CU136,902 (the present value of a CU32,500 annuity for the 5-year total term of the lease). Thus, the lessee measures the right-of-use asset before adjustment for accrued rent at CU109,522 (CU136,902 × 4 remaining years ÷ 5-year lease term).

842-10-55-76 The difference between the right-of-use asset and the lease liability on January 1, 20X2, is an adjustment to opening retained earnings at that date.

842-10-55-77 In summary, on January 1, 20X2, the lessee recognizes the following to reflect the transition of the operating lease to a Type A lease.

Right-of-use asset	CU109,522	
Retained earnings	CU2,940	
Lease liability		CU112,462

842-10-55-78 The lessee also makes an adjustment to the right-of-use asset for the amount of the previously recognized accrued rent.

Accrued rent	CU1,200	
Right-of-use asset		CU1,200

> > > Illustration of Lessee Transition—Operating Lease to Type B Lease

842-10-55-79 The following Example illustrates lessee accounting for the transition of existing operating leases to Type B leases when applying the permitted alternative to a full retrospective transition approach.

> > > > Example 15—Lessee Transition—Operating Lease to Type B Lease

842-10-55-80 A lessee enters into a five-year lease of land on January 1, 20X1, with annual lease payments payable at the end of each year. The lessee originally accounts for the lease as an operating lease. On January 1, 20X2 (and before transition adjustments), the lessee has an accrued rent liability of CU1,200 for the lease, reflecting rent that was previously recognized as an expense but was not paid at that date. Four lease payments remain: 1 payment of CU31,000 followed by 3 payments of CU33,000.

842-10-55-81 January 1, 20X2, is the beginning of the earliest comparative period presented in the financial statements in which the lessee first applies the requirements in this Subtopic. At the effective date, the lessee's incremental borrowing rate is 6 percent. The lessee classifies the lease of land as a Type B lease.

842-10-55-82 On January 1, 20X2, the lessee measures the lease liability at CU112,462, the present value of 1 payment of CU31,000 and 3 payments of CU33,000, discounted using the rate of 6 percent.

842-10-55-83 The right-of-use asset is equal to the lease liability before adjustment for accrued rent. The lessee does not include initial direct costs in determining the right-of-use asset as permitted by paragraph 842-10-65-1(g)(1).

842-10-55-84 In summary, on January 1, 20X2, the lessee recognizes the following to reflect the transition of the operating lease to a Type B lease.

Right-of-use asset	CU112,462	
Lease liability		CU112,462

842-10-55-85 The lessee also makes an adjustment to the right-of-use asset for the amount of the previously recognized accrued rent.

Accrued rent	CU1,200	
Right-of-use asset		CU1,200

> > > Illustration of Lessor Transition—Operating Lease to Type A Lease

842-10-55-86 The following Example illustrates lessor accounting for the transition of existing operating leases to Type A leases when applying the permitted alternative to a full retrospective transition approach.

> > > > Example 16—Lessor Transition—Operating Lease to Type A Lease

842-10-55-87 A lessor leases a vehicle for five years on January 1, 20X1, with annual lease payments receivable at the end of each year. The lessor originally accounts for the lease as an operating lease. On January 1, 20X2 (and before transition adjustments), the lessor has a rent accrual of CU1,200 for the lease, reflecting rent that was previously recognized as income but was not received at that date. Four lease payments remain: 1 payment of CU31,000 followed by 3 payments of CU33,000.

842-10-55-88 January 1, 20X2, is the beginning of the earliest comparative period presented in the financial statements in which the lessor first applies the requirements in this Subtopic. On January 1, 20X2, the lessor classifies the lease of the vehicle as a Type A lease. Immediately before January 1, 20X2, the vehicle was recognized in the lessor's financial statements at CU176,000 (historical cost of CU200,000 – depreciation of CU24,000). The lessor also has an asset for accrued rent of CU1,200.

842-10-55-89 The **rate implicit in the lease** at the commencement date is 5.27 percent. The fair value of the vehicle on January 1, 20X2, is CU180,000, and the expected value of the vehicle at the end of the lease term is CU80,000. The present value of 1 payment of CU31,000 plus 3 payments of CU33,000, discounted using the rate of 5.27 percent, is CU114,390. The present value of the expected value of the vehicle at the end of the lease term, discounted using the rate of 5.27 percent, is CU65,147.

842-10-55-90 The lessor determines the **residual asset** on the basis of information available on January 1, 20X2. The lessor determines that profit of CU1,779 relates to the lease (CU180,000 fair value of the vehicle – CU177,200 carrying amount of the vehicle immediately before January 1, 20X2, after adjustment for accrued rent) × (CU114,390 [the **lease receivable**] ÷ CU180,000 [the fair value of the vehicle]). The lessor determines the unearned profit relating to the residual asset as CU1,021 at January 1, 20X2 (CU180,000 fair value of the vehicle – CU177,200 carrying value of the vehicle after adjustment for accrued rent − CU1,779 profit relating to the lease). The net residual asset of CU64,126 comprises the **gross residual asset** of CU65,147 and the unearned profit on the residual asset of CU1,021.

842-10-55-91 The difference between the assets previously recognized (vehicle of CU176,000 and accrued rent of CU1,200) and the assets recognized at January 1, 20X2 (lease receivable of CU114,390 and net residual asset of CU64,126), is a transition adjustment to opening retained earnings at January 1, 20X2, of CU1,316.

842-10-55-92 In summary, at January 1, 20X2, the lessor recognizes the following to reflect the transition of the operating lease to a Type A lease.

Lease receivable	CU114,390	
Gross residual asset [(a)]	CU65,147	
Accumulated depreciation	CU24,000	
Vehicle		CU200,000
Unearned profit on the residual asset [(a)]		CU1,021
Accrued rent		CU1,200
Retained earnings		CU1,316

(a) Not required to be presented or disclosed as two amounts but only required to be presented on a net basis.

Transition and Open Effective Date Information

General

> Transition Related to Accounting Standards Update No. 201X-XX, *Leases (Topic 842)*

842-10-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 201X-XX, *Leases (Topic 842):*

a. The pending content that links to this paragraph shall be applied for annual reporting periods beginning on or after [date to be inserted after exposure].
b. In the financial statements in which an entity first applies the pending content that links to this paragraph, the entity shall recognize and measure **leases** within the scope of the pending content that links to this paragraph that exist at the beginning of the earliest comparative period presented, using the approach described in (g) through (h) and (k) through (y).
c. An entity shall adjust equity at the beginning of the earliest comparative period presented, and the other comparative amounts disclosed for each prior period presented, as if the pending content that links to this paragraph had always been applied, subject to the requirements in (g) through (h) and (k) through (y).

d. If a **lessee** elects not to apply the recognition and measurement requirements in the pending content that links to this paragraph to **short-term leases**, the lessee need not apply the approach described in (k) through (o) to short-term leases. If a **lessor** elects not to apply the recognition and measurement requirements in the pending content that links to this paragraph to short-term leases, the lessor shall apply the requirements in (q).
e. Notwithstanding the requirements in (b), an entity may apply all of the requirements in the pending content that links to this paragraph retrospectively in accordance with Topic 250 on accounting changes, taking into consideration the requirements in (r).
f. See Examples 14 through 16 (paragraphs 842-10-55-70 through 55-92) for illustrations of the transition requirements.

Specified reliefs

g. An entity may use one or both of the following specified reliefs when applying the pending content that links to this paragraph to leases that commenced before the effective date:
    1. An entity need not include **initial direct costs** in the measurement of the **right-of-use asset** (if the entity is a lessee) or the **lease receivable** (if the entity is a lessor).
    2. An entity may use hindsight, such as in determining whether a **contract** contains a lease, in classifying a lease or in determining the **lease term** if the contract contains options to extend or terminate the lease.

Amounts previously recognized in respect of business combinations

h. If an entity has previously recognized an asset or a liability in accordance with Topic 805 on business combinations relating to favorable or unfavorable terms of an operating lease acquired as part of a business combination, the entity shall do all of the following:
    1. Derecognize that asset and liability (except for those arising from Type B leases for which the entity is a lessor)
    2. Adjust the carrying amount of the right-of-use asset by a corresponding amount if the entity is a lessee
    3. Make a corresponding adjustment to equity at the beginning of the earliest comparative period presented if assets or liabilities arise from Type A leases for which the entity is a lessor.

Disclosure

i. An entity shall provide the transition disclosures required by Topic 250, except for the requirements in paragraph 250-10-50-1(b)(2).
j. If an entity uses one or both of the specified reliefs in (g), it shall disclose that fact.

Lessees

Leases previously classified as operating leases

k. Unless the requirements in (m) apply, at the beginning of the earliest comparative period presented, a lessee shall recognize all of the following:
   1. A **lease liability**, measured at the present value of the remaining **lease payments**, discounted using the **lessee's incremental borrowing rate** at the effective date (see (l)).
      i. Nonpublic entities are permitted to use a risk-free discount rate determined using a period comparable to that of the remaining lease term as an accounting policy election for all leases.
   2. For each Type A lease, a right-of-use asset measured as the applicable proportion of the lease liability at the **commencement date**, which can be imputed from the lease liability determined in accordance with (k)(1). The applicable proportion is the remaining lease term at the beginning of the earliest comparative period presented relative to the total lease term. A lessee shall adjust the right-of-use asset recognized by the amount of any previously recognized prepaid or accrued lease payments.
   3. For each Type B lease, a right-of-use asset measured at an amount that equals the lease liability. A lessee shall adjust the right-of-use asset recognized by the amount of any previously recognized prepaid or accrued lease payments.

l. A lessee can apply a single discount rate to a portfolio of leases with reasonably similar characteristics (for example, a similar remaining lease term for a similar class of **underlying asset** in a similar economic environment). The lessee shall consider its total financial liabilities when calculating the discount rate for each portfolio of leases.

Leases previously classified as capital leases

m. For leases that were classified as capital leases in accordance with Topic 840, the carrying amount of the right-of-use asset and the lease liability at the beginning of the earliest comparative period presented shall be the carrying amount of the lease asset and lease liability immediately before that date in accordance with Topic 840.

n. For those leases, a lessee shall do all of the following:
   1. Subsequently measure the right-of-use asset and the lease liability in accordance with paragraphs 842-20-35-1 through 35-2, 842-20-35-8 through 35-9, and 842-20-35-11.
   2. Not apply the reassessment requirements in paragraphs 842-20-35-4 through 35-7.

3. Classify the assets and liabilities held under capital leases as right-of-use assets and lease liabilities arising from Type A leases for the purposes of presentation and disclosure.

o. If a modification to the contractual terms and conditions of any of those leases results in a substantive change to the lease as described in paragraph 842-10-25-13, a lessee shall account for the lease as a new lease in accordance with the requirements of the pending content that links to this paragraph.

Lessors

Leases previously classified as operating leases

p. Unless the requirements in (s) apply, at the beginning of the earliest comparative period presented for each Type A lease, a lessor shall do all of the following:
   1. Derecognize the underlying asset. A lessor shall adjust the carrying amount of the underlying asset derecognized by the amount of any previously recognized prepaid or accrued lease payments.
   2. Recognize a lease receivable measured at the present value of the remaining lease payments, discounted using the **rate the lessor charges the lessee** determined at the commencement date, subject to any adjustments required to reflect impairment.
   3. Recognize a **residual asset** according to the initial measurement requirements in paragraph 842-30-30-4, using information available at the beginning of the earliest comparative period presented.

q. For Type B leases, the carrying amount of the underlying asset and any lease assets or liabilities at the beginning of the earliest comparative period presented shall be the same as the amounts recognized by the lessor immediately before that date in accordance with Topic 840.

r. If a lessor had previously securitized receivables arising from leases that were classified as operating leases in accordance with Topic 840, the lessor shall account for those transactions as secured borrowings in accordance with other Topics, regardless of whether the lessor chooses to apply the pending content that links to this paragraph retrospectively.

Leases previously classified as direct finance or sale-type leases

s. For leases that were classified as direct finance or sales-type leases in accordance with Topic 840, the carrying amount of the lease receivable at the beginning of the earliest comparative period presented shall be the carrying amount of the net investment in the lease immediately before that date in accordance with Topic 840.

t. For those leases, a lessor shall do all of the following:

1. Subsequently measure the lease receivable in accordance with paragraphs 842-30-35-1(a), 2(a), and 2(c), 842-30-35-10, and 842-30-35-13.
2. Not apply the requirements in paragraphs 842-30-35-1(b) and 2(b), 842-30-35-3 through 35-8, and 842-30-35-11 through 35-12.
3. Classify the net investment arising from direct finance or sales-type leases as lease receivables arising from Type A leases for the purposes of presentation and disclosure.

u. If a modification to the contractual terms and conditions of any of those leases results in a substantive change to the lease as described in paragraph 842-10-25-13, a lessor shall account for the lease as a new lease in accordance with the requirements of the pending content that links to this paragraph.

Leveraged leases

v. For leases that were classified as leveraged leases in accordance with Topic 840, a lessor shall apply the requirements in the pending content that links to this paragraph as of the commencement date (that is, a retrospective application).

Sale and leaseback transactions before the beginning of the earliest comparative period presented

w. If a previous sale and leaseback transaction was accounted for as a sale and a direct finance or sales-type lease in accordance with Topic 840, an entity shall do all of the following:
   1. Not reassess the transaction to determine whether it is a sale and leaseback transaction
   2. Not remeasure lease assets and lease liabilities at the beginning of the earliest comparative period presented
   3. Continue to amortize any deferred gain or loss in respect of the transaction.

x. An entity shall reassess the transaction to determine whether the transferee obtains control of the underlying asset in accordance with the requirements for determining when a performance obligation is satisfied in the proposed Accounting Standards Update on revenue recognition if either of the following applies:
   1. A previous sale and leaseback transaction was accounted for as a sale and an operating lease in accordance with Topic 840
   2. A previous transaction was assessed to determine whether it was a sale and leaseback transaction in accordance with Topic 840, but it did not qualify for sale and leaseback accounting.

y. If a transferee obtains control of the underlying asset in accordance with the requirements for determining when a performance obligation is satisfied in the proposed Accounting Standards Update on revenue recognition, a lessee shall use the requirements in (k) through (l) to measure lease assets and lease liabilities and shall derecognize any deferred gain or loss at the beginning of the earliest comparative period presented.

13. Add Subtopic 842-20, with a link to transition paragraph 842-10-65-1, as follows:

Leases—Lessee

Overview and Background

General

842-20-05-1 This Subtopic addresses accounting by **lessees** for **leases** that have been classified as Type A or Type B leases in accordance with the requirements in Subtopic 842-10. Lessees should follow the requirements in this Subtopic as well as in Subtopic 842-10.

842-20-05-2 See Examples 1 through 5 (paragraphs 842-20-55-9 through 55-66) for illustrations of the requirements in this Subtopic.

842-20-05-3 Paragraphs presented in **bold** type in this Topic state the main principles. All paragraphs have equal authority.

Scope and Scope Exceptions

General

842-20-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic.

Recognition

General

842-20-25-1 At the {add glossary link}commencement date{add glossary link}, a {add glossary link}lessee{add glossary link} shall recognize a {add glossary link}right-of-use asset{add glossary link} and a {add glossary link}lease liability{add glossary link}.

Initial Measurement

General

842-20-30-1 At the {add glossary link}commencement date{add glossary link}, a {add glossary link}lessee{add glossary link} shall measure both of the following:

- **a. The {add glossary link}lease liability{add glossary link} at the present value of the {add glossary link}lease payments{add glossary link} discounted using the {add glossary link}rate the lessor charges the lessee{add glossary link}. If that rate cannot be readily determined, the lessee shall use its {add glossary link}incremental borrowing rate{add glossary link} (as described in paragraphs 842-20-55-1 through 55-4).**
  - **1. Nonpublic entities are permitted to use a risk-free discount rate, determined using a period comparable to that of the {add glossary link}lease term{add glossary link}, as an accounting policy election for all {add glossary link}leases{add glossary link}.**
- **b. The {add glossary link}right-of-use asset{add glossary link} as described in paragraph 842-20-30-4.**

842-20-30-2 See paragraphs 842-20-55-1 through 55-4 for implementation guidance on the discount rate.

> Initial Measurement of the Lease Payments Included in the Lease Liability

842-20-30-3 At the commencement date, the lease payments included in the lease liability shall consist of the following payments relating to the use of the **underlying asset** during the lease term (as described in paragraph 842-10-25-1) that are not yet paid:

- a. Fixed payments, less any lease incentives receivable from the **lessor**
- b. **Variable lease payments** that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate at the commencement date
- c. Variable lease payments that are in-substance fixed payments (see paragraphs 842-20-55-45 through 55-52)
- d. Amounts expected to be payable by the lessee under **residual value guarantees**
- e. The exercise price of a purchase option if the lessee has a significant economic incentive to exercise that option (assessed considering the factors described in paragraph 842-10-55-4)

f. Payments for penalties for terminating the lease, if the lease term (as determined in accordance with paragraph 842-10-25-1) reflects the lessee exercising an option to terminate the lease.

> Initial Measurement of the Right-of-Use Asset

842-20-30-4 At the commencement date, the cost of the right-of-use asset shall consist of all of the following:

a. The amount of the initial measurement of the lease liability
b. Any lease payments made to the lessor at or before the commencement date, less any lease incentives received from the lessor
c. Any **initial direct costs** incurred by the lessee (as described in paragraphs 842-20-55-5 through 55-6).

842-20-30-5 See paragraphs 842-20-55-5 through 55-6 for implementation guidance on initial direct costs.

Subsequent Measurement

General

842-20-35-1 After the {add glossary link}commencement date{add glossary link}, a {add glossary link}lessee{add glossary link} shall measure both of the following:

a. The {add glossary link}lease liability{add glossary link} by increasing the carrying amount to reflect the unwinding of the discount on the lease liability and reducing the carrying amount to reflect the {add glossary link}lease payments{add glossary link} made during the period. The lessee shall determine the unwinding of the discount on the lease liability in each period during the {add glossary link}lease term{add glossary link} as the amount that produces a constant periodic discount rate on the remaining balance of the liability, taking into consideration the reassessment requirements in paragraph 842-20-35-4.
b. The {add glossary link}right-of-use asset{add glossary link} at cost less any accumulated amortization and any accumulated impairment losses, taking into consideration the reassessment requirements in paragraph 842-20-35-4.

842-20-35-2 After the commencement date, a lessee shall recognize in profit or loss, unless the costs are included in the carrying amount of another asset in accordance with other Topics, all of the following:

a. For Type A **leases**, the unwinding of the discount on the lease liability as interest and the amortization of the right-of-use asset.
b. For Type B leases, a single lease cost, combining the unwinding of the discount on the lease liability with the amortization of the right-of-use asset, calculated so that the remaining cost of the lease (as described in paragraphs 842-20-55-7 through 55-8) is allocated over the remaining lease term on a straight-line basis. However, the periodic lease cost shall not be less than the periodic unwinding of the discount on the lease liability.
c. **Variable lease payments** not included in the lease liability in the period in which the obligation for those payments is incurred.

842-20-35-3 See paragraphs 842-20-55-7 through 55-8 for implementation guidance on the total cost of a Type B lease for a lessee.

> Reassessment of the Lease Liability

842-20-35-4 After the commencement date, a lessee shall remeasure the lease liability to reflect changes to the lease payments as described in paragraph 842-20-35-5 and changes to the discount rate as described in paragraphs 842-20-35-6 through 35-7. A lessee shall recognize the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset, except as follows:

a. A lessee shall identify the amount of the remeasurement arising from a change in an index or a rate (as described in paragraph 842-20-35-5(d)) that is attributable to the current period and shall recognize that amount in profit or loss.
b. If the carrying amount of the right-of-use asset is reduced to zero, a lessee shall recognize any remaining amount of the remeasurement in profit or loss.

842-20-35-5 A lessee shall reassess the lease payments if there is a change in any of the following:

a. The lease term, as described in paragraph 842-10-25-3. A lessee shall determine the revised lease payments on the basis of the revised lease term.
b. Relevant factors that result in the lessee having or no longer having a significant economic incentive to exercise an option to purchase the **underlying asset**, assessed in accordance with paragraph 842-10-55-5. A lessee shall determine the revised lease payments to reflect the change in amounts payable under the purchase option.
c. The amounts expected to be payable under **residual value guarantees**. A lessee shall determine the revised lease payments to reflect the change in amounts expected to be payable under residual value guarantees.

d. An index or a rate used to determine lease payments during the reporting period. A lessee shall determine the revised lease payments using the index or rate at the end of the reporting period.

842-20-35-6 A lessee shall reassess the discount rate if there is a change in any of the following, unless the possibility of change was reflected in determining the discount rate at the commencement date:

a. The lease term
b. Relevant factors that result in the lessee having or no longer having a significant economic incentive to exercise an option to purchase the underlying asset
c. A reference interest rate, if variable lease payments are determined using that rate.

842-20-35-7 A lessee shall determine the revised discount rate at the date of reassessment as the rate the **lessor** would charge the lessee at that date (or, if that rate is not readily determinable, the **lessee's incremental borrowing rate** at that date, or the risk-free rate at that date for a nonpublic entity that elected to use the risk-free rate) on the basis of the remaining lease term.

> Amortization of the Right-of-Use Asset

> > Type A Leases

842-20-35-8 For Type A leases, a lessee shall amortize the right-of-use asset on a straight-line basis, unless another systematic basis is more representative of the pattern in which the lessee expects to consume the right-of-use asset's future economic benefits.

842-20-35-9 A lessee shall amortize the right-of-use asset from the commencement date to the earlier of the end of the **useful life** of the right-of-use asset or the end of the lease term. However, if the lessee has a significant economic incentive to exercise a purchase option, the lessee shall amortize the right-of-use asset to the end of the useful life of the underlying asset.

> > Type B Leases

842-20-35-10 For Type B leases, a lessee shall determine the amortization of the right-of-use asset for the period as the difference between the following:

a. The periodic lease cost, determined in accordance with paragraph 842-20-35-2(b)
b. The periodic unwinding of the discount on the lease liability, determined in accordance with paragraph 842-20-35-1(a).

> Impairment of the Right-of-Use Asset

842-20-35-11 A lessee shall determine whether the right-of-use asset is impaired and shall recognize any impairment loss in accordance with Topic 360 on property, plant, and equipment.

Other Presentation Matters

General

> Statement of Financial Position

842-20-45-1 A **lessee** shall either present in the statement of financial position or disclose in the notes all of the following:

a. **Right-of-use assets** separately from other assets
b. **Lease liabilities** separately from other liabilities
c. Right-of-use assets arising from Type A **leases** separately from right-of-use assets arising from Type B leases
d. Lease liabilities arising from Type A leases separately from lease liabilities arising from Type B leases.

842-20-45-2 If a lessee does not present right-of-use assets and lease liabilities separately in the statement of financial position, the lessee shall do both of the following:

a. Present right-of-use assets within the same line item as the corresponding **underlying assets** would be presented if they were owned
b. Disclose which line items in the statement of financial position include right-of-use assets and lease liabilities.

> Statement of Comprehensive Income

842-20-45-3 In the statement of comprehensive income, a lessee shall present both of the following:

a. For Type A leases, the unwinding of the discount on the lease liability separately from the amortization of the right-of-use asset
b. For Type B leases, the unwinding of the discount on the lease liability together with the amortization of the right-of-use asset.

> Statement of Cash Flows

842-20-45-4 In the statement of cash flows, a lessee shall classify the following:

a. Repayments of the principal portion of the lease liability arising from Type A leases within financing activities

b. The unwinding of the discount on the lease liability arising from Type A leases in accordance with the requirements relating to interest paid in Topic 230 on cash flows
c. Payments arising from Type B leases within operating activities
d. **Variable lease payments** and **short-term lease** payments not included in the lease liability within operating activities.

Disclosure

General

842-20-50-1 The objective of the disclosure requirements is to enable users of financial statements to understand the amount, timing, and uncertainty of cash flows arising from {add glossary link}leases{add glossary link}. To achieve that objective, a {add glossary link}lessee{add glossary link} shall disclose qualitative and quantitative information about all of the following:

a. Its leases (as described in paragraphs 842-20-50-3(a) through (b) and 842-20-50-10)
b. The significant judgments made in applying the requirements in this Topic to those leases (as described in paragraph 842-20-50-3(c))
c. The amounts recognized in the financial statements relating to those leases (as described in paragraphs 842-20-50-4 through 50-9).

842-20-50-2 A lessee shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. A lessee shall aggregate or disaggregate disclosures so that useful information is not obscured by including a large amount of insignificant detail or by aggregating items that have different characteristics.

842-20-50-3 A lessee shall disclose the following:

a. Information about the nature of its leases, including:
    1. A general description of those leases.
    2. The basis, and terms and conditions, on which **variable lease payments** are determined.
    3. The existence, and terms and conditions, of options to extend or terminate the lease. A lessee should provide narrative disclosure about the options that are recognized as part of the **right-of-use asset** and **lease liability** and those that are not.
    4. The existence, and terms and conditions, of **residual value guarantees** provided by the lessee.
    5. The restrictions or covenants imposed by leases, for example, those relating to dividends or incurring additional financial obligations.

A lessee should identify the information relating to **subleases** included in the disclosures provided in (1) through (5).

b. Information about leases that have not yet commenced but that create significant rights and obligations for the lessee.
c. Information about significant assumptions and judgments made in applying the requirements of this Topic, which may include the following:
    1. The determination of whether a **contract** contains a lease (as described in paragraphs 842-10-15-2 through 15-16)
    2. The allocation of the consideration in a contract between lease and nonlease components (as described in paragraphs 842-10-15-20 through 15-21)
    3. The determination of the discount rate (as described in paragraphs 842-20-55-1 through 55-4).

842-20-50-4 A lessee shall disclose a reconciliation of opening and closing balances of the lease liability separately for Type A leases and Type B leases. Those reconciliations should include the periodic unwinding of the discount on the lease liability and other items that are useful in understanding the change in the carrying amount of the lease liability, for example, the following:

a. Liabilities created due to leases commencing or being extended
b. Liabilities extinguished due to leases being terminated
c. Remeasurements relating to a change in an index or a rate used to determine **lease payments**
d. Cash paid
e. Foreign currency transaction gains and losses
f. Effects of business combinations.

842-20-50-5 A nonpublic entity may elect not to provide the disclosure required by the preceding paragraph.

842-20-50-6 A lessee shall disclose costs that are recognized in the period relating to variable lease payments not included in the lease liability**.**

842-20-50-7 A lessee shall disclose information about the acquisition of right-of-use assets in exchange for lease liabilities, arising from both Type A leases and Type B leases, as a supplemental noncash transaction disclosure (see Topic 230 on cash flows).

842-20-50-8 A lessee shall disclose a maturity analysis of the lease liability, showing the undiscounted cash flows on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessee shall reconcile the undiscounted cash flows to the lease liability recognized in the statement of financial position.

842-20-50-9 A lessee shall disclose a maturity analysis of commitments for nonlease components related to a lease, showing the undiscounted cash flows on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years.

842-20-50-10 A lessee shall disclose lease transactions between related parties (see Topic 850 on related party disclosures).

Implementation Guidance and Illustrations

General

> Implementation Guidance

> > Application of Discount Rate

842-20-55-1 The discount rate initially used to determine the present value of the **lease payments** for a **lessee** is calculated on the basis of information available at the **commencement date**.

842-20-55-2 The discount rate used to determine the present value of the lease payments for a **lessor** is the **rate the lessor charges the lessee**. The rate the lessor charges the lessee could be, for example, the **rate implicit in the lease** or the property yield. An entity should use the rate implicit in the lease as the rate the lessor charges the lessee whenever that rate is available.

842-20-55-3 Both the **lessee's incremental borrowing rate** and the rate the lessor charges the lessee reflect the nature of the transaction and the terms and conditions of the lease; for example, the lease payments, the **lease term**, the security attached to the lease, the nature of the **underlying asset**, and the economic environment.

842-20-55-4 Nonpublic entities are permitted to use a risk-free discount rate determined using a period comparable to that of the lease term, as an accounting policy election for all **leases**.

> > Application of Initial Direct Costs

842-20-55-5 Initial direct costs for a lessee or a lessor may include, for example, any of the following:

a. Commissions
b. Legal fees
c. Evaluating the prospective lessee's financial condition
d. Evaluating and recording guarantees, collateral, and other security **contracts**
e. Negotiating lease terms and conditions
f. Preparing and processing lease documents
g. Payments made to existing tenants to obtain the lease.

842-20-55-6 Both of the following items are examples of costs that are not initial direct costs:

a. General overheads, including for example, depreciation, occupancy and equipment costs, unsuccessful origination efforts, and idle time
b. Costs related to activities performed by the lessor for advertising, soliciting potential lessees, servicing existing leases, or other ancillary activities.

> > Application of Cost of a Type B Lease for the Lessee

842-20-55-7 For Type B leases, paragraph 842-20-35-2(b) requires a lessee to recognize a lease cost in each period calculated as the greater of the remaining cost of the lease (calculated at the beginning of each period) allocated over the remaining lease term on a straight-line basis or the periodic unwinding of the discount on the **lease liability**.

842-20-55-8 Throughout the lease term, the remaining cost of a lease consists of the following:

a. Lease payments (determined at the commencement date); plus
b. Initial direct costs (determined at the commencement date); minus
c. The periodic lease cost recognized in prior periods; minus
d. Any impairment of the **right-of-use asset** recognized in prior periods; plus or minus
e. Any adjustments to reflect changes made to the lease liability that arise from remeasuring the liability in accordance with paragraphs 842-20-35-4 through 35-7. The adjustment to the remaining cost of a lease would equal the total change in future lease payments less any amounts recognized in profit or loss at the date of remeasurement of the lease liability.

> Illustrations

> > Illustrations of Lessee Measurement and Reassessment of the Lease Term

842-20-55-9 The following Examples illustrate how a lessee would initially and subsequently measure lease assets and lease liabilities. They also illustrate how a lessee would account for a change in the assessment of the lease term.

> > > Example 1—Initial and Subsequent Measurement by a Lessee and Accounting for a Change in the Lease Term

> > > > Part 1—Initial and Subsequent Measurement of the Right-of-Use Asset and the Lease Liability

842-20-55-10 A lessee enters into a 10-year lease of an asset, with an option to extend for 5 years. Lease payments are CU50,000 per year during the initial term and CU55,000 per year during the optional period, all payable at the beginning of each year. The lessee incurs initial direct costs of CU15,000.

842-20-55-11 At the commencement date, the lessee concludes that it does not have a significant economic incentive to exercise the option to extend and therefore determines the lease term to be 10 years.

842-20-55-12 The rate that the lessor charges the lessee is not readily determinable. The lessee's incremental borrowing rate is 5.87 percent, which reflects the fixed rate at which the lessee could borrow a similar amount in the same currency, for the same term, and with similar collateral as in the lease.

842-20-55-13 At the commencement date, the lessee makes the lease payment for the first year, incurs initial direct costs, and measures the lease liability at the present value of the remaining 9 payments of CU50,000, discounted at the rate of 5.87 percent, which is CU342,017.

842-20-55-14 The lessee recognizes lease assets and liabilities as follows.

Right-of-use asset	CU407,017 (CU342,017 + CU50,000 + CU15,000)	
Lease liability		CU342,017
Cash (lease payment for first year)		CU50,000
Cash (initial direct costs)		CU15,000

842-20-55-15 During the first year of the lease, the lessee recognizes lease expenses as follows, depending on how the lease is classified.

> > > > > If the Lease Is Classified as a Type A Lease

842-20-55-16 The lessee expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, amortizes the right-of-use asset on a straight-line basis.

Interest expense	CU20,076 (5.87% × CU342,017)	
Lease liability		CU20,076
Amortization expense	CU40,702 (CU407,017 ÷ 10)	
Right-of-use asset		CU40,702

842-20-55-17 At the end of the first year of the lease, the carrying amount of the lessee's right-of-use asset is CU366,315 (CU407,017 – CU40,702).

> > > > > If the Lease Is Classified as a Type B Lease

842-20-55-18 The lessee determines the cost of the lease to be the sum of CU500,000 (sum of the lease payments for the lease term) and CU15,000 (initial direct costs incurred by the lessee). The annual lease expense to be recognized is therefore CU51,500 (CU515,000 ÷ 10 years).

Lease expense	CU51,500	
Lease liability		CU20,076 (5.87% × CU342,017)
Right-of-use asset		CU31,424 (CU51,500 – CU20,076)

842-20-55-19 At the end of the first year of the lease, the carrying amount of the lessee's right-of-use asset is CU375,593 (CU407,017 – CU31,424).

842-20-55-20 At the end of the first year of the lease, the lessee's lease liability is CU362,093 (CU342,017 + CU20,076), regardless of how the lease is classified.

842-20-55-21 At the beginning of the second year of the lease, the lessee makes the payment for that year, recognized as follows.

Lease liability	CU50,000	
Cash		CU50,000

> > > > Part 2—Accounting for a Change in the Lease Term

842-20-55-22 In the sixth year of the lease, the lessee makes significant leasehold improvements. Those improvements are expected to have significant economic value for the lessee at the end of the original noncancellable period of 10 years. That is because the improvements result in the underlying asset having greater utility to the lessee than alternative assets that could be leased for a similar amount. Consequently, at the end of Year 6, the lessee concludes that it has a significant economic incentive to exercise the option to extend the lease. The lessee's incremental borrowing rate at the end of Year 6, taking into consideration the extended remaining lease term, is 7.83 percent. Although the lease term changes, the lessee does not reassess the lease classification.

842-20-55-23 At the end of the sixth year, before accounting for the change in the lease term, the lease liability is CU183,972 (present value of 4 remaining payments of CU50,000, discounted at the rate of 5.87 percent). The lessee's right-of-use asset is CU162,806 if the lease is classified as a Type A lease or CU189,971 if the lease is classified as a Type B lease.

842-20-55-24 The lessee remeasures the lease liability, which is now equal to the present value of 4 payments of CU50,000 followed by 5 payments of CU55,000, all discounted at the rate of 7.83 percent, which is CU355,189. The lessee increases the lease liability by CU171,217 representing the difference between the remeasured liability of CU355,189 and its current carrying amount of CU183,972. The corresponding adjustment is made to the right-of-use asset to reflect the cost of the additional rights, recognized as follows.

Right-of-use asset	CU171,217	
Lease liability		CU171,217

842-20-55-25 Following the adjustment, the carrying amount of the lessee's right-of-use asset is CU334,023 if the lease is a Type A lease (that is, CU162,806 + CU171,217) or CU361,188 if the lease is a Type B lease (that is, CU189,971 + CU171,217).

842-20-55-26 The lessee then makes the lease payment for Year 7, recognized as follows.

Lease liability	CU50,000	
Cash		CU50,000

842-20-55-27 Following this payment, the lessee's lease liability is CU305,189 (CU355,189 – CU50,000), regardless of how the lease is classified.

842-20-55-28 The lessee recognizes lease expense in Year 7 as follows, depending on how the lease had been classified at the commencement date.

> > > > > If the Lease Is Classified as a Type A Lease at the Commencement Date

842-20-55-29 The lessee expects to consume the right-of-use asset's future economic benefits evenly over the remaining lease term and amortizes the right-of-use asset on a straight-line basis.

Interest expense	CU23,896 (7.83% × CU305,189)	
Lease liability		CU23,896
Amortization expense	CU37,114 (CU334,023 ÷ 9)	
Right-of-use asset		CU37,114

> > > > > If the Lease Is Classified as a Type B Lease at the Commencement Date

842-20-55-30 The lessee determines the remaining cost of the lease as follows:

a. The sum of CU500,000 (10 payments of CU50,000 during the initial lease term) and CU275,000 (5 payments of CU55,000 during lease extension) and CU15,000 (initial direct costs incurred by lessee), that is, CU790,000; less

b. The cost of the lease already recognized as an expense of CU309,000 (annual lease expense of CU51,500 recognized during the first 6 years of the lease).

842-20-55-31 The amount of the remaining cost of the lease is therefore CU481,000 (CU790,000 – CU309,000). Consequently, the lessee determines that the annual expense to be recognized is CU53,444 (CU481,000 ÷ remaining lease term of 9 years).

Lease expense	CU53,444	
Lease liability		CU23,896 (7.83% × CU305,189)
Right-of-use asset		CU29,548 (CU53,444 – CU23,896)

> > > Example 2—Termination Penalties

842-20-55-32 A lessee enters into a 10-year lease of an asset, which it can terminate at the end of each year once the lease enters its sixth year. Lease payments are CU50,000 per year during the 10-year term, payable at the beginning of each year. If the lessee terminates the lease at the end of Year 6, the lessee must pay a penalty to the lessor of CU20,000. The termination penalty decreases by CU5,000 in each successive year.

842-20-55-33 At the commencement date, the lessee concludes that it does not have a significant economic incentive not to exercise the termination option in Year 6 (that is, the lessee does not have a significant economic incentive to continue to use the underlying asset after Year 6), having considered all factors including the termination penalties and the lease payments during the remaining years of the lease. Accordingly, the lessee determines that the lease term is six years.

842-20-55-34 At the commencement date, the lessee measures the lease liability on the basis of lease payments of CU50,000 for 6 years plus the penalty of CU20,000 payable at the end of Year 6.

> > Illustration of Lessee Accounting for Purchase Options

842-20-55-35 The following Example illustrates how a lessee accounts for a lease when the lessee has a significant economic incentive to exercise an option to purchase the underlying asset.

> > > Example 3—Purchase Option

842-20-55-36 A lessee enters into a 5-year lease of equipment with annual lease payments of CU59,000, payable at the end of each year. This Example ignores any initial direct costs. At the end of Year 5, the lessee has an option to purchase the equipment for CU5,000. The residual value of the equipment in 5 years is

CU75,000. Consequently, the lessee concludes that it has a significant economic incentive to exercise the purchase option. The fair value of the equipment at the commencement date is CU250,000, and its **useful life** is 7 years.

842-20-55-37 The rate that the lessor charges the lessee in this Example is the rate implicit in the lease, which is 6.33 percent. That is the rate that causes the present value of lease payments, including the exercise price of the purchase option, to equal the fair value of the equipment at the commencement date.

842-20-55-38 The lessee classifies the lease as a Type A lease.

842-20-55-39 The lessee measures the lease liability at the commencement date at CU250,000 (the present value of 5 payments of CU59,000 plus the present value of the purchase option payment of CU5,000).

842-20-55-40 At the commencement date, the lessee recognizes lease assets and liabilities as follows.

Right-of-use asset	CU250,000	
Lease liability		CU250,000

842-20-55-41 The lessee amortizes the right-of-use asset over the useful life of the equipment of seven years, and not over the lease term of five years, because the lessee has a significant economic incentive to exercise the purchase option. The lessee expects to consume the asset's future economic benefits evenly over the seven years and, thus, amortizes the asset on a straight-line basis.

842-20-55-42 During the first year of the lease, the lessee recognizes interest on the lease liability and amortization of the right-of-use asset as follows.

Interest expense	CU15,825 (6.33% × CU250,000)	
Lease liability		CU15,825
Amortization expense	CU35,714 (CU250,000 ÷ 7)	
Right-of-use asset		CU35,714

842-20-55-43 At the end of Year 1, the right-of-use asset is CU214,286 (CU250,000 – CU35,714) and the lease liability is CU206,825 (CU250,000 + CU15,825 – CU59,000).

842-20-55-44 At the end of Year 5, the lessee has amortized the right-of-use asset to CU71,430 (CU250,000 – CU35,714 × 5) and has a liability of CU5,000 relating to the purchase option. The lessee exercises the option to purchase the equipment and settles the remaining liability. The lessee then reclassifies the right-of-use asset and recognizes the item of equipment as follows.

Lease liability	CU5,000	
Cash		CU5,000
Property, plant, and equipment	CU71,430	
Right-of-use asset [(a)]		CU71,430

(a) The lessee could choose to present the right-of-use asset as part of property, plant, and equipment during the 5-year term of the lease; alternatively, the lessee could choose to present the right-of-use asset separately from property, plant, and equipment.

> > Illustrations of Lessee Accounting for Variable Lease Payments

842-20-55-45 The following Example illustrates variable lease payments that are in-substance fixed lease payments.

> > > Example 4—Variable Lease Payments Linked to Performance

> > > > Example 4A—Variable Lease Payments That Are In-Substance Fixed Lease Payments

842-20-55-46 A lessee enters into a 5-year lease of property, with annual payments determined as 2 percent of the lessee's sales generated from the leased property. The annual lease payment must be at least CU100,000 in each year of the lease.

842-20-55-47 At the commencement date, the lessee measures the lease liability on the basis of annual fixed payments of CU100,000. The lessee is required to make payments of at least CU100,000 in each year, regardless of the level of sales from the property. Accordingly, those payments are in-substance fixed lease payments.

> > > > Example 4B—Variable Lease Payments That Are In-Substance Fixed Lease Payments

842-20-55-48 A lessee enters into a 5-year lease of property, with an initial annual payment of CU100,000. The contract includes an escalation clause specifying that the lease payment for each year (excluding the first year of the lease) will increase by the higher of the annual increase in the Consumer Price Index for the preceding 12 months, or 2 percent.

842-20-55-49 At the commencement date, the lessee measures the lease liability on the basis of fixed lease payments of CU100,000 in Year 1, CU102,000 in Year 2, CU104,040 in Year 3, CU106,121 in Year 4, and CU108,243 in Year 5. The lessee is required to make payments of at least those amounts in each year during the lease term, regardless of the movement in the Consumer Price Index. Accordingly, those payments are in-substance fixed lease payments.

> > > > Example 4C—Variable Lease Payments That Are In-Substance Fixed Lease Payments

842-20-55-50 A lessee enters into a 10-year lease of property, with annual fixed lease payments of CU100,000 and **variable lease payments** that are determined as 3 percent of the lessee's sales from the property. At the end of the 10-year period, if sales from the property are at least CU1,000,000 in each of the 10 years, the lessee has the option to purchase the property for CU375,000 (at the commencement date, the lessee determines that it does not have a significant economic incentive to exercise the purchase option). However, if sales from the property are less than CU1,000,000 in any of the 10 years of the lease, the lessee is required to purchase the property for CU375,000 at the end of the 10-year period.

842-20-55-51 At the commencement date, the lessee measures the lease liability at the present value of either of the following:

a. Yearly payments of CU130,000 (the CU100,000 annual fixed payment plus CU30,000 variable payment assuming sales are CU1,000,000)
b. Fixed annual payments of CU100,000 plus the CU375,000 purchase price payable at the end of Year 10.

842-20-55-52 The exercise price of the purchase option of CU375,000, or the annual payments of CU30,000 for 10 years, are considered to be in-substance fixed payments because the lessee is required to pay at least the lower of those 2 amounts, regardless of the level of sales during the 10-year lease term.

> > Illustrations of Lessee Accounting for Variable Lease Payments Dependent on an Index or a Rate

842-20-55-53 The following Example illustrates how a lessee would account for variable lease payments that depend on an index or a rate and variable lease payments that are linked to performance.

> > > Example 5—Variable Lease Payments Dependent on an Index and Variable Lease Payments Linked to Performance

> > > > Example 5A—Variable Lease Payments Dependent on an Index and Variable Lease Payments Linked to Performance

842-20-55-54 A lessee enters into a 10-year lease of property with annual lease payments of CU100,000, payable at the beginning of each year. The contract specifies that lease payments for each year will increase on the basis of the increase in the Consumer Price Index for the preceding 12 months. The Consumer Price Index at the commencement date is 125. This Example ignores any initial direct costs. The lease is classified as a Type B lease.

842-20-55-55 The rate the lessor charges the lessee is not readily determinable. The lessee's incremental borrowing rate is 8 percent, which reflects the rate at which the lessee could borrow a similar amount in the same currency, for the same term, and with similar collateral as in the lease.

842-20-55-56 At the commencement date, the lessee makes the lease payment for the first year and measures the lease liability at CU624,689 (the present value of 9 payments of CU100,000 discounted at the rate of 8 percent).

842-20-55-57 The lessee recognizes lease assets and liabilities as follows.

Right-of-use asset	CU724,689 (CU624,689 + CU100,000)	
Lease liability		CU624,689
Cash (lease payment for first year)		CU100,000

842-20-55-58 The lessee determines the cost of the lease to be CU1,000,000 (the lease payments for the lease term). The annual lease expense to be recognized is CU100,000 (CU1,000,000 ÷ 10 years).

Lease expense	CU100,000	
Lease liability		CU49,975 (8% × CU624,689)
Right-of-use asset		CU50,025 (CU100,000 – CU49,975)

842-20-55-59 At the end of the first year of the lease, the Consumer Price Index is 128. The lessee calculates the payment for the second year, adjusted to the Consumer Price Index, to be CU102,400 (CU100,000 × 128 ÷ 125).

842-20-55-60 Because the lease payments are variable payments that depend on an index, the lessee adjusts the lease liability to reflect the Consumer Price Index rate at the end of the reporting period; that is, the lease liability now reflects annual lease payments of CU102,400. The lessee does not reassess the discount rate because a change in variable lease payments that depend on an index does not require the discount rate to be reassessed.

842-20-55-61 The lessee's adjustment to the lease liability is the difference between the present value of the revised and the original lease payments, discounted using the rate determined at the commencement date, that is, the present value of 9 payments of CU2,400 payable at the beginning of the period, discounted at the rate of 8 percent, which equals CU16,192. The lessee determines that all of the remeasurement relates to future periods and adjusts the carrying amount of the right-of-use asset as follows.

Right-of-use asset	CU16,192	
Lease liability		CU16,192

842-20-55-62 At the beginning of the second year of the lease, the lessee makes the lease payment for the year and recognizes the following.

Lease liability	CU102,400	
Cash		CU102,400

> > > Example 5B—Variable Lease Payments Dependent on an Index and Variable Lease Payments Linked to Performance

842-20-55-63 Assume the same facts as Example 5A except that the lessee also is required to make variable lease payments for each year of the lease, which are determined as 2 percent of the lessee's sales generated from the leased property.

842-20-55-64 At the commencement date, the lessee measures the lease assets and liabilities recognized at the same amounts as in Example 5A because the variable lease payments are linked to performance (that is, those payments are variable lease payments that neither depend on an index or a rate nor are in-substance fixed payments). Accordingly, the lessee does not include the variable lease payments determined as a percentage of sales in the measurement of the lease liability or right-of-use asset.

Right-of-use asset	CU724,689 (CU624,689 + CU100,000)	
Lease liability		CU624,689
Cash (lease payment for first year)		CU100,000

842-20-55-65 The lessee prepares financial statements on an annual basis. The lessee determines the cost of the lease to be CU1,000,000 (the lease payments for the lease term). The annual lease expense to be recognized is therefore CU100,000 (CU1,000,000 ÷ 10 years). During the first year of the lease, the lessee generates sales of CU1,200,000 from the leased property, incurring an additional lease expense of CU24,000 (2% × CU1,200,000).

Lease expense	CU124,000 (CU100,000 + CU24,000)	
Lease liability		CU49,975 (8% × CU624,689)
Right-of-use asset		CU50,025 (CU100,000 – CU49,975)
Accrued variable lease payments/cash		CU24,000

842-20-55-66 At the end of the first year of the lease, the lessee would remeasure the lease liability consistent with Example 5A. Consequently, the lessee calculates the payment for the second year, adjusted to the Consumer Price Index, to be CU102,400 and adjusts the lease liability and right-of-use asset by CU16,192.

14. Add Subtopic 842-30, with a link to transition paragraph 842-10-65-1, as follows:

Leases—Lessor

Overview and Background

General

842-30-05-1 This Subtopic addresses accounting by **lessors** for **leases** that have been classified as Type A or Type B leases in accordance with the requirements in Subtopic 842-10. Lessors should follow the requirements in this Subtopic as well as in Subtopic 842-10.

842-30-05-2 See Examples 1 through 4 (paragraphs 842-30-55-6 through 55-47) for illustrations of the requirements.

842-30-05-3 Paragraphs presented in **bold** type in this Topic state the main principles. All paragraphs have equal authority.

Scope and Scope Exceptions

General

842-30-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic; see Section 842-10-15.

Recognition

General

> Type A Leases

842-30-25-1 At the {add glossary link}commencement date{add glossary link}, a {add glossary link}lessor{add glossary link} shall recognize each of the following (and derecognize the underlying asset in accordance with paragraph 842-30-40-1):

- **a. A {add glossary link}lease receivable{add glossary link}**
- **b. A {add glossary link}residual asset{add glossary link}**
- **c. Any resulting profit or loss on the {add glossary link}lease{add glossary link} in profit or loss (as described in paragraph 842-30-30-7).**

> Type B Leases

842-30-25-2 A lessor shall recognize {add glossary link}lease payments{add glossary link} as lease income in profit or loss over the {add

glossary link}lease term{add glossary link} on either a straight-line basis or another systematic basis if that basis is more representative of the pattern in which income is earned from the {add glossary link}underlying asset{add glossary link}.

842-30-25-3 A lessor shall recognize **initial direct costs** as an expense over the lease term on the same basis as lease income (as described in the preceding paragraph).

842-30-25-4 A lessor shall recognize **variable lease payments** in profit or loss in the period in which that income is earned.

Initial Measurement

General

> Type A Leases

842-30-30-1 At the {add glossary link}commencement date{add glossary link}, a {add glossary link}lessor{add glossary link} shall measure both of the following:

a. **The {add glossary link}lease receivable{add glossary link} at the present value of the {add glossary link}lease payments{add glossary link}, discounted using the {add glossary link}rate the lessor charges the lessee{add glossary link} (as described in paragraphs 842-20-55-2 through 55-3), plus any {add glossary link}initial direct costs{add glossary link} (as described in paragraphs 842-20-55-5 through 55-6)**
b. **The {add glossary link}residual asset{add glossary link} as described in paragraph 842-30-30-4.**

> > Initial Measurement of the Lease Payments Included in the Lease Receivable

842-30-30-2 At the commencement date, the lease payments included in the lease receivable shall consist of the following payments relating to the use of the **underlying asset** during the **lease term** (as described in paragraph 842-10-25-1) that are not yet received:

a. Fixed payments, less any lease incentives payable to the **lessee**
b. **Variable lease payments** that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate at the commencement date
c. Variable lease payments that are in-substance fixed payments
d. Lease payments structured as **residual value guarantees** (as described in paragraphs 842-30-55-1 through 55-2)

e. The exercise price of a purchase option if the lessee has a significant economic incentive to exercise that option (assessed considering the factors described in paragraph 842-10-55-4)
f. Payments for penalties for terminating the **lease**, if the lease term (as determined in accordance with paragraph 842-10-25-1) reflects the lessee exercising an option to terminate the lease.

842-30-30-3 See paragraphs 842-30-55-1 through 55-2 for implementation guidance on lease payments structured as a residual value guarantee.

> > Initial Measurement of the Residual Asset

842-30-30-4 At the commencement date, a lessor shall measure the residual asset as follows:

$$A + B - C$$

A = The present value of the amount the lessor expects to derive from the underlying asset following the end of the lease term, discounted using the rate the lessor charges the lessee (**gross residual asset**).
B = The present value of expected variable lease payments (as described in paragraph 842-30-30-5).
C = Any unearned profit, determined in accordance with paragraphs 842-30-30-6 through 30-8.

> > > Variable Lease Payments Included in the Rate the Lessor Charges the Lessee

842-30-30-5 If a lessor reflects an expectation of variable lease payments in determining the rate the lessor charges the lessee and those payments are not included in the lease receivable, the lessor shall include in the initial measurement of the residual asset the present value of variable lease payments expected to be earned during the lease term, discounted using the rate the lessor charges the lessee.

> > > Profit

842-30-30-6 If the fair value of the underlying asset is greater than its carrying amount immediately before the commencement date, a lessor shall allocate that difference between profit relating to the lease, which the lessor recognizes at the commencement date, and unearned profit, which is included in the initial measurement of the residual asset.

842-30-30-7 A lessor shall calculate the profit relating to the lease recognized at the commencement date as the difference between the fair value and the carrying amount of the underlying asset immediately before the commencement date, multiplied by the present value of the lease payments (discounted using the rate the lessor charges the lessee), divided by the fair value of the underlying asset.

842-30-30-8 A lessor shall determine the unearned profit included in the initial measurement of the residual asset as the difference between the fair value and the carrying amount of the underlying asset immediately before the commencement date, less the profit recognized at the commencement date.

> Type B Leases

842-30-30-9 A lessor shall continue to measure the underlying asset subject to a Type B lease in accordance with other Topics.

Subsequent Measurement

General

> Type A Leases

842-30-35-1 After the {add glossary link}commencement date{add glossary link}, a {add glossary link}lessor{add glossary link} shall measure both of the following:

a. **The {add glossary link}lease receivable{add glossary link} by increasing the carrying amount to reflect the unwinding of the discount on the lease receivable and reducing the carrying amount to reflect the {add glossary link}lease payments{add glossary link} made during the period. A lessor shall determine the unwinding of the discount on the lease receivable in each period during the {add glossary link}lease term{add glossary link} as the amount that produces a constant periodic discount rate on the remaining balance of the receivable, taking into consideration the reassessment and impairment requirements in paragraphs 842-30-35-3 and 842-30-35-10.**
b. **The {add glossary link}residual asset{add glossary link} at its initial carrying amount plus the unwinding of the discount in accordance with paragraph 842-30-35-7, taking into consideration the requirements on reassessment, {add glossary link}variable lease payments{add glossary link}, and impairment in paragraphs 842-30-35-3, 842-30-35-8, and 842-30-35-11.**

842-30-35-2 After the commencement date, a lessor shall recognize all of the following in profit or loss:

a. The unwinding of the discount on the lease receivable as interest income

b. The unwinding of the discount on the **gross residual asset** as interest income
c. Variable lease payments that are not included in the lease receivable in the periods in which that income is earned.

> > Reassessment of the Lease Receivable

842-30-35-3 After the commencement date, a lessor shall remeasure the lease receivable to reflect changes to the lease payments as described in the following paragraph and changes to the discount rate as described in paragraphs 842-30-35-5 through 35-6. A lessor shall do both of the following:

a. Adjust the carrying amount of the residual asset to reflect the amount the lessor expects to derive from the **underlying asset** following the end of the revised lease term, if there is a change in the lease term or in the assessment of whether the **lessee** has or no longer has a significant economic incentive to exercise a purchase option, as described in paragraph 842-30-35-4(a) through (b).
b. Recognize any difference between the carrying amounts of the lease receivable and residual asset before and after the remeasurement in profit or loss.

842-30-35-4 A lessor shall reassess the lease payments if there is a change in any of the following:

a. The lease term, as described in paragraph 842-10-25-3. A lessor shall determine the revised lease payments on the basis of the revised lease term.
b. Relevant factors that result in the lessee having or no longer having a significant economic incentive to exercise an option to purchase the underlying asset, assessed in accordance with paragraph 842-10-55-5. A lessor shall determine the revised lease payments to reflect the change in amounts receivable under a purchase option.
c. An index or a rate used to determine lease payments during the reporting period. A lessor shall determine the revised lease payments using the index or rate at the end of the reporting period.

842-30-35-5 A lessor shall reassess the discount rate if there is a change in any of the following, unless the possibility of change was reflected in determining the discount rate at the commencement date:

a. The lease term
b. Relevant factors that result in the lessee having or no longer having a significant economic incentive to exercise an option to purchase the underlying asset
c. A reference interest rate, if variable lease payments are determined using that rate.

842-30-35-6 A lessor shall determine the revised discount rate at the date of reassessment as the rate the lessor would charge the lessee at that date on the basis of the remaining lease term.

> > Subsequent Measurement of the Residual Asset

842-30-35-7 After the commencement date, a lessor shall increase the carrying amount of the residual asset in each period to account for the effect of the unwinding of the discount on the gross residual asset, using the **rate the lessor charges the lessee**.

842-30-35-8 If a lessor includes variable lease payments in the initial measurement of the residual asset in accordance with paragraph 842-30-30-4, the lessor shall derecognize a portion of the carrying amount of the residual asset in each period and recognize a corresponding expense in profit or loss. The lessor shall determine the portion to derecognize on the basis of the variable lease payments expected to be earned in the period (as described in paragraphs 842-30-55-3 through 55-5).

842-30-35-9 See paragraphs 842-30-55-3 through 55-5 for implementation guidance on variable lease payments included in the rate a lessor charges a lessee for Type A **leases**.

> > > Impairment of the Lease Receivable and the Residual Asset

842-30-35-10 A lessor shall determine whether the lease receivable is impaired and should recognize any impairment in accordance with Topic 310 on receivables (as described in paragraphs 310-10-35-16 through 35-30). When determining the loss allowance for a lease receivable, a lessor shall take into consideration the collateral relating to the receivable. The collateral relating to the receivable represents the cash flows that the lessor would expect to derive from the underlying asset during the remaining lease term, which excludes the cash flows that the lessor would expect to derive from the underlying asset following the end of the lease term (see Example 4 in paragraphs 842-30-55-36 through 55-47).

842-30-35-11 A lessor shall apply Topic 360 on property, plant, and equipment to determine whether the residual asset is impaired, taking into consideration any **residual value guarantees** relating to the underlying asset when assessing impairment of the residual asset. A lessor shall recognize any impairment loss in profit or loss in accordance with Topic 360.

> > Accounting for the Underlying Asset at the End of the Lease Term or on Termination of a Lease

842-30-35-12 At the end of the lease term, a lessor shall reclassify the residual asset to the appropriate category of asset (for example, **property**, plant, and equipment) in accordance with other Topics, measured at the carrying amount of the residual asset. The lessor shall account for the asset that was the subject of a lease in accordance with other Topics.

842-30-35-13 If a lease is terminated before the end of the lease term, a lessor shall do all of the following:

a. Test the lease receivable for impairment in accordance with Topic 310 (as described in paragraphs 310-10-35-16 through 35-30) and recognize any impairment loss identified
b. Reclassify the lease receivable (less any amounts still expected to be received by the lessor) and the residual asset to the appropriate category of asset in accordance with other Topics, measured at the sum of the carrying amounts of the lease receivable (less any amounts still expected to be received by the lessor) and the residual asset
c. Account for the asset that was the subject of the lease in accordance with other Topics.

> Type B Leases

842-30-35-14 A lessor shall continue to measure the underlying asset subject to a Type B lease in accordance with other Topics.

Derecognition

General

> Type A Leases

842-30-40-1 At the {add glossary link}commencement date{add glossary link}, a {add glossary link}lessor{add glossary link} shall derecognize the carrying amount of the {add glossary link}underlying asset{add glossary link} (if previously recognized).

Other Presentation Matters

General

> Type A Leases

> > Statement of Financial Position

842-30-45-1 A **lessor** shall present **lease** assets (that is, the sum of the carrying amounts of **lease receivables** and **residual assets**) separately from other assets in the statement of financial position.

842-30-45-2 A lessor also shall either present in the statement of financial position or disclose in the notes the carrying amount of lease receivables and the carrying amount of residual assets.

> > Statement of Comprehensive Income

842-30-45-3 A lessor shall either present in the statement of comprehensive income or disclose in the notes income arising from leases. If a lessor does not present lease income in the statement of comprehensive income, the lessor shall disclose which line items include the income in the statement of comprehensive income.

842-30-45-4 A lessor shall present any profit or loss on the lease recognized at the **commencement date** in a manner that best reflects the lessor's business model(s). Examples of presentation include the following:

a. If a lessor uses leases as an alternative means of realizing value from the goods that it would otherwise sell, the lessor shall present revenue and cost of goods sold relating to its leasing activities in separate line items so that income and expenses from sold and leased items are presented consistently.
b. If a lessor uses leases for the purposes of providing finance, the lessor shall present the profit or loss in a single line item.

> > Statement of Cash Flows

842-30-45-5 In the statement of cash flows, a lessor shall classify cash receipts from **lease payments** within operating activities.

> Type B Leases

> > Statement of Financial Position

842-30-45-6 A lessor shall continue to present the **underlying asset** subject to a Type B lease in accordance with other Topics.

> > Statement of Cash Flows

842-30-45-7 In the statement of cash flows, a lessor shall classify cash receipts from lease payments within operating activities.

Disclosure

General

842-30-50-1 The objective of the disclosure requirements is to enable users of financial statements to understand the amount, timing, and uncertainty of cash flows arising from {add glossary link}leases{add glossary link}. To achieve that objective, a {add glossary link}lessor{add glossary link} shall disclose qualitative and quantitative information about all of the following:

a. Its leases (as described in paragraphs 842-30-50-3(a) and 842-30-50-4)

b. **The significant judgments made in applying the requirements in this Topic to those leases (as described in paragraph 842-30-50-3(b))**
c. **The amounts recognized in the financial statements relating to those leases (as described in paragraphs 842-30-50-5 through 50-12).**

842-30-50-2 A lessor shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. A lessor shall aggregate or disaggregate disclosures so that useful information is not obscured by including a large amount of insignificant detail or by aggregating items that have different characteristics.

842-30-50-3 A lessor shall disclose the following:

a. Information about the nature of its leases, including:
   1. A general description of those leases
   2. The basis, and terms and conditions, on which **variable lease payments** are determined
   3. The existence, and terms and conditions, of options to extend or terminate the lease
   4. The existence, and terms and conditions, of options for a **lessee** to purchase the **underlying asset**.
b. Information about significant assumptions and judgments made in applying the requirements of this Topic, which may include the following:
   1. The determination of whether a **contract** contains a lease (as described in paragraphs 842-10-15-2 through 15-16)
   2. The allocation of the consideration in a contract between lease and nonlease components (as described in paragraph 842-10-15-22)
   3. The initial measurement of the **residual asset** (as described in paragraph 842-30-30-4).

842-30-50-4 A lessor shall disclose any lease transactions between related parties (see Topic 850 on related party disclosures).

842-30-50-5 A lessor shall disclose lease income recognized in the reporting period, in a tabular format, to include the following:

a. For Type A leases:
   1. Profit or loss recognized at the **commencement date** (gross or net consistent with paragraph 842-30-45-4)
   2. The unwinding of the discount on the **lease receivable**
   3. The unwinding of the discount on the **gross residual asset**.
b. For Type B leases, lease income relating to **lease payments**
c. Lease income relating to variable lease payments not included in the measurement of the **lease receivable**
d. **Short-term lease** income.

> Type A Leases

842-30-50-6 In addition to the disclosures required by paragraphs 842-30-50-3 through 50-5, a lessor also shall provide the disclosures in paragraphs 842-30-50-7 through 50-10 for Type A leases.

842-30-50-7 A lessor shall disclose a reconciliation of the opening and closing balances of the lease receivable. The reconciliation should include items that are useful in understanding the change in the carrying amount of the lease receivable, for example, the following:

a. Additions due to leases commencing or being extended
b. Receivables derecognized due to leases being terminated
c. Cash received
d. The unwinding of the discount on the lease receivable
e. Foreign currency transaction gains and losses
f. Effects of business combinations
g. Changes to the loss allowance.

842-30-50-8 A lessor shall disclose a reconciliation of the opening and closing balances of the residual asset. The reconciliation should include items that are useful in understanding the change in the carrying amount of the residual asset, for example, the following:

a. Additions due to leases commencing
b. Reductions due to leases being extended
c. Reclassifications at expiration or termination of a lease
d. The unwinding of the discount on the gross residual asset
e. Effects of business combinations
f. Impairment.

842-30-50-9 A lessor shall disclose a maturity analysis of the lease receivable, showing the undiscounted cash flows to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessor shall reconcile the undiscounted cash flows to the lease receivable recognized in the statement of financial position.

842-30-50-10 A lessor shall disclose information about how it manages its risk associated with residual assets. In particular, a lessor should disclose all of the following:

a. Its risk management strategy for residual assets
b. The carrying amount of residual assets covered by **residual value guarantees** (excluding guarantees considered to be lease payments for the lessor, as described in paragraph 842-30-30-2(d))
c. Any other means by which the lessor reduces its residual asset risk (for example, buyback agreements or variable lease payments for use in excess of specified limits).

> Type B Leases

842-30-50-11 In addition to the disclosures required by paragraphs 842-30-50-3 through 50-5, a lessor also shall provide the disclosures in the following paragraph for Type B leases.

842-30-50-12 A lessor shall disclose a maturity analysis of lease payments, showing the undiscounted cash flows to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessor shall present that maturity analysis separately from the maturity analysis required by paragraph 842-30-50-9 for Type A leases.

Implementation Guidance and Illustrations

General

> Implementation Guidance

> > Application of Lease Payments Structured as a Residual Value Guarantee

842-30-55-1 In some **contracts**, a **lessor** not only obtains a **residual value guarantee**, but the contract also states that the lessor will pay to the counterparty, or the counterparty can retain, any difference between the selling price of the **underlying asset** and an amount specified in the contract. The counterparty may or may not be the **lessee**.

842-30-55-2 In those cases, the lessor will pay to, or receive from, the counterparty any difference between the selling price of an underlying asset and a specified amount. Accordingly, the lessor receives a fixed amount for the **residual asset**, which is similar to a fixed **lease** payment receivable at the end of the **lease term**. Those guarantees are considered to be **lease payments** for the lessor.

> > Application of Variable Lease Payments Included in the Rate the Lessor Charges the Lessee for Type A Leases

842-30-55-3 If a lessor includes **variable lease payments** in the initial measurement of the residual asset in accordance with paragraph 842-30-30-5, paragraph 842-30-35-8 requires the lessor to derecognize a portion of the carrying amount of the residual asset in each period and recognize a corresponding expense in profit or loss.

842-30-55-4 At the **commencement date**, a lessor should calculate the portion of the residual asset to derecognize in each period on the basis of the expected variable lease payments as follows:

$$\frac{A}{B} \times C \times \frac{D}{E}$$

A = The amount of variable lease payments expected to be earned in the current period reflected in determining the **rate the lessor charges the lessee**.

B = The amount of total variable lease payments expected to be earned during the lease term reflected in determining the rate the lessor charges the lessee.

C = The amount of the initial measurement of the residual asset relating to variable lease payments (that is, the present value of variable lease payments expected to be earned during the lease term, discounted using the rate the lessor charges the lessee).

D = The carrying amount of the underlying asset immediately before the commencement date.

E = The fair value of the underlying asset at the commencement date.

842-30-55-5 Changes in estimates relating to variable lease payments do not affect the amounts to be derecognized by the lessor in each period. A lessor should recognize any difference between expected and actual variable lease payments in profit or loss in the reporting period.

> Illustrations

> > Illustrations of Lessor Measurement for Type A Leases

842-30-55-6 The following Examples illustrate how a lessor would account for Type A leases.

> > > Example 1—Lessor Accounting for Type A Leases—the Carrying Amount of the Underlying Asset Equals Fair Value

842-30-55-7 A lessor leases a vehicle for 3 years for lease payments of CU2,400, payable annually at the end of each year, and incurs **initial direct costs** of CU200. At the commencement date, the carrying amount and fair value of the vehicle is CU10,000 and the amount the lessor expects to derive from the vehicle following the end of 3 years is CU4,500. The lessee has an option to purchase the vehicle at the end of the initial lease term at a market price or to extend the lease for 2 years for the same annual payment of CU2,400. The **economic life** of the vehicle is seven years.

842-30-55-8 The lessor concludes that the lessee does not have a significant economic incentive to extend the lease or exercise the purchase option and therefore determines the lease term to be three years. The lessor also determines that the lease is a Type A lease.

842-30-55-9 The rate that the lessor charges the lessee is the **rate implicit in the lease**, which is 6.87 percent (that is, it is the rate that causes the present value of the lease payments and the estimated value of the vehicle at the end of the lease term to equal the fair value of the vehicle at the commencement date).

842-30-55-10 The lessor measures the **lease receivable** at CU6,513, which is the present value of 3 payments of CU2,400, discounted at 6.87 percent, plus the initial direct costs of CU200.

842-30-55-11 The lessor measures the **gross residual asset** at CU3,687, which is the present value of the amount the lessor expects to derive from the vehicle following the end of the lease term of CU4,500, discounted at 6.87 percent.

842-30-55-12 Because there is no difference between the carrying amount and the fair value of the vehicle at the commencement date, the lessor does not recognize any profit at that date or any unearned profit relating to the residual asset. The lessor therefore recognizes the residual asset at CU3,687.

842-30-55-13 At the commencement date, the lessor derecognizes the vehicle and recognizes the lease receivable and residual asset as follows.

Lease receivable	CU6,513	
Residual asset	CU3,687	
Vehicle		CU10,000
Cash/payable for initial direct costs		CU200

842-30-55-14 The lessor also may present revenue and cost of goods sold at CU6,313 at the commencement date depending on the lessor's business model.

842-30-55-15 Because the initial direct costs are included in the receivable, the lessor determines the imputed rate that will reduce the balance of the lease receivable to CU0 at the end of the lease term. The imputed rate for the lease is 5.18 percent. The imputed rate is used to determine the interest income on the lease receivable in each year of the lease.

842-30-55-16 At the end of Year 1, the lessor recognizes the receipt of a lease payment, interest on the lease receivable, and interest on the residual asset as follows.

Cash	CU2,400	
Lease receivable		CU2,400
Lease receivable	CU338 (5.18% × CU6,513)	
Residual asset	CU253 (6.87% × CU3,687)	
Interest income		CU591 (CU338 + CU253)

842-30-55-17 Following those entries, the carrying amount of the lease receivable is CU4,451 (CU6,513 – CU2,400 + CU338), and the carrying amount of the residual asset is CU3,940 (CU3,687 + CU253).

842-30-55-18 The lessor accounts for the lease during the remainder of the lease term as follows.

	Statement of Financial Position			Statement of Comprehensive Income		
End of Year	Lease Receivable	Gross Residual Asset	Carrying Amount of Residual Asset	Interest on Lease Receivable	Interest on Residual Asset	Interest Income
1	CU4,451	CU3,940	CU3,940	CU338	CU253	CU591
2	2,282	4,211	4,211	231	271	502
3	-	4,500	4,500	118	289	407

842-30-55-19 At the end of the lease term, the lessor reclassifies the residual asset to, for example, inventory.

Inventory	CU4,500	
Residual asset		CU4,500

842-30-55-20 The vehicle is then sold for CU5,000, and the lessor recognizes the sale.

Cash/accounts receivable	CU5,000	
Inventory		CU4,500
Gain on sale of inventory		CU500

> > > Example 2—Lessor Accounting for Type A Leases—the Carrying Amount of the Underlying Asset Is Lower Than Fair Value

842-30-55-21 Assume the same facts as in Example 1 except that the carrying amount of the vehicle at the commencement date is CU7,500 and any initial direct costs are ignored in this Example.

842-30-55-22 The lessor measures the lease receivable in the same way as in Example 1, except that this Example ignores initial direct costs (CU200); that is, the lease receivable at the commencement date is CU6,313 (CU6,513 – CU200).

842-30-55-23 The lessor measures the gross residual asset in the same way as in Example 1 (that is, at the present value of the amount the lessor expects to derive from the vehicle following the end of the lease term, which is CU3,687). To calculate both the recognized and the unearned profit, the lessor first determines the difference between the fair value and the carrying amount of the vehicle to be CU2,500 (CU10,000 – CU7,500). The lessor calculates the profit recognized at the commencement date on the basis of the present value of the lease payments as a proportion of the fair value of the vehicle as CU1,578 ((CU10,000 – CU7,500) × (CU6,313 ÷ CU10,000)). Accordingly, the lessor calculates the unearned profit on the residual asset as CU922 (CU2,500 – CU1,578).

842-30-55-24 At the commencement date, the lessor derecognizes the vehicle and recognizes the lease receivable, gross residual asset, and unearned profit on the residual asset, as well as profit on the lease as follows.

Lease receivable	CU6,313	
Revenue [(a)]		CU6,313
Gross residual asset [(b)]	CU3,687	
Cost of goods sold [(a)]	CU4,735 (CU7,500 – CU3,687 + CU922)	
Unearned profit on the residual asset [(b)]		CU922
Vehicle		CU7,500

(a) This Example illustrates a gross presentation of profit on the lease at the commencement date. If a net presentation best reflects the lessor's business model, the lessor would present a gain of CU1,578 (CU6,313 – CU4,735) instead of separately presenting revenue and cost of goods sold.

(b) Not required to be presented or disclosed as two amounts but only required to be presented on a net basis.

842-30-55-25 At the end of Year 1, the lessor recognizes the receipt of a lease payment, interest on the lease receivable, and interest on the gross residual asset as follows.

Cash	CU2,400	
Lease receivable		CU2,400
Lease receivable [(a)]	CU434 (6.87% × CU6,313)	
Residual asset	CU253 (6.87% × CU3,687)	
Interest income		CU687 (CU434 + CU253)

(a) This rate is different from the rate applied to the lease receivable in Example 1 because the lease receivable in this Example does not include any initial direct costs.

842-30-55-26 Following those entries, the carrying amount of the lease receivable is CU4,347 (CU6,313 – CU2,400 + CU434), and the carrying amount of the net residual asset is CU3,018 (CU3,687 – CU922 + CU253).

842-30-55-27 The lessor accounts for the lease during the remainder of the lease term as follows.

	Statement of Financial Position				Statement of Comprehensive Income	
End of Year	Lease Receivable	Gross Residual Asset	Unearned Profit on Residual Asset	Carrying Amount of Residual Asset	Interest on Lease Receivable	Interest on Residual Asset
1	CU4,347	CU3,940	CU(922)	CU3,018	CU434	CU253
2	2,246	4,211	(922)	3,289	299	271
3	-	4,500	(922)	3,578	154	289

842-30-55-28 At the end of the lease term, the lessor reclassifies the residual asset to, for example, inventory.

Inventory	CU3,578	
Unearned profit	CU922	
Residual asset		CU4,500

842-30-55-29 The vehicle is then sold for CU5,000, and the lessor recognizes the sale.

Cash/accounts receivable	CU5,000	
Cost of sales	CU3,578	
Inventory		CU3,578
Revenue		CU5,000

> > > Example 3—Lessor Accounting for a Type A Lease—Residual Value Guarantees

842-30-55-30 The following Example illustrates how a lessor would account for a residual value guarantee for Type A leases.

> > > > Example 3A—Lessor Accounting for Type A Leases—Residual Value Guarantees

842-30-55-31 Assume the same facts as Example 1 and, in addition, the lessee guarantees the residual value of the vehicle.

842-30-55-32 According to the residual value guarantee, if the market value of the vehicle at the end of the lease term is lower than CU4,500, the lessee will compensate the lessor for the difference. The lessor will obtain the benefits if the market value is in excess of CU4,500.

842-30-55-33 At the commencement date, the lessor does not recognize the residual value guarantee as part of the lease receivable. If, during the lease term, the amount the lessor expects to derive from the vehicle following the end of the lease term falls below the original estimate of CU4,500, the lessor would not recognize any impairment of the residual asset (assuming no deterioration in the lessee's credit standing). That is because the original amount expected to be derived from the vehicle of CU4,500 will be recovered through the residual value guarantee.

> > > > Example 3B—Lessor Accounting for Type A Leases—Residual Value Guarantees

842-30-55-34 In addition to the guarantee provided by the lessee in Example 3A, the contract also states that if the vehicle is sold for more than CU4,500, after the end of the lease the lessor will pay the difference between the selling price and CU4,500 to the lessee.

842-30-55-35 In this Example, CU4,500 is considered to be a fixed lease payment structured as a residual value guarantee. Accordingly, the lessor includes CU4,500, discounted using the rate implicit in the lease, as part of the lease receivable at the commencement date.

> > Illustration of Lessor Impairment of Lease Receivable for Type A Leases

842-30-55-36 The following Example illustrates how a lessor would measure an impairment of the lease receivable for Type A leases.

> > > Example 4—Lessor Accounting for Type A Leases—Impairment of the Lease Receivable

> > > > Part 4A—Impairment of the Lease Receivable

842-30-55-37 This Example illustrates the measurement of any impairment loss and allowance for expected credit losses but does not consider the timing of recognition of impairment of the lease receivable. The timing of recognition would be determined in accordance with the requirements for financial instruments. For the purpose of this Example, it is assumed that the lessor is required to recognize an impairment allowance equal to the full expected credit losses for the lease receivable at the end of Year 2 of the lease. The lessor may have already recognized an impairment allowance before this date in accordance with the requirements for financial instruments, which is ignored in this Example.

842-30-55-38 A lessor leases a vehicle for 3 years for lease payments of CU2,400, payable annually at the beginning of each year. At the commencement date, the carrying amount of the vehicle is CU7,500, the fair value of the vehicle is CU10,000, and the amount the lessor expects to derive from the vehicle following the end of 3 years is CU4,500. The rate implicit in the lease is 9.64 percent.

842-30-55-39 At the start of the lease, the lessor would expect to account for the lease as follows before accounting for expected credit losses.

	Statement of Financial Position				Statement of Comprehensive Income	
End of Year	Lease Receivable	Gross Residual Asset	Unearned Profit on Residual Asset	Carrying Amount of Residual Asset	Interest on Lease Receivable and Residual Asset	Profit on the Lease
0	CU6,586	CU3,414	CU(854)	CU2,560	CU -	CU1,646
1	4,589	3,744	(854)	2,890	733	-
2	2,400	4,104	(854)	3,250	571	-
3	-	4,500	(854)	3,646	396	-

842-30-55-40 At the end of Year 2, the lessor measures the allowance for expected credit losses on the lease receivable in accordance with the requirements for financial instruments.

842-30-55-41 In accordance with the terms and conditions of the lease agreement, the lessor is entitled to retrieve the vehicle if the lessee fails to make the final lease payment at the beginning of Year 3, that is, the vehicle provides collateral against the receivable.

842-30-55-42 At the end of Year 2, the lessor estimates that it would be able to sell the vehicle for CU5,500 if the vehicle were to be retrieved at the beginning of Year 3. The amount the lessor expects to derive from the vehicle following the end of the lease term remains unchanged at CU4,500.

842-30-55-43 When measuring the impairment allowance, the lessor allocates the expected cash flows from the sale of the collateral between the lease receivable and the residual asset. The portion of the collateral allocated to the residual asset represents the cash flows that the lessor expects to derive from the vehicle following the end of the lease term (that is, CU4,104, representing the present value of CU4,500), and the portion allocated to the lease receivable represents the cash flows that the lessor expects to derive during the remaining lease term (that is, CU1,396, calculated as CU5,500 less CU4,104).

842-30-55-44 Accordingly, at the end of Year 2 the lessor recognizes an impairment allowance on the lease receivable of CU1,004 (that is, CU2,400, the carrying amount of the lease receivable less CU1,396, the portion of the collateral allocated to the lease receivable). The amount of impairment recognized in profit or loss would represent the difference between the impairment allowance of CU1,004 at the end of Year 2 and the amount of the impairment allowance already recognized in accordance with the requirements for financial instruments. The lessor does not recognize any impairment on the residual asset because the lessor expects to derive economic benefits from the residual asset that exceed the carrying amount of that asset.

> > > > Part 4B—Return of the Underlying Asset

842-30-55-45 The lessee fails to pay the final lease payment at the beginning of Year 3. The lessor retrieves the vehicle from the lessee and sells it for CU5,500.

842-30-55-46 The lessor recognizes the vehicle at CU4,646, that is, the carrying amount of the lease receivable (CU1,396) and the residual asset (CU3,250).

Inventory	CU4,646	
Lease receivable		CU1,396
Residual asset		CU3,250

842-30-55-47 The vehicle is then sold for CU5,500, and the lessor recognizes the sale.

Cash/accounts receivable	CU5,500	
Inventory		CU4,646
Gain on sale of inventory		CU854

15. Add Subtopic 842-40, with a link to transition paragraph 842-10-65-1, as follows:

Leases—Sale and Leaseback Transactions

Overview and Background

General

842-40-05-1 This Subtopic addresses accounting for sale and leaseback transactions when a **lease** has been accounted for in accordance with Subtopic 842-10, and Subtopic 842-20 or 842-30.

Scope and Scope Exceptions

General

842-40-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic; see Section 842-10-15.

842-40-15-2 If an entity (the transferor) transfers an asset to another entity (the transferee) and leases that asset back from the transferee, both the transferor and the transferee shall account for the transfer **contract** and the **lease** in accordance with Sections 842-40-25, 842-40-30, and 842-40-50.

Recognition

General

> Determining Whether the Transfer of the Asset Is a Sale

842-40-25-1 An entity shall apply the requirements for determining when a performance obligation is satisfied in the requirements in the proposed Accounting Standards Update on revenue recognition when determining whether the transfer of an asset shall be accounted for as a sale of the asset.

842-40-25-2 The existence of the leaseback (that is, the transferor's right to use the asset for a period of time) does not, in isolation, prevent the transferee from obtaining control of the asset. However, if the leaseback provides the transferor with the ability to direct the use of and obtain substantially all of the remaining benefits from the asset, then the transferee does not obtain control of the asset and the transfer is not a sale. The transferor is considered to have the ability to direct the use of and obtain substantially all of the remaining benefits from the asset, if either of the following occurs:

a. The **lease term** is for the major part of the remaining **economic life** of the asset.
b. The present value of the **lease payments** accounts for substantially all of the fair value of the asset.

> Transfer of the Asset Is a Sale

842-40-25-3 If a transferee obtains control of the asset in accordance with the requirements for determining when a performance obligation is satisfied in the requirements in the proposed Accounting Standards Update on revenue recognition:

a. The transferor shall account for a sale in accordance with other Topics and for the **lease** in accordance with **lessee** accounting in Subtopic 842-20.
b. The transferee shall account for a purchase in accordance with other Topics and for the lease in accordance with **lessor** accounting in Subtopic 842-30.

> Transfer of the Asset Is Not a Sale

842-40-25-4 If a transferee does not obtain control of the asset in accordance with the requirements for determining when a performance obligation is satisfied in the requirements in the proposed Accounting Standards Update on revenue recognition:

a. The transferor shall not derecognize the transferred asset and shall account for any amounts received as a financial liability in accordance with other Topics.
b. The transferee shall not recognize the transferred asset and shall account for the amounts paid as a receivable in accordance with other Topics.

Initial Measurement

General

> Transfer of the Asset Is a Sale

842-40-30-1 If the consideration for the sale of an asset is not at fair value or the **lease payments** are not at market rates, an entity shall make the following adjustments to recognize the sale at fair value:

a. The transferor shall measure the **right-of-use asset** and the gain or loss on disposal of the **underlying asset** to reflect current market rates for lease payments for that asset. The transferor shall subsequently account for the **lease** to reflect those current market rates.
b. The transferee shall measure the **lease receivable** and the **residual asset** for Type A leases, or the underlying asset for Type B leases, to reflect current market rates for lease payments for that asset. The transferee shall subsequently account for the lease to reflect those current market rates.

842-40-30-2 If the transaction is a related party lease, a transferor and a transferee shall not make the adjustments required in the preceding paragraph, but shall provide the required disclosures as discussed in paragraphs 842-20-50-10 and 842-30-50-4.

842-40-30-3 See Example 1 (paragraphs 842-40-55-4 through 55-9) for illustrations of the requirements.

Disclosure

General

842-40-50-1 If a transferor or a transferee enters into a sale and leaseback transaction that is accounted for in accordance with paragraphs 842-40-25-3 and 842-40-30-1 through 30-2, it shall provide the disclosures required in paragraphs 842-20-50-1 through 50-10 or 842-30-50-1 through 50-12.

842-40-50-2 In addition to the disclosures required by paragraphs 842-20-50-1 through 50-10, a transferor that enters into a sale and leaseback transaction shall disclose the following:

a. The main terms and conditions of that transaction
b. Any gains or losses arising from the transaction separately from gains or losses on disposal of other assets.

Implementation Guidance and Illustrations

General

> Implementation Guidance

> > Application of Costs of the Lessee Relating to the Construction or Design of an Underlying Asset

842-40-55-1 An entity may negotiate a **lease** before the **underlying asset** is available for use by the **lessee**. For some leases, the underlying asset may need to be constructed or redesigned for use by the lessee. Depending on the terms and conditions of the **contract**, a lessee may be required to make payments relating to the construction or design of the asset.

842-40-55-2 If a lessee incurs costs relating to the construction or design of an underlying asset, the lessee should account for those costs in accordance with other Topics, for example, Topic 330 on inventory or Topic 360 on property, plant, and equipment. If the lessee controls the underlying asset before the **commencement date**, the transaction is a sale and leaseback transaction that is accounted for in accordance with paragraphs 842-40-25-3 and 842-40-30-1 through 30-2.

842-40-55-3 Costs relating to the construction or design of an underlying asset do not include payments made by the lessee for the right to use the underlying asset. Payments for the right to use the underlying asset are **lease payments**, regardless of the timing of those payments.

> Illustrations

> > Illustration of Sale and Leaseback Transaction

842-40-55-4 The following Example illustrates how a lessee and a **lessor** would account for a sale and leaseback transaction.

> > > Example 1—Sale and Leaseback Transaction

842-40-55-5 An entity (Seller) sells a piece of land to an unrelated entity (Buyer) for cash of CU2 million. Immediately before the transaction, the land is carried at a cost of CU1 million. At the same time, Seller enters into a contract with Buyer for the right to use the land for 10 years, with annual payments of CU120,000 payable at the end of each year. The terms and conditions of the transaction are such that Buyer obtains control of the land in accordance with the requirements for determining when a performance obligation is satisfied in the requirements in the proposed Accounting Standards Update on revenue recognition. Accordingly, Seller and Buyer account for the transaction as a sale and leaseback. This Example ignores any **initial direct costs** associated with the transaction.

842-40-55-6 The market rates for the lease of the land are CU90,000, payable annually at the end of each year. Because the consideration for the sale of the land is not at fair value, Seller and Buyer are required to make adjustments to recognize the transaction at fair value. The **rate the lessor charges the lessee** is 5 percent. This rate is readily determinable by Seller. The lease is classified as a Type B lease.

842-40-55-7 At the commencement date, Seller accounts for the transaction as follows.

Leaseback of the land recognized using the market rates for the lease.

Right-of-use asset	CU694,956	
Lease liability		CU694,956 (10 payments of CU90,000, discounted at 5%)

Sale of the land (adjusted to account for the lease using market rates).

Cash	CU2,000,000	
Land		CU1,000,000
Financial liability		CU231,652 (10 payments of CU30,000, discounted at 5%)
Gain on sale of land		CU768,348

842-40-55-8 At the commencement date, Buyer accounts for the transaction as follows.

Land	CU1,768,348 (CU2 million – CU231,652)	
Financial asset	CU231,652 (10 payments of CU30,000, discounted at 5%)	
Cash		CU2,000,000

842-40-55-9 After the commencement date, both Seller and Buyer account for the lease by treating CU90,000 of the annual payments of CU120,000 as lease payments. The remaining CU30,000 of annual payments made by Seller are accounted for as payments made to settle the financial liability of CU231,652 (recognized by Seller) and payments received to settle the financial asset of CU231,652 (recognized by Buyer).

Amendments to Subtopic 205-20

16. Amend paragraph 205-20-55-50, with a link to transition paragraph 842-10-65-1, as follows:

Presentation of Financial Statements—Discontinued Operations

Implementation Guidance and Illustrations

> Illustrations

> > Example 3: Sporting Goods Manufacturer

> > > Case C: Indirect Cash Flows and No Continuing Involvement

205-20-55-50 The entity has experienced losses in its bicycle division resulting from an increase in manufacturing costs (principally, labor costs). The entity decides to remain in the bicycle business but will outsource the manufacturing operations and commits to a plan to sell the related manufacturing facility. The facility is classified as held for sale at that date. The entity will sell the manufacturing facility along with the third-party customer contracts and will enter into an outsourcing agreement with the buyer of that facility. The agreement will allow the ongoing entity to purchase 5 percent of the output from the facility at market for a period of 10 years, which will be sold through the company-owned store locations. The outsourcing agreement includes customary terms and does not permit the ongoing entity to be otherwise involved in the operations of the disposed component. The revenues generated from sales to company-owned store locations approximated 5 percent of the total revenues generated by the disposed component. The outsourcing agreement does not meet the definition of a lease based on an evaluation of the guidance in Subtopic 842-10.~~840-10.~~

Amendments to Subtopic 210-20

17. Amend paragraph 210-20-15-3, with a link to transition paragraph 842-10-65-1, as follows:

Balance Sheet—Offsetting

Scope and Scope Exceptions

> Other Considerations

210-20-15-3 The general principle of a **right of setoff** involves only two parties, and exceptions to that general principle shall be limited to practices specifically permitted by the Subtopics listed in this paragraph. Various accounting Subtopics specify accounting treatments in circumstances that result in offsetting or in a presentation in a statement of financial position that is similar to the effect of offsetting. The guidance in this Subtopic does not modify the accounting treatment in the particular circumstances prescribed by any of the following Subtopics:

a. Subparagraph superseded by Accounting Standards Update 201X-XX.~~Paragraphs 840-30-35-32 through 35-52 (leveraged leases)~~
b. Subtopic 715-30 (accounting for pension plan assets and liabilities)
c. Subtopic 715-60 (accounting for plan assets and liabilities)
d. Subtopic 740-30 (net tax asset or liability amounts reported)
dd. Paragraphs 815-10-45-1 through 45-7 (derivative instruments with the right to reclaim cash collateral or the obligation to return cash collateral)
e. Subtopics 940-320 (trade date accounting for trading portfolio positions) and 910-405 (advances received on construction contracts)
f. Paragraph 942-305-45-1 (reciprocal balances with other banks).

18. Supersede paragraph 210-20-60-4 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Relationships

~~> Leases~~

210-20-60-4 Paragraph superseded by Accounting Standards Update 201X-XX.~~For guidance on leveraged leases, see paragraphs 840-30-35-32 through 35-52.~~

Amendments to Subtopic 230-10

19. Amend paragraph 230-10-50-4, with a link to transition paragraph 842-10-65-1, as follows:

Statement of Cash Flows—Overall

Disclosure

> Noncash Investing and Financing Activities

230-10-50-4 Examples of noncash investing and financing transactions are converting debt to equity; acquiring assets by assuming directly related liabilities, such as purchasing a building by incurring a mortgage to the seller; obtaining a right-of-use asset in exchange for a lease liability; ~~obtaining an asset by entering into a capital lease;~~ obtaining a building or investment asset by receiving a gift; and exchanging noncash assets or liabilities for other noncash assets or liabilities.

20. Amend paragraphs 230-10-55-10 through 55-11, 230-10-55-13, 230-10-55-15, and 230-10-55-19 through 55-20, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Direct and Indirect Method for a Manufacturing Entity

230-10-55-10 The following is a statement of cash flows for the year ended December 31, 19X1, for Entity A, a U.S. corporation engaged principally in manufacturing activities. This statement of cash flows illustrates the direct method of presenting cash flows from operating activities, as encouraged in paragraph 230-10-45-25.

Entity A
Consolidated Statement of Cash Flows
For the Year Ended December 31, 19X1
Increase (Decrease) in Cash and Cash Equivalents

Cash flows from operating activities:		
Cash received from customers	$ 13,850	
Cash paid to suppliers and employees	(12,000)	
Dividend received from affiliate	20	
Interest received	55	
Interest paid (net of amount capitalized)	(220)	
Income taxes paid	(325)	
Insurance proceeds received	15	
Cash paid to settle lawsuit for patent infringement	(30)	
Net cash provided by operating activities		$ 1,365
Cash flows from investing activities:		
Proceeds from sale of facility	600	
Payment received on note for sale of plant	150	
Capital expenditures	(1,000)	
Payment for purchase of Entity B, net of cash acquired	(925)	
Net cash used in investing activities		(1,175)
Cash flows from financing activities:		
Net borrowings under line-of-credit agreement	300	
Principal payments under <u>Type A</u> ~~capital~~ lease obligation	(125)	
Proceeds from issuance of long-term debt	400	
Proceeds from issuance of common stock	500	
Dividends paid	(200)	
Net cash provided by financing activities		875
Net increase in cash and cash equivalents		1,065
Cash and cash equivalents at beginning of year		600
Cash and cash equivalents at end of year		$ 1,665

Reconciliation of net income to net cash provided by operating activities:

Net income		$ 760
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	$ 445	
Provision for losses on accounts receivable	200	
Gain on sale of facility	(80)	
Undistributed earnings of affiliate	(25)	
Payment received on installment note receivable for sale of inventory	100	
Change in assets and liabilities net of effects from purchase of Entity B:		
Increase in accounts receivable	(215)	
Decrease in inventory	205	
Increase in prepaid expenses	(25)	
Decrease in accounts payable and accrued expenses	(250)	
Increase in interest and income taxes payable	50	
Increase in deferred taxes	150	
Increase in other liabilities	50	
Total adjustments		605
Net cash provided by operating activities		$ 1,365

230-10-55-11 The supplemental schedule of noncash **investing** and **financing activities** is as follows.

Entity A purchased all of the capital stock of Entity B for $950. In conjunction with the acquisition, liabilities were assumed as follows.

Fair value of assets acquired	$ 1,580
Cash paid for the capital stock	(950)
Liabilities assumed	$ 630

A Type A ~~capital~~ lease obligation of $850 was incurred when Entity A entered into a lease for new equipment.

Additional common stock was issued upon the conversion of $500 of long-term debt.

230-10-55-12 The disclosure of accounting policy is as follows.

For purposes of the statement of cash flows, the entity considers all highly liquid debt instruments purchased with a maturity of three months or less to be **cash equivalents.**

230-10-55-13 The following is Entity A's statement of cash flows for the year ended December 31, 19X1, prepared using the indirect method, as described in paragraph 230-10-45-28.

Entity A
Consolidated Statement of Cash Flows
For the Year Ended December 31, 19X1
Increase (Decrease) in Cash and Cash Equivalents

Cash flows from operating activities:		
Net income		$ 760
Depreciation and amortization	$ 445	
Provision for losses on accounts receivable	200	
Gain on sale of facility	(80)	
Undistributed earnings of affiliate	(25)	
Payment received on installment note receivable for sale of inventory	100	
Change in assets and liabilities net of effects from purchase of Entity B:		
Increase in accounts receivable	(215)	
Decrease in inventory	205	
Increase in prepaid expenses	(25)	
Decrease in accounts payable and accrued expenses	(250)	
Increase in interest and income taxes payable	50	
Increase in deferred taxes	150	
Increase in other liabilities	50	
Total adjustments		605
Net cash provided by operating activities		1,365
Cash flows from investing activities:		
Proceeds from sale of facility	600	
Payment received on note for sale of plant	150	
Capital expenditures	(1,000)	
Payment for purchase of Entity B, net of cash acquired	(925)	
Net cash used in investing activities		(1,175)
Cash flows from financing activities:		
Net borrowings under line-of-credit agreement	300	
Principal payments under Type A ~~capital~~ lease obligation	(125)	
Proceeds from issuance of long-term debt	400	
Proceeds from issuance of common stock	500	
Dividends paid	(200)	
Net cash provided by financing activities		875
Net increase in cash and cash equivalents		1,065
Cash and cash equivalents at beginning of year		600
Cash and cash equivalents at end of year		$ 1,665

230-10-55-14 The following table illustrates the supplemental disclosures of cash flow information.

Cash paid during the year for:	
Interest (net of amount capitalized)	$ 220
Income taxes	325

230-10-55-15 The supplemental schedule of noncash investing and financing activities is as follows.

Entity A purchased all of the capital stock of Entity B for $950. In conjunction with the acquisition, liabilities were assumed as follows.

Fair value of assets acquired	$ 1,580
Cash paid for the capital stock	(950)
Liabilities assumed	$ 630

A Type A ~~capital~~ lease obligation of $850 was incurred when Entity A entered into a lease for new equipment.

Additional common stock was issued upon the conversion of $500 of long-term debt.

230-10-55-19 The following summarizes financial information for the current year for Entity A, which provides the basis for the statements of cash flows presented in paragraphs 230-10-55-10 through 55-18.

Entity A
Consolidated Statement of Financial Position

	1/1/X1	12/31/X1	Change
Assets:			
Cash and cash equivalents	$ 600	$ 1,665	$ 1,065
Accounts receivable (net of allowance for losses of $600 and $450)	1,770	1,940	170
Notes receivable	400	150	(250)
Inventory	1,230	1,375	145
Prepaid expenses	110	135	25
Investments	250	275	25
Property, plant, and equipment, at cost	6,460	8,460	2,000
Accumulated depreciation	(2,100)	(2,300)	(200)
Property, plant, and equipment, net	4,360	6,160	1,800
Intangible assets	40	175	135
Total assets	$ 8,760	$ 11,875	$ 3,115
Liabilities:			
Accounts payable and accrued expenses	$ 1,085	$ 1,090	$ 5
Interest payable	30	45	15
Income taxes payable	50	85	35
Short-term debt	450	750	300
Type A lease~~Lease~~ obligation	-	725	725
Long-term debt	2,150	2,425	275
Deferred taxes	375	525	150
Other liabilities	225	275	50
Total liabilities	4,365	5,920	1,555
Stockholders' equity:			
Capital stock	2,000	3,000	1,000
Retained earnings	2,395	2,955	560
Total stockholders' equity	4,395	5,955	1,560
Total liabilities and stockholders' equity	$ 8,760	$ 11,875	$ 3,115

Entity A
Consolidated Statement of Income
For the Year Ended December 31, 19X1

Sales	$ 13,965
Cost of sales	(10,290)
Depreciation and amortization	(445)
Selling, general, and administrative expenses	(1,890)
Interest expense	(235)
Equity in earnings of affiliate	45
Gain on sale of facility	80
Interest income	55
Insurance proceeds	15
Loss from patent infringement lawsuit	(30)
Income before income taxes	1,270
Provision for income taxes	(510)
Net income	$ 760

230-10-55-20 The following transactions were entered into by Entity A during 19X1 and are reflected in the preceding financial statements:

a. Entity A wrote off $350 of accounts receivable when a customer filed for bankruptcy. A provision for losses on accounts receivable of $200 was included in Entity A's selling, general, and administrative expenses.
b. Entity A collected the third and final annual installment payment of $100 on a note receivable for the sale of inventory and collected the third of four annual installment payments of $150 each on a note receivable for the sale of a plant. Interest on these notes through December 31 totaling $55 was also collected.
c. Entity A received a dividend of $20 from an affiliate accounted for under the equity method of accounting.
d. Entity A sold a facility with a book value of $520 and an original cost of $750 for $600 cash.
e. Entity A constructed a new facility for its own use and placed it in service. Accumulated expenditures during the year of $1,000 included capitalized interest of $10.
f. Entity A entered into a ~~capital~~ lease for new equipment with a fair value of $850. The entity classified the lease as a Type A lease. Principal payments under the lease obligation totaled $125.

g. Entity A purchased all of the capital stock of Entity B for $950 in a business combination. The fair values of Entity B's assets and liabilities at the date of acquisition are presented below.

Cash	$ 25
Accounts receivable	155
Inventory	350
Property, plant, and equipment	900
Patents	80
Goodwill	70
Accounts payable and accrued expenses	(255)
Long-term note payable	(375)
Net assets acquired	$ 950

h. Entity A borrowed and repaid various amounts under a line-of-credit agreement in which borrowings are payable 30 days after demand. The net increase during the year in the amount borrowed against the line-of-credit totaled $300.
i. Entity A issued $400 of long-term debt securities.
j. Entity A's provision for income taxes included a deferred provision of $150.
k. Entity A's depreciation totaled $430, and amortization of intangible assets totaled $15.
l. Entity A's selling, general, and administrative expenses included an accrual for incentive compensation of $50 that has been deferred by executives until their retirement. The related obligation was included in other liabilities.
m. Entity A collected insurance proceeds of $15 from a business interruption claim that resulted when a storm precluded shipment of inventory for one week.
n. Entity A paid $30 to settle a lawsuit for patent infringement.
o. Entity A issued $1,000 of additional common stock of which $500 was issued for cash and $500 was issued upon conversion of long-term debt.
p. Entity A paid dividends of $200.

Amendments to Subtopic 255-10

21. Amend paragraphs 255-10-55-1 and 255-10-55-11 and its related heading and supersede paragraphs 255-10-55-6 through 55-9 and their related headings, with a link to transition paragraph 842-10-65-1, as follows:

Changing Prices—Overall

Implementation Guidance and Illustrations

> Implementation Guidance

> > Monetary and Nonmonetary Items

255-10-55-1 Paragraphs 255-10-55-1 through 55-13 of this Section provide guidance on the interpretation of paragraphs 255-10-50-50 through 50-55 for the classification of certain asset and liability items as monetary or nonmonetary. The following table illustrates the application of the definitions to common cases under typical circumstances. In other circumstances the classification should be resolved by reference to the definitions. Paragraphs 255–10–55–1 through 55–13 are not intended to provide answers that should be followed regardless of the circumstances of the case.

Assets	Monetary	Nonmonetary
Cash on hand and demand bank deposits (dollars)	X	
Time deposits (dollars)	X	
Foreign currency on hand and claims to foreign currency [a]	X	
Securities:		
Common stocks (not accounted for on the equity method)		X
Common stocks represent residual interests in the underlying net assets and earnings of the issuer.		
Preferred stock (convertible or participating)	Circumstances may indicate that such stock is either monetary or nonmonetary. See convertible bonds.	
Preferred stock (nonconvertible, nonparticipating)	X	
Future cash receipts are likely to be substantially unaffected by changes in specific prices.		
Convertible bonds	If the market values the security primarily as a bond, it is monetary; if it values the security primarily as stock, it is nonmonetary.	
Bonds (other than convertibles)	X	
Trading account investments in fixed-income securities owned by banks, investment brokers, and others (see paragraphs 255-10-55-2 through 55-3)		X
Accounts and notes receivable	X	
Allowance for doubtful accounts and notes receivable	X	
Variable-rate mortgage loans	X	
The terms of such loans do not link them directly to the rate of inflation. Also, there are practical reasons for classifying all loans as monetary.		
Inventories used on contracts	They are, in substance, right to receive sums of money if the future cash receipts on the contracts will not vary due to future changes in specific prices. Goods used on contracts to be priced at market upon delivery are nonmonetary.	
Inventories (other than inventories used on contracts) and commodity inventories (other than those described below)		X
Commodity inventories whose values are hedged by futures contracts whose contract amounts have not been recorded in the financial statements	See paragraphs 255-10-55-4 through 55-5.	
Loans to employees	X	
Prepaid insurance, advertising, rent, and other prepayments	Claims to future services are nonmonetary. Prepayments that are deposits, advance payments, or receivables are monetary because the prepayment does not obtain a given quantity of future services, but rather is a fixed-money offset.	
Long-term receivables	X	
Refundable deposits	X	
Advances to unconsolidated subsidiaries	X	
Equity investment in unconsolidated subsidiaries or other investees		X
Pension, sinking, and other funds under an entity's control	The specific assets in the fund should be classified as monetary or nonmonetary. See listings under securities.	
Property, plant, and equipment		X
Accumulated depreciation of property, plant, and equipment		X
~~The unguaranteed residual value of property owned by a lessor and leased under direct financing, sales-type, and leveraged leases~~	~~See paragraphs 255-10-55-6 through 55-7.~~	
~~Investment tax credits that are deferred by a lessor as part of the unearned income of a leveraged lease~~	~~See paragraphs 255-10-55-8 through 55-9.~~	
Portion of the carrying amount of lessors' assets leased under Type B ~~noncancellable operating~~ leases that represent claims to fixed sums of money (see paragraph 255-10-55-10) ~~(see paragraphs .255-10-55-10 through 55-11)~~		X
Cash surrender value of life insurance	X	
Purchase commitments—portion paid on fixed-price contracts		X
An advance on a fixed-price contract is the portion of the purchaser's claim to nonmonetary goods or services that is recognized in the accounts; it is not a right to receive money.		
Advances to supplier—not on a fixed-price contract		
Such advances are rights to receive credit for a sum of money, not claims to a specified quantity of goods or services.	X	
Deferred tax assets [a]	X	
Patents, trademarks, licenses, and formulas		X
Goodwill		X
Deferred life insurance policy acquisition costs [a]	X	
Such costs represent the portion of future cash receipts for premiums that is recognized in the accounts and are sometimes viewed as an offset to the policy reserve.		
Deferred property and casualty insurance policy acquisition costs related to unearned premiums		X
Other intangible assets and deferred charges		X

Liabilities	Monetary	Nonmonetary
Accounts and notes payable	X	
Accrued expenses payable (wages and so forth)	X	
Accrued vacation pay	If to be paid at the wage rates as of the vacation dates and if those rates may vary, accrued vacation pay is nonmonetary.	
Cash dividends payable	X	
Obligations payable in foreign currency	X	
Sales commitments—portion collected on fixed-price contracts An advance received on a fixed-price contract is the portion of the seller's obligation to deliver goods or services that is recognized in the accounts; it is not an obligation to pay money.		X
Advances from customers—not on a fixed-price contract Such advances are equivalent to loans from customers and are not obligations to furnish specified quantities of goods or services.	X	
Accrued losses on firm purchase commitments In essence, these are accounts payable.	X	
Deferred revenue	If an obligation to furnish goods or services is involved, deferred revenue is nonmonetary. Certain deferred income items of savings and loan associations are monetary.	
Refundable deposits	X	
Bonds payable and other long-term debt	X	
Unamortized premium or discount and prepaid interest on bonds or notes payable Such items are inseparable from the debt to which they relate—a monetary item.	X	
Convertible bonds payable Until converted, these are obligations to pay sums of money.	X	
Accrued pension obligations	Fixed amounts payable to a fund are monetary; all other amounts are nonmonetary.	
Obligations under warranties These are nonmonetary because they oblige the entity to furnish goods or services or their future price.		X
Deferred tax liabilities [(a)]	X	
Deferred investment tax credits These are not to be settled by payment of cash and are related to nonmonetary assets.		X
Life insurance policy reserves These represent portions of policies' face values that are now deemed liabilities.	X	
Property and casualty insurance loss reserves	X	
Unearned property and casualty insurance premiums These are nonmonetary because they are principally obligations to furnish insurance coverage. The dollar amount of payments to be made under that coverage might vary materially due to changes in specific prices.		X
Deposit liabilities of financial institutions	X	
Equity	**Monetary**	**Nonmonetary**
Capital stock of the entity or of its consolidated subsidiaries subject to mandatory redemption at fixed amounts (see paragraph 255-10-55-13)	X	
Noncontrolling interests in consolidation subsidiaries (see paragraph 255-10-55-12)		X

(a) Although classification of this item as nonmonetary may be technically preferable, the monetary classification provides a more practical solution for the purposes of computing the purchasing power gain or loss on a consolidated basis.

~~> > > The Unguaranteed Residual Value of Property Owned by a Lessor and Leased Under Direct Financing, Sales-type, and Leveraged Leases~~

255-10-55-6 Paragraph superseded by Accounting Standards Update 201X-XX. ~~The unguaranteed residual value is included with the minimum lease payments, at present value, in the net investment in the lease.~~

255-10-55-7 Paragraph superseded by Accounting Standards Update 201X-XX. ~~The minimum lease payments are monetary items because they are claims to fixed sums of money. The residual value is not a claim to a fixed sum of money, so it is a nonmonetary item. Some assets and liabilities, of which the net investment in the lease is a good example, are combinations of claims to (or obligations of) fixed amounts and claims to (or obligations of) variable amounts. Ideally, those claims should be separated for purposes of classifying them as monetary and nonmonetary. However, if the information necessary to make the separation is not available or is impracticable to obtain, such items need not be divided into monetary and nonmonetary components and would be classified according to their dominant element. If the net investment in leases is principally claims to fixed amounts, it would be classified as monetary; it would be classified as nonmonetary if it is principally claims to residuals.~~

~~> > > Investment Tax Credits that Are Deferred by a Lessor as Part of the Unearned Income of a Leveraged Lease~~

255-10-55-8 Paragraph superseded by Accounting Standards Update 201X-XX.~~Under paragraph 840-30-35-33, the deferred investment tax credit related to the leased asset is subtracted from rentals receivable and estimated residual value as part of the calculation of the lessor's investment in the leveraged lease. The investment, including the deferred investment tax credit related to the leveraged lease, is presented as one amount in the balance sheet. As indicated in the preceding paragraph, the investment in a leveraged lease would be classified as monetary or nonmonetary according to its dominant element.~~

255-10-55-9 Paragraph superseded by Accounting Standards Update 201X-XX.~~As indicated in the table in paragraph 255-10-55-1, a deferred investment tax credit should be classified as nonmonetary but, if it is part of an investment in a leveraged lease and if the information necessary to separate its elements is not available or is impracticable to obtain, the investment would be classified according to its dominant element.~~

> > > Portion of the Carrying Amount of Lessors' Assets Leased Under Type B ~~Noncancellable Operating~~ Leases that Represent Claims to Fixed Sums of Money

255-10-55-10 These assets are carried at depreciated **historical cost** under generally accepted accounting principles (GAAP) and are classified with or near property, plant, and equipment, which are nonmonetary.

255-10-55-11 ~~The classification of a lease as an operating lease under paragraph 840-10-25-1 indicates that the lease has not transferred substantially all of the benefits and risks incident to ownership to the lessee. Thus, the economic significance of the asset continues to depend heavily on the value of~~

~~the future lease rentals, residual values, and associated costs. Therefore, an~~ An asset subject to ~~an operating~~ a Type B lease should be classified as nonmonetary.

Amendments to Subtopic 270-10

22. Add paragraph 270-10-50-6A and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Interim Reporting—Overall

Disclosure

> Leases

270-10-50-6A A lessor shall disclose a table of all lease-related income items in its interim financial statements (see paragraph 842-30-50-5 for lease-related income items).

Amendments to Subtopic 274-10

23. Amend paragraph 274-10-50-2(m), with a link to transition paragraph 842-10-65-1, as follows:

Personal Financial Statements—Overall

Disclosure

274-10-50-2 Personal financial statements disclosures shall include, but are not limited to, all of the following:

m. Noncancellable commitments that do not have the characteristics discussed in paragraph 274-10-35-13.~~274-10-35-13, for example, operating leases.~~

Amendments to Subtopic 310-10

24. Amend paragraph 310-10-35-13, with a link to transition paragraph 842-10-65-1, as follows:

Receivables—Overall

Subsequent Measurement

> Loans That Are Identified for Evaluation or That Are Individually Considered Impaired

> > Applicability

310-10-35-13 This guidance applies to all creditors. It addresses the accounting by creditors for impairment of a loan by specifying how allowances for credit losses related to certain loans shall be determined. The accounting for impaired loans shall be consistent among all creditors and for all types of lending except for loans that are measured at **fair value** or at the lower of cost or fair value in accordance with specialized industry practice. Therefore, this guidance applies to all loans that are identified for evaluation, uncollateralized as well as collateralized, except the following:

a. Large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment. Those loans may include but are not limited to credit card, residential mortgage, and consumer installment loans.
b. Loans that are measured at fair value or at the lower of cost or fair value, for example, in accordance with Topic 948 or other specialized industry practice.
c. Leases as defined in Topic 842.~~Topic 840.~~
d. Debt securities as defined in Topic 320.

This guidance does not address when a creditor should record a direct write-down of an impaired loan, nor does it address how a creditor should assess the overall adequacy of the allowance for credit losses.

25. Amend paragraph 310-10-50-11A, with a link to transition paragraph 842-10-65-1, as follows:

Disclosure

> Allowance for Credit Losses Related to Financing Receivables

310-10-50-11A The guidance in paragraph 310-10-50-11B does not apply to the following financing receivables:

a. Financing receivables listed in paragraph 310-10-50-7B
b. Subparagraph superseded by Accounting Standards Update 201X-XX.~~Lessor's net investments in leveraged leases.~~

26. Amend paragraphs 310-10-55-7 through 55-9, 310-10-55-11 through 55-12, 310-10-55-14, and 310-10-55-17, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 2: Disclosures about Credit Quality and the Allowance for Credit Losses

310-10-55-7 The following table illustrates certain of the disclosures required by paragraph 310-10-50-11B(c), (g), and (h).

Allowance for Credit Losses and Recorded Investment in Financing Receivables
For the Years Ended December 31, 20X1, and 20X0

	Commercial	Commercial Real Estate	Consumer	Residential	Type A ~~Finance~~ Leases	Unallocated	Total
20X1							
Allowance for credit losses:							
Beginning balance	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Charge-offs	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Recoveries	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Provision	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Ending balance	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Ending balance: individually evaluated for impairment	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	-	$XX,XXX
Ending balance: collectively evaluated for impairment	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Ending balance: loans acquired with deteriorated credit quality	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Financing receivables:							
Ending balance	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	-	$XX,XXX
Ending balance: individually evaluated for impairment	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	-	$XX,XXX
Ending balance: collectively evaluated for impairment	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	-	$XX,XXX
Ending balance: loans acquired with deteriorated credit quality	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	-	$XX,XXX
20X0							
Allowance for credit losses:							
Beginning balance	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Charge-offs	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Recoveries	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Provision	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Ending balance	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Ending balance: individually evaluated for impairment	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	-	$XX,XXX
Ending balance: collectively evaluated for impairment	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Ending balance: loans acquired with deteriorated credit quality	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Financing receivables:							
Ending balance	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	-	$XX,XXX
Ending balance: individually evaluated for impairment	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	-	$XX,XXX
Ending balance: collectively evaluated for impairment	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	-	$XX,XXX
Ending balance: loans acquired with deteriorated credit quality	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	-	$XX,XXX

310-10-55-8 The following table illustrates certain of the disclosures required by paragraph 310-10-50-29(b).

Credit Quality Indicators
As of December 31, 20X1, and 20X0

Corporate Credit Exposure
Credit Risk Profile by Creditworthiness Category

	Commercial		Commercial Real Estate Construction		Commercial Real Estate—Other	
	20X1	**20X0**	**20X1**	**20X0**	**20X1**	**20X0**
AAA – AA	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
A	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
BBB – BB	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
B	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
CCC – C	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
D	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Total	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX

Consumer Credit Exposure
Credit Risk Profile by Internally Assigned Grade

	Residential—Prime		Residential—Subprime	
	20X1	**20X0**	**20X1**	**20X0**
Grade:				
Pass	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Special mention	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Substandard	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Total	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX

Consumer Credit Exposure
Credit Risk Profile Based on Payment Activity

	Consumer—Credit		Consumer—Other		Type A ~~Finance~~ Leases		Consumer—Auto	
	20X1	**20X0**	**20X1**	**20X0**	**20X1**	**20X0**	**20X1**	**20X0**
Performing	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Nonperforming	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Total	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX

310-10-55-9 The following table illustrates certain of the disclosures required by paragraphs 310-10-50-7(b) and 310-10-50-7A.

Age Analysis of Past Due Financing Receivables
As of December 31, 20X1, and 20X0

	30–59 Days Past Due	60–89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
20X1							
Commercial	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Commercial real estate:							
Commercial real estate construction	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Commercial real estate—other	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Consumer:							
Consumer—credit card	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Consumer—other	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Consumer—auto	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Residential:							
Residential—prime	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Residential—subprime	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Type A ~~Finance~~ leases	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Total	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
20X0							
Commercial	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX
Commercial—real estate:							
Commercial real estate construction	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Commercial real estate—other	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Consumer:							
Consumer—credit card	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Consumer—other	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Consumer—auto	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Residential:							
Residential—prime	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Residential—subprime	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Type A ~~Finance~~ leases	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Total	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX	$XX,XXX

310-10-55-11 The following table illustrates certain of the disclosures required by paragraph 310-10-50-7(a).

Financing Receivables on Nonaccrual Status
As of December 31, 20X1, and 20X0

	20X1	20X0
Commercial	$XX,XXX	$XX,XXX
Commercial real estate:		
Commercial real estate construction	XX,XXX	XX,XXX
Commercial real estate—other	XX,XXX	XX,XXX
Consumer:		
Consumer—credit card	XX,XXX	XX,XXX
Consumer—other	XX,XXX	XX,XXX
Consumer—auto	XX,XXX	XX,XXX
Residential:		
Residential—prime	XX,XXX	XX,XXX
Residential—subprime	XX,XXX	XX,XXX
Type A ~~Finance~~ leases	XX,XXX	XX,XXX
Total	$XX,XXX	$XX,XXX

310-10-55-12 The following table illustrates certain of the disclosures required by paragraphs 310-10-50-33 through 50-34.

Modifications
As of December 31, 20X1, and 20X0

	20X1			20X0		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings						
Residential—prime	XXX	$XX,XXX	$XX,XXX	XXX	$XX,XXX	$XX,XXX
Residential—subprime	XXX	XX,XXX	XX,XXX	XXX	XX,XXX	XX,XXX
Consumer—other	XXX	XX,XXX	XX,XXX	XXX	XX,XXX	XX,XXX
Type A ~~Finance~~ leases	XXX	XX,XXX	XX,XXX	XXX	XX,XXX	XX,XXX
	Number of Contracts	Recorded Investment		Number of Contracts	Recorded Investment	
Troubled Debt Restructurings That Subsequently Defaulted						
Troubled debt restructurings:						
Residential—prime	XXX	$XX,XXX		XXX	$XX,XXX	
Residential—subprime	XXX	XX,XXX		XXX	XX,XXX	
Consumer—other	XXX	XX,XXX		XXX	XX,XXX	
Type A ~~Finance~~ leases	XXX	XX,XXX		XXX	XX,XXX	

> > Meaning of *Financing Receivable*

310-10-55-13 This implementation guidance addresses the meaning of the term **financing receivable**.

310-10-55-14 All of the following are examples of financing receivables:

a. Loans
b. Trade accounts receivable
c. Notes receivable
d. Credit cards
e. Receivables relating to a lessor’s right(s) to payment(s) from a Type A lease ~~other than an operating lease that should be recognized as assets~~ in accordance with Topic 842 on leases.~~the following paragraphs:~~
    1. Subparagraph superseded by Accounting Standards Update 201X-XX.~~Paragraph 840-30-25-8 (for leveraged leases)~~
    2. Subparagraph superseded by Accounting Standards Update 201X-XX.~~Paragraph 840-30-25-7 (for direct financing leases)~~
    3. Subparagraph superseded by Accounting Standards Update 201X-XX.~~Paragraph 840-30-25-6 (for sales-type leases).~~

> > Application of the Definition of *Class of Financing Receivable*

310-10-55-17 In determining the appropriate level of its internal reporting to use as a basis for disclosure, an entity should consider the level of detail needed by a user to understand the risks inherent in the entity's financing receivables. An entity could further disaggregate its financing receivables portfolio by considering numerous factors. Examples of factors that the entity should consider include any of the following:

a. Categorization of borrowers, such as any of the following:
    1. Commercial loan borrowers
    2. Consumer loan borrowers
    3. **Related party** borrowers.
b. Type of financing receivable, such as any of the following:
    1. Mortgage loans
    2. Credit card loans
    3. Interest-only loans
    4. Type A ~~Finance~~ leases.
c. Industry sector, such as either of the following:
    1. Real estate
    2. Mining.
d. Type of collateral, such as any of the following:
    1. Residential property
    2. Commercial property
    3. Government-guaranteed collateral
    4. Uncollateralized (unsecured) financing receivables.
e. Geographic distribution, including both of the following:
    1. Domestic
    2. International.

An entity also may consider factors related to concentrations of credit risk as discussed in Section 825-10-55.

Amendments to Subtopic 310-20

27. Amend paragraph 310-20-15-1, with a link to transition paragraph 842-10-65-1, as follows:

Receivables—Nonrefundable Fees and Other Costs

Scope and Scope Exceptions

> Entities

310-20-15-1 The guidance in this Subtopic applies to entities as follows:

a. All paragraphs apply to both lenders and purchasers.

b. Paragraphs 310-20-25-2 through 25-3 and 310-20-35-2 through 35-3 and the definition of **direct loan origination costs** apply to lessors in determining the net amount of initial direct costs as that term is used in Topic 842 on leases.~~840.~~

Amendments to Subtopic 310-30

28. Amend paragraph 310-30-15-2(c), with a link to transition paragraph 842-10-65-1, as follows:

Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality

Scope and Scope Exceptions

> Transactions

310-30-15-2 The guidance in this Subtopic applies to all loans with evidence of deterioration of credit quality since origination acquired by **completion of a transfer** for which it is **probable**, at acquisition, that the investor will be unable to collect all **contractually required payments receivable**, except for any of the following:

c. Leases as defined in Topic 842.~~840.~~ Only contracts that are classified by the purchaser as leases under that Topic meet this exclusion. The distinction between purchasing a lease and purchasing a stream of cash flows must be drawn to determine applicability of this Section.

Amendments to Subtopic 310-40

29. Amend paragraph 310-40-15-11(a), with a link to transition paragraph 842-10-65-1, as follows:

Receivables—Troubled Debt Restructurings by Creditors

Scope and Scope Exceptions

> Other Considerations

> > Troubled Debt Restructuring

310-40-15-11 For purposes of this Subtopic, none of the following are considered troubled debt restructurings:

a. Changes in lease agreements (for guidance, see Topic 842)~~840)~~

Amendments to Subtopic 323-740

30. Amend paragraph 323-740-25-3, with a link to transition paragraph 842-10-65-1, as follows:

Investments—Equity Method and Joint Ventures—Income Taxes

Recognition

Qualified Affordable Housing Project Investments

323-740-25-3 A liability shall be recognized for delayed equity contributions that are unconditional and legally binding. A liability also shall be recognized for equity contributions that are contingent upon a future **event** when that contingent event becomes probable. Topic 450 provides ~~and paragraph 840-30-55-15 provide~~ additional guidance on the accounting for delayed equity contributions.

Amendments to Subtopic 350-40

31. Supersede paragraph 350-40-25-16, with a link to transition paragraph 842-10-65-1, as follows:

Intangibles—Goodwill and Other—Internal-Use Software

Recognition

> Capitalization of Cost

350-40-25-16 Paragraph superseded by Accounting Standards Update 201X-XX.~~Entities often license internal-use software from third parties. Though Subtopic 840-10 excludes licensing agreements from its scope, entities shall analogize to that Subtopic when determining the asset acquired in a software licensing arrangement.~~

Amendments to Subtopic 360-10

32. Amend paragraph 360-10-15-4, with a link to transition paragraph 842-10-65-1, as follows:

Property, Plant, and Equipment—Overall

Scope and Scope Exceptions

Impairment or Disposal of Long-Lived Assets

> Transactions

360-10-15-4 The guidance in the Impairment or Disposal of Long-Lived Assets Subsections applies to the following transactions and activities:

a. Except as indicated in (b) and the following paragraph, all of the transactions and activities related to recognized long-lived assets of an entity to be held and used or to be disposed of, including:
   1. Right-of-use assets of lessees ~~Capital leases of lessees~~
   2. Residual assets of Type A leases, and long-lived ~~Long-lived~~ assets of lessors subject to Type B leases and short-term leases~~operating leases~~
   3. Proved oil and gas properties that are being accounted for using the successful-efforts method of accounting
   4. Long-term prepaid assets.
b. The following transactions and activities related to assets and liabilities that are considered part of an **asset group** or a **disposal group**:
   1. If a long-lived asset (or assets) is part of a group that includes other assets and liabilities not covered by the Impairment or Disposal of Long-Lived Assets Subsections, the guidance in the Impairment or Disposal of Long-Lived Assets Subsections applies to the group. In those situations, the unit of accounting for the long-lived asset is its group. For a long-lived asset or assets to be held and used, that group is referred to as an asset group. For a long-lived asset or assets to be disposed of by sale or otherwise, that group is referred to as a disposal group. Examples of liabilities included in a disposal group are legal obligations that transfer with a long-lived asset, such as certain environmental obligations, and obligations that, for business reasons, a potential buyer would prefer to settle when assumed as part of a group, such as warranty obligations that relate to an acquired customer base.
   2. The guidance in the Impairment or Disposal of Long-Lived Assets Subsections does not change generally accepted accounting

principles (GAAP) applicable to those other individual assets (such as accounts receivable and inventory) and liabilities (such as accounts payable, long-term debt, and asset retirement obligations) not covered by the Impairment or Disposal of Long-Lived Assets Subsections that are included in such groups.

33. Amend paragraph 360-10-30-8, with a link to transition paragraph 842-10-65-1, as follows:

Initial Measurement

> Other Asset Acquisition Concepts

> > Accounting for Leases

360-10-30-8 See ~~Subtopic 840-30~~<u>Topic 842</u> for guidance related to assets acquired under a ~~capital~~ lease.

34. Supersede paragraphs 360-10-40-1 through 40-2 and add paragraph 360-10-40-2A, with a link to transition paragraph 842-10-65-1, as follows:

Derecognition

> Sale of Leased Property

360-10-40-1 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u>~~Paragraph 840-20-40-3 states that the sale of property subject to an operating lease (or of property that is leased by or intended to be leased by the third-party purchaser to another party) shall not be treated as a sale if the seller or any party related to the seller retains substantial risks of ownership in the leased property.~~

360-10-40-2 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u>~~Paragraph 840-20-40-5 states that if a sale to a third party of property subject to an operating lease (or of property that is leased by or intended to be leased by the third-party purchaser to another party) is not to be recorded as a sale because of the provisions of paragraph 840-20-40-3 through 40-4, the transaction shall be accounted for as a borrowing.~~

<u>**360-10-40-2A** For sales of property subject to a lease, see revenue recognition guidance in Topic 605, and for sale and leaseback transactions, see Subtopic 842-40.</u>

35. Amend paragraph 360-10-55-43, with a link to transition paragraph 842-10-65-1, as follows: **[Note: Paragraph 360-10-45-9 is shown for context.]**

Other Presentation Matters

Impairment or Disposal of Long-Lived Assets

> Long-Lived Assets Classified as Held for Sale

> > Initial Criteria for Classification as Held for Sale

360-10-45-9 A long-lived asset (disposal group) to be sold shall be classified as held for sale in the period in which all of the following criteria are met:

a. Management, having the authority to approve the action, commits to a plan to sell the asset (disposal group).
b. The asset (disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (disposal groups). (See Examples 5 through 7 [paragraphs 360-10-55-37 through 55-41], which illustrate when that criterion would be met.)
c. An active program to locate a buyer and other actions required to complete the plan to sell the asset (disposal group) have been initiated.
d. The sale of the asset (disposal group) is probable, and transfer of the asset (disposal group) is expected to qualify for recognition as a completed sale, within one year, except as permitted by paragraph 360-10-45-11. (See Example 8 [paragraph 360-10-55-43], which illustrates when that criterion would be met.) The term **probable** refers to a future sale that is likely to occur.
e. The asset (disposal group) is being actively marketed for sale at a price that is reasonable in relation to its current fair value. The price at which a long-lived asset (disposal group) is being marketed is indicative of whether the entity currently has the intent and ability to sell the asset (disposal group). A market price that is reasonable in relation to fair value indicates that the asset (disposal group) is available for immediate sale, whereas a market price in excess of fair value indicates that the asset (disposal group) is not available for immediate sale.
f. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Implementation Guidance and Illustrations

Impairment or Disposal of Long-Lived Assets

> Illustrations

> > Example 8: Proposed Disposition Not Expected to Qualify as Completed Sale

360-10-55-43 This Example illustrates the classification as held for sale of a long-lived asset (disposal group) in accordance with the criterion in paragraph 360-10-45-9(d). The following illustrates situations in which that criterion would not be met:

a. An entity that is a commercial leasing and finance company is holding for sale or lease equipment that has recently come off lease and the ultimate form of a future transaction (sale or lease) has not yet been determined.
b. An entity commits to a plan to sell <u>a property that is in use and lease that property back;</u> ~~a property that is in use, and~~ <u>however,</u> the transfer of the property ~~will~~ <u>would not</u> be accounted for as a ~~sale-leaseback~~<u>sale and leaseback transaction because the transferee does not obtain control of the asset.</u>~~through which the seller-lessee will retain more than a minor portion of the use of the property.~~ The property would continue to be classified as held and used following the appropriate guidance in Sections 360-10-35, 360-10-45, and 360-10-50. ~~If at the date of the sale-leaseback the fair value of the property is less than its undepreciated cost, a loss would be recognized immediately up to the amount of the difference between undepreciated cost and fair value in accordance with paragraphs 840-40-25-3(c) and 840-40-30-3.~~

Amendments to Subtopic 360-20

36. Supersede paragraphs 360-20-40-56 through 40-59 and their related headings and amend paragraph 360-20-40-60, with a link to transition paragraph 842-10-65-1, as follows:

Property, Plant, and Equipment—Real Estate Sales

Derecognition

~~> > > Seller Sells Property Improvements and Leases the Underlying Land to the Buyer of the Improvements~~

360-20-40-56 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u>~~If the seller sells property improvements (including integral improvements) and leases the underlying land to the buyer of the improvements, the transactions are interdependent and it is impracticable to distinguish between profits on the sale of the improvements and profits under the related lease (for guidance on leases, see Topic 840). The transaction shall be accounted for as a lease of both the land and improvements if the term of the land lease to the buyer from the seller of the improvements either:~~

~~a. Does not cover substantially all of the economic life of the property improvements, thus strongly implying that the transaction is in substance a lease of both land and improvements~~
~~b. Is not for a substantial period, for example, 20 years.~~

360-20-40-57 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u>~~If the land lease described in the preceding paragraph covers substantially all of the economic life of the improvements and extends for at least 20 years, the profit to be recognized on the sale of the improvements at the time of sale shall be the present value of the rental payments not in excess of the seller's cost of the land plus the sales value of the improvements minus the carrying value of the improvements and the land.~~

360-20-40-58 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u>~~The present value of the specified rental payments is the present value of the lease payments specified in the lease over the term of the primary indebtedness, if any, on the improvements, or over the customary amortization term of primary debt instruments on the type of improvements involved. The present value is computed at an interest rate appropriate for either:~~

~~a. Primary debt if the lease is not subordinated~~
~~b. Secondary debt if the lease is subordinated to loans with prior liens.~~

360-20-40-59 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u>~~Profit on either of the following shall be recognized when the land is sold or the rents in excess of the seller's cost of the land are accrued under the lease:~~

~~a. The buyer's rental payments on the land in excess of the seller's cost of the land~~
~~b. The rent to be received on the land after the maturity of the primary indebtedness on the improvements or other customary amortization term.~~

~~Calculations of profit in those circumstances are illustrated in Example 1, Cases C and D (see paragraphs 360-20-55-33 through 55-43).~~

> > > Sale of Property with Leaseback to Seller for All or Part of Its Remaining Economic Life

360-20-40-60 The sale of the property may be accompanied by a leaseback to the seller of all or any part of the property for all or part of its remaining economic life. Real estate sale-leaseback transactions shall be accounted for in accordance with Subtopic 842-40. ~~Subtopic 840-40.~~

37. Amend paragraph 360-20-55-2 and supersede paragraphs 360-20-55-22 through 55-43 and 360-20-55-57 through 55-59 and their related headings, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Accounting for Real Estate Sales under Full Accrual Method

> > > Minimum Initial Investment Requirements

360-20-55-2 This table does not cover every type of real estate property. To evaluate initial investments on other types of property, entities may make analogies to the types of properties specified, or the risks of a particular property can be related to the risks of the properties specified. ~~Use of this table is illustrated in Example 1 (see paragraph 360-20-55-22).~~

	Minimum Initial Investment Expressed as a Percentage of Sales Value
Land	
Held for commercial, industrial, or residential development to commence within two years after sale	20
Held for commercial, industrial, or residential development to commence after two years	25
Commercial and Industrial Property	
Office and industrial buildings, shopping centers, and so forth:	
Properties subject to lease on a long-term lease basis to parties with satisfactory credit rating; cash flow currently sufficient to service all indebtedness	10
Single-tenancy properties sold to a buyer with a satisfactory credit rating	15
All other	20
Other income-producing properties (hotels, motels, marinas, mobile home parks, and so forth):	
Cash flow currently sufficient to service all indebtedness	15
Start-up situations or current deficiencies in cash flow	25
Multifamily Residential Property	
Primary residence:	
Cash flow currently sufficient to service all indebtedness	10
Start-up situations or current deficiencies in cash flow	15
Secondary or recreational residence:	
Cash flow currently sufficient to service all indebtedness	15
Start-up situations or current deficiencies in cash flow	25
Single-Family Residential Property (including condominium or cooperative housing)	
Primary residence of the buyer	5 [a]
Secondary or recreational residence	10 [a]

[a] If collectibility of the remaining portion of the sales price cannot be supported by reliable evidence of collection experience, the minimum initial investment shall be at least 60 percent of the difference between the sales value and the financing available from loans guaranteed by regulatory bodies such as the Federal Housing Authority or the Veterans Administration, or from independent, established lending institutions. This 60-percent test applies when independent first-mortgage financing is not used and the seller takes a receivable from the buyer for the difference between the sales value and the initial investment. If independent first mortgage financing is used, the adequacy of the initial investment on sales of single-family residential property should be determined in accordance with the preceding paragraph.

> Illustrations

~~> > Example 1: Effect of Land Lease—New Multifamily Residential Property~~

360-20-55-22 Paragraph superseded by Accounting Standards Update 201X-XX.~~This Example illustrates the guidance in paragraph 360-20-55-2.~~

360-20-55-23 Paragraph superseded by Accounting Standards Update 201X-XX.~~Land improvements may be sold and concurrently the land under the improvements may be leased to the buyer of the improvements.~~

360-20-55-24 Paragraph superseded by Accounting Standards Update 201X-XX.~~This Example illustrates the effect of loans issued in connection with long-term land leases on evaluations of the adequacy of a buyer's initial investment if improvements on the land are sold separately. In addition, it demonstrates the limit that a lease places on profit recognition if the leased land is owned by the seller of the improvements, making the lease of land and sale of improvements interdependent transactions.~~

360-20-55-25 Paragraph superseded by Accounting Standards Update 201X-XX.~~The calculations are illustrated in the following Cases:~~

~~a. Primary land lease—land owned by third party lessor—nonqualifying (Case A)~~
~~b. Primary land lease—land owned by third party lessor—qualifying (Case B)~~
~~c. Subordinated land lease—land owned by seller—qualifying (Case C)~~
~~d. Subordinated land lease—land owned by seller—nonqualifying (Case D).~~

~~> > > Case A: Primary Land Lease—Land Owned by Third Party Lessor—Nonqualifying~~

360-20-55-26 Paragraph superseded by Accounting Standards Update 201X-XX.~~This Case has the following assumptions.~~

~~Assumptions:~~	
~~Sales price of improvements~~	~~$ 875,000~~
~~Represented by proceeds of:~~	
~~Cash down payment~~	~~$ 125,000~~
~~Loan by insurance company—lien on leasehold improvements, 28-year term, 8½%, payable in equal monthly installments of principal and interest~~	~~657,000~~
~~Note received by seller from buyer: 12-year term, 9½%, payable in equal monthly installments of principal and interest~~	~~93,000~~
	~~$ 875,000~~
~~Land lease for 99 years @ $19,000 per year, net, payable monthly in advance~~	
~~Cost of constructing improvements—$750,000~~	
~~No continuing involvement by seller~~	
~~Computations:~~	
~~Present value of 336 monthly payments on land lease of $1,583.33 discounted at 8½% (interest rate on loan from insurance company): $1,583.33 + ($1,583.33 x 127.9071)~~	~~$ 204,000~~
~~Loan from insurance company~~	~~657,000~~
~~Equivalent primary debt~~	~~861,000~~
~~Note receivable from buyer~~	~~93,000~~
~~Total debt or equivalent~~	~~954,000~~
~~Down payment~~	~~125,000~~
~~Sales value~~	~~$ 1,079,000~~

360-20-55-27 Paragraph superseded by Accounting Standards Update 201X-XX.~~Because 15% of the sales value of the improvements is $161,850, the initial investment of $125,000 (about 12% of adjusted sales value) is inadequate to recognize profit on the sale of improvements. The second test is therefore irrelevant.~~

~~> > > Case B: Primary Land Lease—Land Owned by Third Party Lessor—Qualifying~~

360-20-55-28 Paragraph superseded by Accounting Standards Update 201X-XX.~~This Case has the following assumptions.~~

~~Sales price of improvements~~	~~$ 875,000~~
~~Represented by proceeds of:~~	
~~Cash down payment~~	~~$165,000~~
~~Loan by insurance company: lien on leasehold improvements, 28-year term, 8½%, payable in equal monthly installments of principal and interest~~	~~657,000~~
~~Note received by seller from buyer: 12-year term, 9½%, payable in equal monthly installments of principal and interest~~	~~53,000~~
	~~$ 875,000~~
~~Land lease for 99 years @ $17,880 per year, net, payable monthly in advance~~	
~~Cost of constructing improvements—$750,000~~	
~~No continuing involvement by seller~~	
~~Computations:~~	
~~Present value of 336 monthly payments on land lease of $1,490 discounted at 8½% (interest rate on loan from insurance company): $1,490 + ($1,490 x 127.9071)~~	~~$ 192,000~~
~~Loan from insurance company~~	~~657,000~~
~~Equivalent primary debt~~	~~849,000~~
~~Note receivable from buyer~~	~~53,000~~
~~Total debt or equivalent~~	~~902,000~~
~~Down payment~~	~~165,000~~
~~Sales value~~	~~$ 1,067,000~~

360-20-55-29 Paragraph superseded by Accounting Standards Update 201X-XX.~~Because 15% of the sales value of the improvements is $160,050, the initial investment of $165,000 (15% of the sales value) is adequate to recognize profit on the sale of improvements. However, the second test must also be applied.~~

360-20-55-30 Paragraph superseded by Accounting Standards Update 201X-XX.~~The initial investment required by the second test is as follows.~~

~~Sales value~~	~~$ 1,067,000~~
~~115% of $849,000 (loan from primary lender)~~	~~976,350~~
	~~$ 90,650~~

360-20-55-31 Paragraph superseded by Accounting Standards Update 201X-XX.~~The initial investment of $165,000 exceeds the amount required, so recognition of profit on sale of improvements is appropriate. The second test may alternatively be applied as the ratio of total debt or equivalent to the equivalent primary debt: $902,000/$849,000 = 106%. Because 106% is less than 115%, the initial investment exceeds the difference between the sales value of the property and 115% of the equivalent primary debt.~~

360-20-55-32 Paragraph superseded by Accounting Standards Update 201X-XX.~~The following table illustrates profit recognition.~~

~~Sales price of improvements~~	~~$ 875,000~~
~~Less: Cost of improvements~~	~~750,000~~
~~Profit recognized at time of sale~~	~~$ 125,000~~

~~> > > Case C: Subordinated Land Lease—Land Owned by Seller—Qualifying~~

360-20-55-33 Paragraph superseded by Accounting Standards Update 201X-XX.~~This Case has the following assumptions.~~

~~Sales price of improvements~~	~~$ 914,000~~
~~Represented by proceeds of:~~	
~~Cash down payment~~	~~$ 154,000~~
~~Loan by insurance company: first lien on the fee or on subordinated leasehold, 28-year term, 8 1/4%, payable in equal monthly installments of principal and interest~~	~~760,000~~
	~~$ 914,000~~
~~Land lease for 99 years @ $11,580/year, net, payable monthly in advance, and 5% of gross rents~~	
~~Cost of land—$200,000~~	
~~Cost of constructing improvements—$750,000~~	
~~No continuing involvement by seller~~	
~~Computations:~~	
~~Present value of 336 monthly payments on land lease at $965 discounted at 12% (imputed interest for a second lien receivable): $965 + ($965 x 96.432696)~~	~~$ 94,000~~
~~Loan from insurance company (primary debt)~~	~~760,000~~
~~Total debt or equivalent~~	~~854,000~~
~~Down payment~~	~~154,000~~
~~Sales value~~	~~$ 1,008,000~~
~~The initial investment ($154,000) is more than 15% of the sales value. (15% x $1,008,000 = $151,200).~~	
~~The initial investment is also larger than the excess of the sales value over 115% of the primary debt.~~	
~~Sales value~~	~~$ 1,008,000~~
~~115% of $760,000~~	~~874,000~~
~~Excess of sales value over 115% of debt~~	~~$ 134,000~~

360-20-55-34 Paragraph superseded by Accounting Standards Update 201X-XX.~~Therefore, the initial investment of $154,000 is adequate, and recognizing profit on the sale of the improvements is appropriate.~~

360-20-55-35 Paragraph superseded by Accounting Standards Update 201X-XX.~~Profit recognition is as follows.~~

~~Sales value~~		~~$ 1,008,000~~
~~Less: Cost of improvements~~	~~$ 750,000~~	
~~Cost of land~~	~~200,000~~	~~950,000~~
~~Profit recognized at time of sale~~		~~$ 58,000~~

360-20-55-36 Paragraph superseded by Accounting Standards Update 201X-XX.~~The effect of including the present value of the lease is to reduce profit recognized by $106,000: $94,000 (present value of the land lease) – $200,000 (cost of land).~~

~~> > > Case D: Subordinated Land Lease—Land Owned by Seller—Nonqualifying~~

360-20-55-37 Paragraph superseded by Accounting Standards Update 201X-XX.~~This Case has the following assumptions.~~

~~Sales price of improvements~~	~~$ 875,000~~
~~Represented by proceeds of:~~	
~~Cash down payment~~	~~$ 132,000~~
~~Loan by insurance company: first lien on the fee or on subordinated leasehold, 28-year term, 8 1/4%, payable in equal monthly installments of principal and interest~~	~~743,000~~
	~~$ 875,000~~
~~Land lease for 99 years @ $19,332/year, net, payable monthly in advance~~	
~~Cost of land—$200,000~~	
~~Cost of improvements—$750,000~~	
~~No continuing involvement by seller~~	
~~Computations:~~	
~~Present value of 336 monthly payments on land lease of $1,611 discounted at 12% (imputed interest for a second lien receivable): $1,611 + ($1,611 × 96.432696)~~	~~$ 157,000~~
~~Loan from insurance company (primary debt)~~	~~743,000~~
~~Total debt or equivalent~~	~~900,000~~
~~Down payment~~	~~132,000~~
~~Sales value~~	~~$ 1,032,000~~

360-20-55-38 Paragraph superseded by Accounting Standards Update 201X-XX.~~The initial investment ($132,000) is less than 15% of the sales value (15% x $1,032,000 = $154,800), and therefore is inadequate to recognize profit on sale of improvements. Profit recognized at time of sale should not exceed that recognizable under the installment method as if the subordinated lease were an installment receivable.~~

360-20-55-39 Paragraph superseded by Accounting Standards Update 201X-XX.~~Profit recognition on the installment method is as follows.~~

~~Sales value~~		~~$ 1,032,000~~
~~Less: Cost of improvements~~	~~$ 750,000~~	
~~Cost of land~~	~~200,000~~	~~950,000~~
~~Anticipated profit on sale of improvements~~		~~$ 82,000~~

360-20-55-40 Paragraph superseded by Accounting Standards Update 201X-XX.~~Cash received or to be received by the seller, other than the proceeds of the primary loan, is as follows.~~

~~Down payment~~	~~$ 132,000~~
~~Present value of land lease payments~~	~~157,000~~
	~~$ 289,000~~

360-20-55-41 Paragraph superseded by Accounting Standards Update 201X-XX.~~The percentage of profit in each collection is therefore as follows.~~

~~The percentage of profit in each collection is therefore:~~

$$\cancel{\frac{\$82{,}000}{\$289{,}000} = 28.37\%}$$

360-20-55-42 Paragraph superseded by Accounting Standards Update 201X-XX.~~Profit recognizable in the period of sale is 28.37% of the down payment of $132,000, or $37,450. The remaining profit of $44,550 will be recognized at the rate of 28.37% of the portion of each lease payment that is equivalent to a reduction of principal on a loan of $157,000 for 28 years at 12%.~~

360-20-55-43 Paragraph superseded by Accounting Standards Update 201X-XX.~~The effect of including the present value of the lease in the sales value of the improvements is to reduce the profit recognized on the improvements by $43,000: $157,000 (present value of the land lease) — $200,000 (cost of the land).~~

~~> > Example 5: Determining Whether Equipment Is Integral Equipment~~

360-20-55-57 Paragraph superseded by Accounting Standards Update 201X-XX.~~This Example illustrates the guidance in paragraphs 360-20-15-4 through 15-8.~~

360-20-55-58 Paragraph superseded by Accounting Standards Update 201X-XX.~~Entity A leases equipment to Entity B for use in a manufacturing facility. The fair value of the production equipment (installed) at lease inception is $1,075,000. The estimated cost to remove the equipment after installation (estimate is as of the beginning of the lease term) is $80,000, which includes $30,000 to repair~~

~~damage to the existing location as a result of the removal. The estimated cost to ship and reinstall the equipment at a new site (estimated as of the beginning of the lease term) is $85,000. For this Example, assume that the equipment would have the same fair value (installed) to the seller and a potential buyer. Therefore, there is no diminution in fair value of the equipment beyond the discount a purchaser would presumably require to cover the cost to ship and reinstall the equipment.~~

360-20-55-59 Paragraph superseded by Accounting Standards Update 201X-XX.~~Entity A would assess whether or not the production equipment is **integral equipment** as follows: ($80,000 + $85,000) ÷ $1,075,000 = 15.3 percent. Because the cost of removal combined with the diminution in value exceeds 10 percent of the fair value (installed) of the production equipment, the cost to remove the equipment and use it separately is deemed to be significant. Therefore, the production equipment is integral equipment.~~

38. Supersede paragraph 360-20-60-2 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Relationships

~~> Leases~~

360-20-60-2 Paragraph superseded by Accounting Standards Update 201X-XX.~~For the evaluation of whether leases of certain **integral equipment** meet the ownership transfer requirements of Topic 840, see the Lessors Subsection of Section 840-10-25.~~

Amendments to Subtopic 410-20

39. Amend paragraphs 410-20-15-2 through 15-3, with a link to transition paragraph 842-10-65-1, as follows:

Asset Retirement and Environmental Obligations—Asset Retirement Obligations

Scope and Scope Exceptions

> Transactions

410-20-15-2 The guidance in this Subtopic applies to the following transactions and activities:

a. **Legal obligations** associated with the **retirement** of a tangible long-lived asset that result from the acquisition, construction, or development and (or) the normal operation of a long-lived asset, including any legal obligations that require **disposal** of a replaced part that is a component of a tangible long-lived asset.
b. An environmental remediation liability that results from the normal operation of a long-lived asset and that is associated with the retirement of that asset. The fact that partial settlement of an obligation is required or performed before full retirement of an asset does not remove that obligation from the scope of this Subtopic. If environmental contamination is incurred in the normal operation of a long-lived asset and is associated with the retirement of that asset, then this Subtopic will apply (and Subtopic 410-30 will not apply) if the entity is legally obligated to treat the contamination.
c. A conditional obligation to perform a retirement activity. Uncertainty about the timing of settlement of the **asset retirement obligation** does not remove that obligation from the scope of this Subtopic but will affect the measurement of a liability for that obligation (see paragraph 410-20-25-10).
d. Obligations of a lessor in connection with leased property that meet the provisions in (a). ~~Paragraph 840-10-25-16 requires that lease classification tests performed in accordance with the requirements of Subtopic 840-10 incorporate the requirements of this Subtopic to the extent applicable.~~
e. The costs associated with the retirement of a specified asset that qualifies as historical waste equipment as defined by EU Directive 2002/96/EC. (See paragraphs 410-20-55-23 through 55-30 and Example 4 [paragraph 410-20-55-63] for illustration of this guidance.) Paragraph 410-20-55-24 explains how the Directive distinguishes between new and historical waste and provides related implementation guidance.

410-20-15-3 The guidance in this Subtopic does not apply to the following transactions and activities:

a. Obligations that arise solely from a plan to sell or otherwise dispose of a long-lived asset covered by Subtopic 360-10.
b. An environmental remediation liability that results from the improper operation of a long-lived asset (see Subtopic 410-30). Obligations resulting from improper operations do not represent costs that are an integral part of the tangible long-lived asset and therefore should not be accounted for as part of the cost basis of the asset. For example, a certain amount of spillage may be inherent in the normal operations of a fuel storage facility, but a catastrophic accident caused by noncompliance with an entity's safety procedures is not. The obligation to clean up the spillage resulting from the normal operation of the fuel

storage facility is within the scope of this Subtopic. The obligation to clean up after the catastrophic accident results from the improper use of the facility and is not within the scope of this Subtopic.

c. Activities necessary to prepare an asset for an alternative use as they are not associated with the retirement of the asset.
d. Historical waste held by private households. (The guidance in this paragraph does not pertain to an asset retirement obligation in the scope of this Subtopic.) For guidance on accounting for historical electronic equipment waste held by private households for obligations associated with Directive 2002/96/EC on Waste Electrical and Electronic Equipment adopted by the European Union, see Subtopic 720-40.
e. Obligations of a lessee in connection with leased property, whether imposed by a lease agreement or by a party other than the lessor, that meet the definition of lease payments in Topic 842. ~~either minimum lease payments or contingent rentals in paragraphs 840-10-25-4 through 25-7.~~ Those obligations shall be accounted for by the lessee in accordance with the requirements of Topic 842.~~Subtopic 840-10.~~ However, if obligations of a lessee in connection with leased property, whether imposed by a lease agreement or by a party other than the lessor, meet the provisions in paragraph 410-20-15-2 but do not meet the definition of lease payments in Topic 842, ~~either minimum lease payments or contingent rentals in paragraphs 840-10-25-4 through 25-7,~~ those obligations shall be accounted for by the lessee in accordance with the requirements of this Subtopic.
f. An obligation for asbestos removal that results from the other-than-normal operation of an asset. Such an obligation may be subject to the provisions of Subtopic 410-30.
g. Costs associated with complying with funding or assurance provisions. Paragraph 410-20-35-9 otherwise addresses the measurement effects of funding and assurance provisions.
h. Obligations associated with maintenance, rather than retirement, of a long-lived asset.
i. The cost of a replacement part that is a component of a long-lived asset.

40. Amend paragraph 410-20-55-44, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 2: Recognition and Measurement

> > > Case D: Conditional with Low Likelihood of Enforcement

410-20-55-44 This Case illustrates a timber lease in which the lessor has an option to require the lessee to settle an asset retirement obligation. Assume an entity enters into a five-year lease agreement that grants it the right to harvest timber on a tract of land and that agreement grants the lessor an option to require that the lessee reforest the underlying land at the end of the lease term. Based on past history, the lessee believes that the likelihood that the lessor will exercise that option is low. Rather, at the end of the lease, the lessor will likely accept the land without requiring reforestation. The lessee estimates that there is only a 10 percent probability that the lessor will elect to enforce reforestation. Topic 842 ~~Paragraph 840-10-15-15 explains that Topic 840~~ does not apply to lease agreements concerning biological assets, including timber.~~the rights to explore for or to exploit **natural resources** such as timber.~~

Amendments to Subtopic 420-10

41. Amend paragraph 420-10-05-2, with a link to transition paragraph 842-10-65-1, as follows:

Exit or Disposal Cost Obligations—Overall

Overview and Background

420-10-05-2 Those costs include, but are not limited to, the following:

a. Involuntary employee termination benefits pursuant to a one-time benefit arrangement that, in substance, is not an ongoing benefit arrangement or an individual deferred compensation contract
b. Costs to terminate a contract that is not a ~~capital~~ lease
c. Other associated costs, including costs to consolidate or close facilities and relocate employees.

42. Amend paragraph 420-10-15-3, with a link to transition paragraph 842-10-65-1, as follows:

Scope and Scope Exceptions

> Transactions

420-10-15-3 The guidance in the Exit or Disposal Cost Obligations Topic applies to the following transactions and activities:

a. Termination benefits provided to current employees that are involuntarily terminated under the terms of a benefit arrangement that, in substance, is not an ongoing benefit arrangement or an individual deferred compensation contract (referred to as **one-time employee termination benefits**)
b. Costs to terminate a contract that is not a ~~capital~~ lease (see paragraphs 420-10-25-11 through 25-13 for further description of contract termination costs and <u>Topic 842 for leases guidance)</u> ~~paragraph 840-30-40-1 for terminations of a capital lease)~~
c. Costs to consolidate facilities or relocate employees
d. Costs associated with a disposal activity covered by Subtopic 205-20
e. Costs associated with an exit activity, including exit activities associated with an entity newly acquired in a business combination or an **acquisition by a not-for-profit entity**.

43. Amend paragraph 420-10-25-11, with a link to transition paragraph 842-10-65-1, as follows:

Recognition

> Contract Termination Costs

420-10-25-11 For purposes of this Subtopic, costs to terminate ~~an operating lease or other~~<u>a</u> contract <u>(excluding contracts within the scope of Topic 842)</u> are either of the following:

a. Costs to terminate the contract before the end of its term
b. Costs that will continue to be incurred under the contract for its remaining term without economic benefit to the entity.

44. Supersede paragraph 420-10-30-8, with a link to transition paragraph 842-10-65-1, as follows:

Initial Measurement

> Contract Termination Costs

420-10-30-8 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u> ~~If the contract is an operating lease, the fair value of the liability at the~~ ~~**cease-use date**~~ ~~shall be determined based on the remaining lease rentals, adjusted for the effects of any prepaid or deferred items recognized under the lease, and reduced by estimated sublease rentals that could be reasonably obtained for the property, even if the entity does not intend to enter into a sublease. Remaining lease rentals shall not be reduced to an amount less than zero.~~

45. Supersede paragraphs 420-10-55-11 through 55-15 and their related heading, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

~~> > Example 4: Costs to Terminate an Operating Lease~~

420-10-55-11 Paragraph superseded by Accounting Standards Update 201X-XX. ~~This Example illustrates the guidance in paragraphs 420-10-25-11 through 25-13 and paragraphs 420-10-30-7 through 30-9 related to terminating an operating lease at the~~ ~~**cease-use date**~~ ~~and after the cease-use date.~~

420-10-55-12 Paragraph superseded by Accounting Standards Update 201X-XX. ~~An entity leases a facility under an operating lease that requires the entity to pay lease rentals of $100,000 per year for 10 years. After using the facility for five years, the entity commits to an exit plan. In connection with that plan, the entity will cease using the facility in 1 year (after using the facility for 6 years), at which time the remaining lease rentals will be $400,000 ($100,000 per year for the remaining term of 4 years). In accordance with paragraphs 420-10-30-7 through 30-9, a liability for the remaining lease rentals, reduced by actual (or estimated) sublease rentals, would be recognized and measured at its fair value at the cease-use date (as illustrated in the following paragraph). In accordance with paragraphs 420-10-35-1 through 35-4, the liability would be adjusted for changes, if any, resulting from revisions to estimated cash flows after the cease-use date, measured using the credit-adjusted risk-free rate that was used to measure the liability initially (as illustrated in paragraph 420-10-55-15).~~

420-10-55-13 Paragraph superseded by Accounting Standards Update 201X-XX. ~~Based on market rentals for similar leased property, the entity determines that if it desired, it could sublease the facility and receive sublease rentals of $300,000 ($75,000 per year for the remaining lease term of 4 years). However, for competitive reasons, the entity decides not to sublease the facility (or otherwise terminate the lease) at the cease-use date. The fair value of the liability at the cease-use date is $89,427, estimated using an expected present value technique. The expected net cash flows of $100,000 ($25,000 per year for the remaining lease term of 4 years) are discounted using a credit-adjusted risk-free rate of 8 percent. In this case, a risk premium is not considered in the present value measurement. Because the lease rentals are fixed by contract and the estimated sublease rentals are based on market prices for similar leased property for other entities having similar credit standing as the entity, there is little uncertainty in the amount and timing of the expected cash flows used in estimating fair value at the cease-use date and any risk premium would be insignificant. In other circumstances, a risk premium would be appropriate if it is~~

~~significant. Thus, a liability (expense) of $89,427 would be recognized at the cease-use date.~~

420-10-55-14 Paragraph superseded by Accounting Standards Update 201X-XX. ~~Accretion expense would be recognized after the cease-use date in accordance with the guidance beginning in paragraph 420-10-35-1 and in paragraph 420-10-45-5. (The entity will recognize the impact of deciding not to sublease the property over the period the property is not subleased. For example, in the first year after the cease-use date, an expense of $75,000 would be recognized as the impact of not subleasing the property, which reflects the annual lease payment of $100,000 net of the liability extinguishment of $25,000.)~~

420-10-55-15 Paragraph superseded by Accounting Standards Update 201X-XX. ~~At the end of one year, the competitive factors referred to above are no longer present. The entity decides to sublease the facility and enters into a sublease. The entity will receive sublease rentals of $250,000 ($83,333 per year for the remaining lease term of 3 years), negotiated based on market rentals for similar leased property at the sublease date. The entity adjusts the carrying amount of the liability at the sublease date to $46,388 to reflect the revised expected net cash flows of $50,000 ($16,667 per year for the remaining lease term of 3 years), which are discounted at the credit-adjusted risk-free rate that was used to measure the liability initially (8 percent). Accretion expense would be recognized after the sublease date in accordance with the guidance beginning in paragraph 420-10-35-1 and in paragraph 420-10-45-5.~~

Amendments to Subtopic 440-10

46. Amend paragraphs 440-10-25-1 through 25-2, with a link to transition paragraph 842-10-65-1, as follows:

Commitments—Overall

Recognition

Unconditional Purchase Obligations

440-10-25-1 Depending on its terms, an **unconditional purchase obligation** can be subject to the guidance in Topic 842 on leases, ~~840,~~ to the guidance in Topic 815, or to neither.

440-10-25-2 The guidance in ~~Section 840-10-15 and paragraph 840-10-55-26~~ Topic 842 shall be applied first to determine whether an unconditional purchase obligation is within the scope of that Topic ~~840~~.

47. Amend paragraphs 440-10-50-1 and 440-10-50-3, with a link to transition paragraph 842-10-65-1, as follows:

Disclosure

General

440-10-50-1 Notwithstanding more explicit disclosures required elsewhere in this Codification, all of the following situations shall be disclosed in financial statements:

a. Unused letters of credit
b. Leases (see Topic 842)~~Long-term leases (see Sections 840-10-50, 840-20-50, and 840-30-50)~~
c. Assets pledged as security for loans
d. Pension plans (see Section 715-20-50)
e. The existence of cumulative preferred stock dividends in arrears
f. Commitments, including:
   1. A commitment for plant acquisition
   2. An obligation to reduce debts
   3. An obligation to maintain working capital
   4. An obligation to restrict dividends.

Unconditional Purchase Obligations

440-10-50-3 Future ~~minimum~~ lease payments under leases that meet the conditions in the preceding paragraph need not be disclosed in accordance with the following paragraph or paragraph 440-10-50-6 if those future ~~minimum~~ lease payments are disclosed in accordance with Topic 842.~~the Lessees Subsections of Sections 840-10-50; 840-20-50; and 840-30-50.~~

48. Amend paragraphs 440-10-60-12 through 60-13, with a link to transition paragraph 842-10-65-1, as follows:

Relationships

> Leases

440-10-60-12 For commitments under lease agreements, see Topic 842.~~Topic 840.~~

440-10-60-13 For nuclear fuel leases structured as **take-or-pay contracts**, consider whether the arrangement is within the scope of Topic 842 on leases.~~see paragraph 840-10-55-7.~~

Amendments to Subtopic 450-10

49. Amend paragraph 450-10-60-8, with a link to transition paragraph 842-10-65-1, as follows:

Contingencies—Overall

Relationships

> Leases

450-10-60-8 For variable lease payments,~~contingent rentals,~~ see Topic 842 on leases.~~paragraph 840-10-25-35.~~

Amendments to Subtopic 450-20

50. Amend paragraph 450-20-60-15 and supersede paragraph 450-20-60-16, with a link to transition paragraph 842-10-65-1, as follows:

Contingencies—Loss Contingencies

Relationships

> Leases

450-20-60-15 For variable lease payments,~~contingent rent,~~ see Topic 842 on leases.~~paragraph 840-10-25-35.~~

450-20-60-16 Paragraph superseded by Accounting Standards Update 201X-XX.~~For the classification effects of a provision in a lease that requires lessee indemnifications for environmental contamination caused by the lessee during its use of the property, see paragraph 840-10-25-12.~~

Amendments to Subtopic 450-30

51. Amend paragraph 450-30-60-5, with a link to transition paragraph 842-10-65-1, as follows:

Contingencies—Gain Contingencies

Relationships

> Leases

450-30-60-5 For a lessor's accounting for income from variable lease payments, ~~contingent rental income,~~ see Topic 842. ~~paragraph 840-10-50-5.~~

Amendments to Subtopic 460-10

52. Amend paragraph 460-10-15-7, with a link to transition paragraph 842-10-65-1, as follows:

Guarantees—Overall

Scope and Scope Exceptions

> Transactions

> > Transactions That Are Excluded from the Scope of This Topic

460-10-15-7 The guidance in this Topic does not apply to the following types of guarantee contracts:

a. A guarantee or an indemnification that is excluded from the scope of Topic 450 (see paragraph 450-20-15-2—primarily employment-related guarantees)
b. A lessee's guarantee of the residual value of the leased ~~property~~ asset at the expiration of the **lease term** under Topic 842~~, if the lessee (guarantor) accounts for the lease as a capital lease under Subtopic 840-30~~
c. A contract that meets the characteristics in paragraph 460-10-15-4(a) but is accounted for as variable lease payments ~~contingent rent~~ under Topic 842~~Subtopic 840-30~~
d. A guarantee (or an indemnification) that is issued by either an insurance entity or a reinsurance entity and accounted for under Topic 944 (including guarantees embedded in either insurance contracts or investment contracts)
e. A contract that meets the characteristics in paragraph 460-10-15-4(a) but provides for payments that constitute a vendor rebate (by the

guarantor) based on either the sales revenues of, or the number of units sold by, the guaranteed party

f. A contract that provides for payments that constitute a vendor rebate (by the guarantor) based on the volume of purchases by the buyer (because the underlying relates to an asset of the seller, not the buyer who receives the rebates)
g. A guarantee or an indemnification whose existence prevents the guarantor from being able to either account for a transaction as the sale of an asset that is related to the guarantee's underlying or recognize in earnings the profit from that sale transaction
h. A registration payment arrangement within the scope of Subtopic 825-20 (see Section 825-20-15)
i. A guarantee or an indemnification of an entity's own future performance (for example, a guarantee that the guarantor will not take a certain future action)
j. A guarantee that is accounted for as a **credit derivative** at fair value under Topic 815.

For related implementation guidance, see Section 460-10-55.

53. Amend paragraph 460-10-25-1, with a link to transition paragraph 842-10-65-1, as follows:

Recognition

460-10-25-1 The following types of guarantees are not subject to the recognition provisions of this Subsection:

a. A guarantee that is accounted for as a derivative instrument at fair value under Topic 815.
b. A product **warranty** or other guarantee for which the **underlying** is related to the performance (regarding function, not price) of nonfinancial assets that are owned by the guaranteed party (see paragraph 460-10-15-9 for related guidance).
c. A guarantee issued in a business combination or an **acquisition by a not-for-profit entity** that represents contingent consideration (as addressed in Subtopics 805-30 and 958-805).
d. A guarantee for which the guarantor's obligation would be reported as an equity item rather than a liability under generally accepted accounting principles (GAAP) (see Topics 480 and 505).
e. A guarantee by an original lessee that has become secondarily liable under a new lease that relieved the original lessee from being the primary obligor (that is, principal debtor) under the original lease. ~~lease, as discussed in paragraph 840-30-40-5.~~ This exception shall not be applied by analogy to secondary obligations that are not accounted for under the original lease. ~~that paragraph.~~

f. A guarantee issued either between parents and their subsidiaries or between corporations under common control.
g. A parent's guarantee of its subsidiary's debt to a third party (whether the parent is a corporation or an individual).
h. A subsidiary's guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.

54. Amend paragraph 460-10-30-2, with a link to transition paragraph 842-10-65-1, as follows:

Initial Measurement

> Fair Value Objective

460-10-30-2 Except as indicated in paragraphs 460-10-30-3 through 30-4, the objective of the initial measurement of a guarantee liability is the fair value of the guarantee at its inception. For example:

a. If a guarantee is issued in a standalone arm's-length transaction with an unrelated party, the liability recognized at the inception of the guarantee shall be the premium received or receivable by the guarantor as a practical expedient.
b. If a guarantee is issued as part of a transaction with multiple elements with an unrelated party (such as in conjunction with selling an asset), ~~asset or entering into an operating lease),~~ the liability recognized at the inception of the guarantee should be an estimate of the guarantee's fair value. In that circumstance, a guarantor shall consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm's-length transaction with an unrelated party as a practical expedient.
c. If a guarantee is issued as a contribution to an unrelated party, the liability recognized at the inception of the guarantee shall be measured at its fair value, consistent with the requirement to measure the contribution made at fair value, as prescribed in Section 720-25-30. For related implementation guidance, see paragraph 460-10-55-14.

55. Amend paragraph 460-10-55-23, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Recognition and Measurement Guidance—Overall Guidance

460-10-55-23 Although paragraph 460-10-25-4 does not prescribe a specific account, the following illustrate a guarantor's offsetting entries when it recognizes the liability at the inception of the guarantee:

a. If the guarantee were issued in a standalone transaction for a premium, the offsetting entry would be consideration received (such as cash or a receivable).
b. If the guarantee were issued in conjunction with the sale of assets, a product, or a business, the overall proceeds (such as the cash received or receivable) would be allocated between the consideration being remitted to the guarantor for issuing the guarantee and the proceeds from the sale. That allocation would affect the calculation of the gain or loss on the sale transaction.
c. If the guarantee were issued in conjunction with the formation of a partially owned business or a venture accounted for under the equity method, the recognition of the liability for the guarantee would result in an increase to the carrying amount of the investment.
d. Subparagraph superseded by Accounting Standards Update 201X-XX.~~If a residual value guarantee were provided by a lessee-guarantor when entering into an operating lease, the offsetting entry (representing a payment in kind made by the lessee when entering into the operating lease) would be reflected as prepaid rent, which would be accounted for under Section 840-20-25.~~
e. If a guarantee were issued to an unrelated party for no consideration on a standalone basis (that is, not in conjunction with any other transaction or ownership relationship), the offsetting entry would be to expense.

56. Add paragraph 460-10-60-15A and supersede paragraphs 460-10-60-16 through 60-27 and 460-10-60-29 through 60-33, with a link to transition paragraph 842-10-65-1, as follows:

Relationships

> Leases

460-10-60-15A For leases, see Topic 842.

460-10-60-16 Paragraph superseded by Accounting Standards Update 201X-XX. ~~For the effect on the lease term of a provision or condition that in substance is a guarantee of a lessor's debt or a loan to a lessor by the lessee that is related to the leased property but is structured in such a manner that it does not represent a direct guarantee or loan, see the definition of **lease term**.~~

460-10-60-17 Paragraph superseded by Accounting Standards Update 201X-XX. ~~For the effects on minimum lease payments of a guarantee by the lessee of the lessor's debt, see paragraph 840-10-25-5.~~

460-10-60-18 Paragraph superseded by Accounting Standards Update 201X-XX. ~~For the effects on minimum lease payments of a guarantee by the lessee of the residual value of the leased property at the expiration of the lease term, see paragraphs 840-10-25-6 and 840-10-55-8 through 55-10.~~

460-10-60-19 Paragraph superseded by Accounting Standards Update 201X-XX. ~~For allocation of a residual value or first-loss guarantee to minimum lease payments in leases involving land and building(s), see paragraphs 840-10-25-21 through 25-22.~~

460-10-60-20 Paragraph superseded by Accounting Standards Update 201X-XX. ~~For a determination of whether a residual value guarantee is subject to the requirements of Topic 815, see paragraph 840-10-15-20.~~

460-10-60-21 Paragraph superseded by Accounting Standards Update 201X-XX. ~~For the classification of a lease that includes a commitment by a lessor to guarantee performance of the leased property in a manner more extensive than a typical product **warranty** or to effectively protect the lessee from obsolescence of the leased property, see paragraphs 840-10-25-42 through 25-43.~~

460-10-60-22 Paragraph superseded by Accounting Standards Update 201X-XX. ~~For a manufacturer's guarantee of the resale value of equipment to the purchaser, see paragraphs 840-10-55-12 through 55-25.~~

460-10-60-23 Paragraph superseded by Accounting Standards Update 201X-XX. ~~For a lessee's indemnification for environmental contamination, see paragraph 840-10-25-13.~~

460-10-60-24 Paragraph superseded by Accounting Standards Update 201X-XX. ~~For a guarantee by a lessee of the leased property's residual value in an operating lease transaction, see paragraph 840-20-30-1.~~

460-10-60-25 Paragraph superseded by Accounting Standards Update 201X-XX. ~~For a guarantee by a lessee of the leased property's residual value in a capital lease transaction, see Section 840-30-35.~~

460-10-60-26 Paragraph superseded by Accounting Standards Update 201X-XX. ~~For classification of a lease that contains an entity's unsecured guarantee of its own lease payments, see paragraph 840-40-25-15.~~

460-10-60-27 Paragraph superseded by Accounting Standards Update 201X-XX. ~~For classification of a lease that contains an unsecured guarantee of the lease payments of one member of a consolidated group by another member of the consolidated group, see paragraph 840-40-25-16.~~

460-10-60-28 Paragraph superseded by Accounting Standards Update No. 2012-04.

460-10-60-29 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u> ~~For an indemnification or guarantee of an owner-lessor against third-party claims relating to construction completion in a sale-leaseback transaction, see paragraph 840-40-55-9.~~

460-10-60-30 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u> ~~For an indemnification or guarantee of an owner-lessor against third-party damage claims other than claims caused by or resulting from the lessee's own actions or failures to act while in possession or control of the construction project in a sale-leaseback transaction, see paragraph 840-40-55-15.~~

460-10-60-31 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u> ~~For an indemnification or guarantee by the seller-lessee to a party other than the owner-lessor in a sale-leaseback transaction, see paragraph 840-40-55-15.~~

460-10-60-32 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u> ~~For a guarantee by the seller-lessee of the leased property's residual value in a sale-leaseback transaction, see paragraph 840-40-55-26.~~

460-10-60-33 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u> ~~For the effect of providing an independent third-party guarantee of the lease payments in a sale-leaseback transaction, see paragraph 840-40-25-14.~~

Amendments to Subtopic 470-10

57. Amend paragraph 470-10-60-4, with a link to transition paragraph 842-10-65-1, as follows:

Debt—Overall

Relationships

> Leases

470-10-60-4 For guidance on the classification of obligations under ~~capital~~ leases, see <u>Topic 842 on leases.</u>~~paragraphs 840-30-45-1 through 45-3.~~

Amendments to Subtopic 470-60

58. Amend paragraph 470-60-15-11, with a link to transition paragraph 842-10-65-1, as follows:

Debt—Troubled Debt Restructurings by Debtors

Scope and Scope Exceptions

> Other Considerations

> > Troubled Debt Restructuring

470-60-15-11 For purposes of this Subtopic, none of the following are considered troubled debt restructurings:

a. Changes in lease agreements (for guidance, see Topic 842)~~840)~~
b. Changes in employment-related agreements, for example, pension plans and deferred compensation contracts
c. Unless they involve an agreement between debtor and creditor to restructure, neither of the following:
    1. Debtors' failures to pay trade accounts according to their terms
    2. Creditors' delays in taking legal action to collect overdue amounts of interest and principal.

Amendments to Subtopic 605-10

[Note: The FASB's project on revenue recognition released an Exposure Draft that would change this Subtopic. Because that guidance is not final, the proposed amendments in this Exposure Draft on leases are to current U.S. GAAP.]

59. Amend paragraph 605-10-05-1(b), with a link to transition paragraph 842-10-65-1, as follows:

Revenue Recognition—Overall

Overview and Background

605-10-05-1 The Revenue Recognition Topic provides guidance for transaction-specific revenue recognition and certain matters related to revenue-generating activities that are not addressed specifically in other Topics. Other Topics may contain transaction-specific revenue recognition guidance related to transactions in those Topics. This Topic includes the following Subtopics:

b. Products. The Products Subtopic provides guidance on the following:
    1. Sales with a right of return

2. Repurchases of product sold subject to a~~an operating~~ lease.

Amendments to Subtopic 605-15

[Note: The FASB's project on revenue recognition released an Exposure Draft that would change this Subtopic. Because that guidance is not final, the proposed amendments in this Exposure Draft on leases are to current U.S. GAAP.]

60. Amend paragraphs 605-15-05-1 and 605-15-05-6 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Revenue Recognition—Products

Overview and Background

605-15-05-1 This Subtopic specifies the accounting for sales of products if either:

a. The buyer has a right to return the product.
b. The product sold is subsequently repurchased subject to a~~an operating~~ lease.

> Product Sold and Subsequently Repurchased Subject to a~~an Operating~~ Lease

605-15-05-6 A manufacturer may sell finished products to dealers who, in turn, sell or lease the products to end users (customers). The customers may be individuals or independent entities. The customers may pay cash for their purchases, finance their purchases using their own financing sources, or use sources available through the dealer. The finance sources may include lease arrangements provided by commercial banks and other finance companies, including the manufacturer or an affiliate of the manufacturer (finance affiliate). Thus, a manufacturer may sell a product to a dealer and the customer subsequently may enter into a~~an operating~~ lease with the manufacturer or its finance affiliate that acquires that product subject to the lease.

61. Amend paragraph 605-15-15-2, with a link to transition paragraph 842-10-65-1, as follows:

Scope and Scope Exceptions

> Transactions

605-15-15-2 The guidance in this Subtopic applies to the following transactions:

a. Sales in which a product may be returned, whether as a matter of contract or as a matter of existing practice, either by the ultimate customer or by a party who resells the product to others. The product may be returned for a refund of the purchase price, for a credit applied to amounts owed or to be owed for other purchases, or in exchange for other products. The purchase price or credit may include amounts related to incidental services, such as installation. However, exchanges by ultimate customers of one item for another of the same kind, quality, and price (for example, one color or size for another) are not considered returns for purposes of this Subtopic.
b. Sales by a manufacturer who repurchases the product subject to a~~an operating~~ lease with the buyer.

62. Amend paragraph 605-15-25-5 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Recognition

> Product Sold and Subsequently Repurchased Subject to a ~~an Operating~~ Lease

605-15-25-5 If, as described in paragraph 605-15-05-6, a manufacturer sells a product to a dealer and the customer subsequently enters into a~~an operating~~ lease with the manufacturer or its finance affiliate that acquires that product subject to the lease, the manufacturer may recognize a sale at the time the product is transferred to the dealer if all of the following conditions exist:

a. The dealer is a substantive and independent entity that transacts business separately with the manufacturer and customers.
b. The manufacturer has delivered the product to the dealer, and the risks and rewards of ownership have passed to the dealer, including responsibility for the ultimate sale of the product and for insurability, theft, or damage. A customer’s failure to enter into a lease with the finance affiliate (or manufacturer) would not allow the dealer to return the product to the manufacturer.
c. The finance affiliate (or manufacturer) has no legal obligation to provide a lease arrangement to a potential customer of the dealer at the time the product is delivered to the dealer.
d. The customer has other financing alternatives available from parties unaffiliated with the manufacturer, and the customer is in control of the selection from the financing alternatives.

Amendments to Subtopic 605-25

[Note: The FASB's project on revenue recognition released an Exposure Draft that would change this Subtopic. Because that guidance is not final, the proposed amendments in this Exposure Draft on leases are to current U.S. GAAP.]

63. Amend paragraphs 605-25-15-3 through 15-3A, with a link to transition paragraph 842-10-65-1, as follows:

Revenue Recognition—Multiple-Element Arrangements

Scope and Scope Exceptions

> Transactions

> > Interaction with Other Codification Topics

605-25-15-3 A multiple-deliverable arrangement may be within the scope of another Codification Topic. Those Topics include all of the following:

a. For leases, see Topic <u>842.</u>~~840.~~
b. For franchisors, see Topic 952.
c. For property, plant, and equipment, see Topic 360; specifically, Subtopic 360-20.
d. For guarantees, see Topic 460.
e. For revenue recognition, see Topic 605; specifically, Subtopics 605-20 and 605-35.
f. For software, see Topic 985; specifically, Subtopic 985-605.
g. For entertainment—films, see Topic 926; specifically, Subtopic 926-605.

605-25-15-3A Those Topics may provide guidance with respect to whether and how to allocate consideration of a multiple-deliverable arrangement. Whether deliverables are within the scope of those other Topics is determined by the scope provisions of those Topics, without regard to the order of delivery of that item in the arrangement. The following describes the three categories into which the other Codification Topics fall and the application of this Subtopic or the other Topics in determining separate units of accounting and allocating arrangement consideration:

a. Other Topics address both separation and allocation. If another Topic provides guidance regarding the determination of separate units of accounting and how to allocate arrangement consideration to those separate units of accounting, the arrangement or the deliverables in the arrangement that is within the scope of that Topic shall be accounted for in accordance with the relevant provisions of that Topic rather than the guidance in this Subtopic.

b. Other Topics address separation, but not allocation. If another Topic provides guidance requiring separation of deliverables within the scope of that Topic from deliverables not within the scope of that Topic, but does not specify how to allocate arrangement consideration to each separate unit of accounting, such allocation shall be based on the relative selling price of the deliverables within the scope of that Topic and the deliverables not within the scope of that Topic. ~~For example, leased assets are required to be accounted for separately under the guidance in Subtopics 840-20 and 840-30.~~ See paragraph 605-25-55-3. (For purposes of the allocation between deliverables within the scope of another Topic and deliverables not within the scope of that other Topic, the selling price shall be determined using the guidance as discussed in paragraphs 605-25-30-6A through 30-6B.) Subsequent identification of separate units of accounting and allocation of arrangement consideration to the deliverables not subject to that other Topic would be governed by the provisions of this Subtopic.

c. Other Topics address neither separation nor allocation. If another Topic provides no guidance regarding the separation of the deliverables within the scope of that Topic from those deliverables that are not or the allocation of arrangement consideration to deliverables within the scope of that Topic and to those that are not, then the guidance in this Subtopic shall be followed for purposes of such separation and allocation. (For example, Subtopic 605-35 provides separation and allocation guidance [segmentation provisions] for deliverables within its scope. However, that Subtopic does not provide separation and allocation guidance for deliverables within its scope and deliverables not within its scope.) In such circumstances, it is possible that a deliverable subject to the guidance of another Topic does not meet the criteria in paragraph 605-25-25-5 to be considered a separate unit of accounting. In that event, the arrangement consideration allocable to such deliverable shall be combined with the amount allocable to the other applicable undelivered items within the arrangement. The appropriate recognition of revenue then shall be determined for those combined deliverables as a single unit of accounting.

64. Supersede paragraphs 605-25-55-2 through 55-3 and their related heading, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

~~> > Multiple Deliverables in an Arrangement that Includes Leased Equipment~~

605-25-55-2 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u> ~~The following provides implementation guidance on how to allocate arrangement consideration to each separate unit of accounting when a multiple-deliverable arrangement contains deliverables that are within the scope of other Topics and those Topics only provide guidance on how to separate the deliverables (see paragraph 605-25-15-3A(b)).~~

605-25-55-3 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u> ~~For example, leased assets are required to be accounted for separately under the guidance in Subtopics 840-20 and 840-30. Consider an arrangement that includes the lease of equipment under an operating lease, the maintenance of the leased equipment throughout the lease term (executory cost), and the sale of additional equipment unrelated to the leased equipment. The arrangement consideration should be allocated between the deliverables subject to the guidance in Subtopic 840-20 and the other deliverables using the relative selling price method. (Although Topic 840 does not provide guidance regarding the accounting for executory costs, it does provide guidance regarding the allocation of arrangement consideration between the lease and the executory cost elements of an arrangement. Therefore, this example refers to the leased equipment and the related maintenance as deliverables subject to the guidance in that Topic.) The guidance in Topic 840 would then be applied to separate the maintenance from the leased equipment and to allocate the related arrangement consideration to those two deliverables. This Subtopic would be applied to further separate any deliverables not subject to the guidance in Topic 840 and to allocate the related arrangement consideration.~~

Amendments to Subtopic 605-30

[Note: The FASB's project on revenue recognition released an Exposure Draft that would change this Subtopic. Because that guidance is not final, the proposed amendments in this Exposure Draft on leases are to current U.S. GAAP.]

65. Amend paragraph 605-30-25-1, with a link to transition paragraph 842-10-65-1, as follows:

Revenue Recognition—Rights to Use

Recognition

605-30-25-1 The following locations, among others in the Codification, provide guidance on rights to use:

a. For revenue from arrangements for the license of a record master or music copyright, see Section 928-605-25.
b. For sales or licensing of films by producers or distributors of films, see Section 926-605-25.
c. For arrangements to license, sell, lease, or otherwise market computer software, see Section 985-605-25.
d. For arrangements under which a vendor will perform multiple revenue-generating activities (that is, provide multiple deliverables), which may include providing the right to use assets, see Subtopic 605-25.
e. For arrangements to lease certain types of assets, see Topic 842.~~840.~~

Amendments to Subtopic 605-50

[Note: The FASB's project on revenue recognition released an Exposure Draft that would change this Subtopic. Because that guidance is not final, the proposed amendments in this Exposure Draft on leases are to current U.S. GAAP.]

66. Supersede paragraph 605-50-60-1 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Revenue Recognition—Customer Payments and Incentives

Relationships

~~**> Leases**~~

605-50-60-1 Paragraph superseded by Accounting Standards Update 201X-XX. ~~For guidance regarding the effect on revenue recognition of a manufacturer selling equipment with an expected useful life of several years with guarantees as to minimum resale values, see the implementation guidance in paragraphs 840-10-55-12 through 55-25.~~

Amendments to Subtopic 740-10

67. Amend paragraph 740-10-25-3(c), with a link to transition paragraph 842-10-65-1, as follows:

Income Taxes—Overall

Recognition

740-10-25-2 Other than the exceptions identified in the following paragraph, the following basic requirements are applied in accounting for income taxes at the date of the financial statements:

a. A tax liability or asset shall be recognized based on the provisions of this Subtopic applicable to tax positions, in paragraphs 740-10-25-5 through 25-17, for the estimated taxes payable or refundable on tax returns for the current and prior years.
b. A **deferred tax liability** or **asset** shall be recognized for the estimated future tax effects attributable to **temporary differences** and **carryforwards**.

740-10-25-3 The only exceptions in applying those basic requirements are:

c. Subparagraph superseded by Accounting Standards Update 201X-XX. ~~The pattern of recognition of after-tax income for leveraged leases or the allocation of the purchase price in a purchase business combination to acquired leveraged leases as required by Subtopic 840-30~~

68. Amend paragraphs 740-10-55-22, 740-10-55-156, and 740-10-55-158, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Application of Accounting Requirements for Income Taxes to Specific Situations

> > > The Need to Schedule Temporary Difference Reversals

740-10-55-22 Minimizing complexity is an appropriate consideration in selecting a method for determining reversal patterns. The methods used for determining reversal patterns should be systematic and logical. The same method should be used for all temporary differences within a particular category of temporary differences for a particular tax jurisdiction. Different methods may be used for different categories of temporary differences. If the same temporary difference exists in two tax jurisdictions (for example, U.S. federal and a state tax jurisdiction), the same method should be used for that temporary difference in both tax jurisdictions. The same method for a particular category in a particular tax jurisdiction should be used consistently from year to year. A change in method is a change in accounting principle under the requirements of Topic 250. An example ~~Two examples~~ of a category of temporary differences is~~are those related to~~ liabilities for deferred compensation.~~compensation and investments in direct financing and sales-type leases.~~

> Illustrations

> > Example 20: Interaction of Loss Carryforwards and Temporary Differences

740-10-55-156 This Example illustrates the guidance in paragraph 740-10-55-37 for the interaction of loss carryforwards and temporary differences that will result in net deductible amounts in future years. This Example has the following assumptions:

a. The financial loss and the loss reported on the tax return for an entity's first year of operations are the same.
b. In Year 2, a gain of $2,500 from a transaction that is a sale for tax purposes but does not meet the sale recognition criteria for financial reporting purposes ~~a sale and leaseback for financial reporting~~ is the only difference between pretax financial income and taxable income.

740-10-55-157 Financial and taxable income in this Example are as follows.

	Financial Income	Taxable Income
Year 1: Income (loss) from operations	$ (4,000)	$ (4,000)
Year 2: Income (loss) from operations	$ -	$ -
Taxable gain on sale		2,500
Taxable income before loss carryforward		2,500
Loss carryforward from Year 1		(4,000)
Taxable income		$ -

740-10-55-158 The $4,000 operating loss carryforward at the end of Year 1 is reduced to $1,500 at the end of Year 2 because $2,500 of it is used to reduce taxable income. The $2,500 reduction in the loss carryforward becomes $2,500 of deductible temporary differences that will reverse and result in future tax deductions.~~deductions when lease payments are made.~~ The entity has no deferred tax liability to be offset by those future tax deductions, the future tax deductions cannot be realized by loss carryback because no taxes have been paid, and the entity has had pretax losses for financial reporting since inception. Unless positive evidence exists that is sufficient to overcome the negative evidence associated with those losses, a valuation allowance is recognized at the end of Year 2 for the full amount of the deferred tax asset related to the $2,500 of deductible temporary differences and the remaining $1,500 of operating loss carryforward.

69. Supersede paragraph 740-10-60-4 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Relationships

~~**> Leases**~~

740-10-60-4 Paragraph superseded by Accounting Standards Update 201X-XX. ~~For the specific requirements for accounting for income taxes related to leveraged leases, see Subtopic 840-30.~~

Amendments to Subtopic 740-270

70. Supersede paragraph 740-270-30-15, with a link to transition paragraph 842-10-65-1, as follows:

Income Taxes—Interim Reporting

Initial Measurement

> Exclusion of Items from Estimated Annual Effective Tax Rate

> > Certain Tax Credits

740-270-30-15 Paragraph superseded by Accounting Standards Update 201X-XX. ~~Further, paragraphs 840-30-30-14 and 840-30-35-34 through 35-35 require that investment tax credits related to leases that are accounted for as leveraged leases shall be deferred and accounted for as return on the net investment in the leveraged leases in the years in which the net investment is positive and explains that the use of the term *years* is not intended to preclude application of the~~

~~accounting described to shorter periods. If an entity accounts for investment tax credits related to leveraged leases in accordance with those paragraphs for interim periods, those investment tax credits shall not be taken into account in estimating the annual effective tax rate.~~

Amendments to Subtopic 805-10

71. Amend paragraph 805-10-55-44, with a link to transition paragraph 842-10-65-1, as follows:

Business Combinations—Overall

Implementation Guidance and Illustrations

805-10-55-44 Paragraph 805-20-50-1(b)

> The fair value of the financial assets acquired includes receivables under ~~capital~~Type A leases of data networking equipment with a fair value of $2,000. The gross amount due under the contracts is $3,100, of which $450 is expected to be uncollectible.

Amendments to Subtopic 805-20

72. Amend paragraphs 805-20-25-5, 805-20-25-8 through 25-9, and 805-20-25-16 through 25-17, supersede paragraphs 805-20-25-11 through 25-13 and their related heading, and add paragraphs 805-20-25-29 through 25-30 and their related heading, with a link to transition paragraph 842-10-65-1, as follows:

Business Combinations—Identifiable Assets and Liabilities, and Any Noncontrolling Interest

Recognition

> Recognition Principle

> > Recognition Conditions

805-20-25-5 Paragraphs ~~805-20-25-11 through 25-13 provide guidance on recognizing operating leases and paragraphs~~ 805-20-55-2 through 55-45 provide guidance on recognizing ~~other~~ intangible assets. Paragraphs 805-20-25-17 through ~~25-28~~ 25-30 specify the types of identifiable assets and liabilities that include items for which this Subtopic and Subtopic 805-740 provide limited exceptions to the recognition principle and conditions in paragraphs 805-20-25-1 through 25-3.

> > Classifying or Designating Identifiable Assets Acquired and Liabilities Assumed in a Business Combination

805-20-25-6 At the acquisition date, the acquirer shall classify or designate the identifiable assets acquired and liabilities assumed as necessary to subsequently apply other GAAP. The acquirer shall make those classifications or designations on the basis of the contractual terms, economic conditions, its operating or accounting policies, and other pertinent conditions as they exist at the acquisition date.

805-20-25-8 This Section provides the following two exceptions to the principle in paragraph 805-20-25-6:

a. Classification of a lease ~~contract~~ as either a Type A lease or a Type B lease ~~an operating lease or a capital lease~~ in accordance with Topic 842.~~the guidance in paragraph 840-10-25-27~~ The acquirer shall classify leases on the basis of the contractual terms and conditions at the commencement date of the lease. If the contractual terms and conditions of a lease are modified, resulting in a substantive change to the original lease, the acquirer shall classify any new lease on the basis of the contractual terms and conditions at the commencement date of the new lease, which might be the acquisition date.
b. Classification of a contract written by an entity that is in the scope of Subtopic 944-10 as an insurance or reinsurance contract or a deposit contract. The acquirer shall classify those contracts on the basis of the contractual terms and other factors at the inception of the contract (or, if the terms of the contract have been modified in a manner that would change its classification, at the date of that modification, which might be the acquisition date).

~~The acquirer shall classify those contracts on the basis of the contractual terms and other factors at the inception of the contract (or, if the terms of the contract have been modified in a manner that would change its classification, at the date of that modification, which might be the acquisition date).~~

> Recognizing Particular Assets Acquired and Liabilities Assumed

805-20-25-9 Guidance on recognizing identifiable intangible assets, including ~~operating leases and~~ reacquired rights follows.

> > Identifiable Intangible Assets

805-20-25-10 The acquirer shall recognize separately from goodwill the identifiable intangible assets acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion described in the definition of identifiable. Additional guidance on applying that definition is provided in paragraphs 805-20-25-14 through 25-15, 805-20-55-2 through 55-45, and Example 1 (see paragraph 805-20-55-52). For guidance on the recognition and subsequent measurement of a **defensive intangible asset**, see Subtopic 350-30.

~~> > Operating Leases~~

805-20-25-11 Paragraph superseded by Accounting Standards Update 201X-XX.~~The acquirer shall recognize no assets or liabilities related to an operating lease in which the acquiree is the lessee except as required by paragraphs 805-20-25-12 through 25-13.~~

805-20-25-12 Paragraph superseded by Accounting Standards Update 201X-XX.~~Regardless of whether the acquiree is the lessee or the lessor, the acquirer shall determine whether the terms of each of an acquiree's operating leases are favorable or unfavorable compared with the market terms of leases of the same or similar items at the acquisition date. The acquirer shall recognize an intangible asset if the terms of an operating lease are favorable relative to market terms and a liability if the terms are unfavorable relative to market terms.~~

805-20-25-13 Paragraph superseded by Accounting Standards Update 201X-XX.~~An identifiable intangible asset may be associated with an operating lease, which may be evidenced by market participants' willingness to pay a price for the lease even if it is at market terms. For example, a lease of gates at an airport or of retail space in a prime shopping area might provide entry into a market or other future economic benefits that qualify as identifiable intangible assets, such as a customer relationship. In that situation, the acquirer shall recognize the associated identifiable intangible asset(s) in accordance with paragraph 805-20-25-10.~~

> Exceptions to the Recognition Principle

805-20-25-16 This Topic provides limited exceptions to the recognition and measurement principles applicable to business combinations. Paragraphs 805-20-25-17 through ~~25-28~~25-30 specify the types of identifiable assets and liabilities that include items for which this Subtopic provides limited exceptions to the recognition principle in paragraph 805-20-25-1. The acquirer shall apply the specified GAAP or the specified requirements rather than that recognition principle to determine when to recognize the assets or liabilities identified in paragraphs 805-20-25-17 through ~~25-28.~~ 25-30. That will result in some items being recognized either by applying recognition conditions in addition to those in paragraphs 805-20-25-2 through 25-3 or by applying the requirements of other GAAP, with results that differ from applying the recognition principle and conditions in paragraphs 805-20-25-1 through 25-3.

805-20-25-17 Guidance is presented on all of the following exceptions to the recognition principle:

a. Assets and liabilities arising from contingencies
b. Income taxes
c. Employee benefits
d. Indemnification assets.
e. Leases.

> > Leases

805-20-25-29 The acquirer shall recognize assets and liabilities arising from leases in accordance with Topic 842 (taking into account the requirements in paragraphs 805-20-25-8(a) and 805-20-25-30), and shall initially measure those assets and liabilities in accordance with paragraphs 805-20-30-23A through 30-23C.

805-20-25-30 The acquirer shall not recognize assets or liabilities at the acquisition date for leases that, at that date, have a remaining maximum possible term under the contract of 12 months or less.

73. Supersede paragraph 805-20-30-5 and its related heading, amend paragraphs 805-20-30-10 and 805-20-30-12, and add paragraphs 805-20-30-23A through 30-23C and their related headings, with a link to transition paragraph 842-10-65-1, as follows:

Initial Measurement

> Measurement Principle

805-20-30-1 The acquirer shall measure the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at their acquisition-date fair values.

> Measuring the Fair Values of Particular Identifiable Assets and a Noncontrolling Interest in an Acquiree

~~**> > Assets Subject to Operating Leases in Which the Acquiree Is the Lessor**~~

805-20-30-5 Paragraph superseded by Accounting Standards Update 201X-XX.~~The acquirer shall measure the acquisition-date fair value of an asset, such~~

~~as a building or a patent or other intangible asset, that is subject to an operating lease in which the acquiree is the lessor separately from the lease contract. In other words, the fair value of the asset shall be the same regardless of whether it is subject to an operating lease. In accordance with paragraph 805-20-25-12, the acquirer separately recognizes an asset or a liability if the terms of the lease are favorable or unfavorable relative to market terms.~~

> Exceptions to the Measurement Principle

805-20-30-10 Paragraph 805-20-25-16 notes that the Business Combinations Topic provides limited exceptions to the recognition and measurement principles applicable to business combinations. Paragraphs 805-20-30-12 through 30-23C~~30-23~~ specify the types of identifiable assets and liabilities that include items for which this Subtopic provides limited exceptions to the paragraph 805-20-30-1 measurement principle. The acquirer shall apply the specified GAAP or the specified requirements rather than that measurement principle to determine how to measure the assets or liabilities identified in paragraphs 805-20-30-12 through 30-23C.~~30-23.~~ That will result in some items being measured at an amount other than their acquisition-date fair values.

805-20-30-11 As noted at paragraph 805-20-25-16, income taxes, employee benefits, and indemnification assets are also exceptions to the recognition principle in paragraph 805-20-25-1.

805-20-30-12 Guidance is presented on all of the following exceptions to the measurement principle:

a. Income taxes
b. Employee benefits
c. Indemnification assets
d. Reacquired rights
e. Share-based payment awards
f. Assets held for sale
g. Certain assets and liabilities arising from contingencies.
h. Leases.

> > Measurement of Assets and Liabilities Arising from Leases in Which the Acquiree Is the Lessee

805-20-30-23A If an acquiree is a lessee, the acquirer shall measure the lease liability at the present value of the remaining lease payments, as if the acquired lease were a new lease at the acquisition date. The acquirer shall measure the right-of-use asset at the same amount as the lease liability, adjusted to reflect both of the following:

a. Favorable or unfavorable terms of the lease when compared with market terms
b. Any other intangible asset associated with the lease, which may be evidenced by market participants' willingness to pay a price for the lease even if it is at market terms (for example, a lease of gates at an airport or of retail space in a prime shopping area that might provide entry into a market or other future economic benefits that qualify as intangible assets).

> > Measurement of Assets and Liabilities Arising from Leases in Which the Acquiree Is the Lessor

805-20-30-23B If an acquiree is a lessor of a Type A lease, the acquirer shall measure both of the following:

a. The lease receivable at the present value of the remaining lease payments, as if the acquired lease were a new lease at the acquisition date
b. The residual asset as the difference between the fair value of the underlying asset at the acquisition date and the carrying amount of the lease receivable at that date. The acquirer shall take into account the terms and conditions of the lease in calculating the acquisition-date fair value of an asset that is subject to a Type A lease.

805-20-30-23C If an acquiree is a lessor of a Type B lease, the acquirer shall take into account the terms and conditions of the lease in measuring the acquisition-date fair value of the underlying asset, such as a building, that is subject to the lease. The acquirer does not recognize a separate asset or liability if the terms of the lease are either favorable or unfavorable when compared with market terms.

74. Amend paragraph 805-20-50-1(b), with a link to transition paragraph 842-10-65-1, as follows:

Disclosure

> Business Combinations Occurring During a Current Reporting Period or After the Reporting Date but Before the Financial Statements Are Issued

805-20-50-1 Paragraph 805-10-50-1 identifies one of the objectives of disclosures about a **business combination**. To meet that objective, the **acquirer** shall disclose all of the following information for each business combination that occurs during the reporting period:

b. For acquired receivables not subject to the requirements of Subtopic 310-30, all of the following:

1. The **fair value** of the receivables (unless those receivables arise from Type A leases for which the acquirer shall disclose the amounts recognized as of the acquisition date)
2. The gross contractual amounts receivable
3. The best estimate at the acquisition date of the contractual cash flows not expected to be collected.

The disclosures shall be provided by major class of receivable, such as loans, ~~direct financing leases~~lease receivables arising from Type A leases in accordance with Topic 842 ~~Subtopic 840-30~~, and any other class of receivables.

75. Amend paragraphs 805-20-55-2 and 805-20-55-31, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Recognition of Intangible Assets Separately from Goodwill

805-20-55-2 Paragraph 805-20-25-10 establishes that an intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion described in the definition of identifiable. An **intangible asset** that meets the contractual-legal criterion is identifiable even if the asset is not transferable or separable from the **acquiree** or from other rights and obligations. For example:

a. An acquiree leases a manufacturing facility under a Type B ~~an operating~~ lease that has terms that are favorable relative to market terms. The lease terms explicitly prohibit transfer of the lease (through either sale or sublease). The amount by which the lease terms are favorable compared with the pricing of current market transactions for the same or similar items is an intangible asset that meets the contractual-legal criterion for recognition separately from **goodwill**, even though the **acquirer** cannot sell or otherwise transfer the lease contract. See also paragraph 805-20-30-23A.~~paragraphs 805-20-25-12 through 25-13.~~
b. An acquiree owns and operates a nuclear power plant. The license to operate that power plant is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. An acquirer may recognize the **fair value** of the ~~operating~~ license and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.
c. An acquiree owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a

specified percentage of future foreign revenue in exchange. Both the technology patent and the related license agreement meet the contractual-legal criterion for recognition separately from goodwill even if selling or exchanging the patent and the related license agreement separately from one another would not be practical.

> > Examples of Intangible Assets That Are Identifiable

> > > Contract-Based Intangible Assets

805-20-55-31 Contract-based intangible assets represent the value of rights that arise from contractual arrangements. Customer contracts are one type of contract-based intangible asset. If the terms of a contract give rise to a liability (for example, if the terms of a ~~an operating lease or~~ customer contract are unfavorable relative to market terms), the acquirer recognizes it as a liability assumed in the business combination. Examples of contract-based intangible assets are:

a. Licensing, royalty, standstill agreements #
b. Advertising, construction, management, service or supply contracts #
c. Subparagraph superseded by Accounting Standards Update 201X-XX. ~~Lease agreements (whether the acquiree is the lessee or the lessor) #~~
d. Construction permits #
e. Franchise agreements #
f. Operating and broadcast rights #
g. Servicing contracts such as mortgage servicing contracts #
h. Employment contracts #
i. Use rights such as drilling, water, air, timber cutting, and route authorities. #

Amendments to Subtopic 805-740

76. Amend paragraphs 805-740-25-3 through 25-4, with a link to transition paragraph 842-10-65-1, as follows:

Business Combinations—Income Taxes

Recognition

805-740-25-3 As of the acquisition date, a deferred tax liability or asset shall be recognized for an acquired entity's taxable or **deductible temporary differences** or operating loss or tax credit carryforwards except for differences relating to the portion of goodwill for which amortization is not deductible for tax purposes~~,~~

~~leveraged leases,~~ and the specific acquired temporary differences identified in paragraph 740-10-25-3(a). Taxable or deductible temporary differences arise from differences between the tax bases and the recognized values of assets acquired and liabilities assumed in a business combination. Example 1 (see paragraph 805-740-55-2) illustrates this guidance. An acquirer shall assess the need for a **valuation allowance** as of the acquisition date for an acquired entity's deferred tax asset in accordance with Subtopic 740-10.

805-740-25-4 Guidance on tax-related matters related to the portion of goodwill for which amortization is not deductible for tax purposes is in paragraphs 805-740-25-8 through 25-9~~25-9; guidance on accounting for the acquisition of leveraged leases in a business combination is in paragraph 840-30-30-15;~~ and guidance on the specific acquired temporary differences identified in paragraph 740-10-25-3(a) is referred to in that paragraph.

77. Amend paragraph 805-740-30-1, with a link to transition paragraph 842-10-65-1, as follows:

Initial Measurement

805-740-30-1 An **acquirer** shall measure a **deferred tax asset** or **deferred tax liability** arising from the assets acquired and liabilities assumed in a **business combination** in accordance with Subtopic 740-10. Discounting deferred tax assets or liabilities is prohibited for **temporary differences** ~~(except for leveraged leases, see Subtopic 840-30)~~ related to business combinations as it is for other temporary differences.

78. Amend paragraph 805-740-55-2, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Nontaxable Business Combination

805-740-55-2 This Example illustrates the guidance in paragraphs 805-740-25-2 through 25-3 and 805-740-30-1 relating to the recognition and measurement of a **deferred tax liability** and **deferred tax asset** in a nontaxable business combination. The assumptions are as follows:

a. The enacted tax rate is 40 percent for all future years, and amortization of **goodwill** is not deductible for tax purposes.
b. A wholly owned entity is acquired for $20,000~~, and the entity has no leveraged leases~~.

c. The tax basis of the net assets acquired (other than goodwill) is $5,000, and the recognized value is $12,000. Future recovery of the assets and settlement of the liabilities at their assigned values will result in $20,000 of taxable amounts and $13,000 of deductible amounts that can be offset against each other. Therefore, no **valuation allowance** is necessary.

Amendments to Subtopic 810-10

79. Amend paragraphs 810-10-55-39 and its related heading, 810-10-55-50, 810-10-55-55, 810-10-55-78 and its related heading, 810-10-55-80, 810-10-55-88 through 55-89, and 810-10-55-172 through 55-174, with a link to transition paragraph 842-10-65-1, as follows:

Consolidation—Overall

Implementation Guidance and Illustrations

Variable Interest Entities

> Implementation Guidance

> > Identifying Variable Interests

> > > ~~Operating~~ Leases

810-10-55-39 ~~Receivables under an operating lease are assets of the lessor entity and provide returns to the lessor entity with respect to the leased property during that portion of the asset's life that is covered by the lease. Most operating leases do not absorb variability in the fair value of a VIE's net assets because they are a component of that variability.~~The existence of a lease does not necessarily establish a variable interest; however, the existence of certain features in a lease may create a variable interest. For example, guarantees~~Guarantees~~ of the residual values of leased assets (or similar arrangements related to leased assets) and options to acquire leased assets at the end of the lease terms at specified prices may be variable interests in the lessor entity if they meet the conditions described in paragraphs 810-10-25-55 through 25-56. Alternatively, such arrangements may be variable interests in portions of a VIE as described in paragraph 810-10-25-57. The guidance in paragraphs 810-10-55-23 through 55-24 related to debt instruments applies to creditors of lessor entities.

> Illustrations

> > Example 2: Calculation of Expected Losses if There Is No History of, nor Future Expectation of, Net Losses

810-10-55-50 This Example illustrates the calculation of expected losses if a legal entity has no history of net losses and expects continued profitability. This Example has the following assumptions:

a. On January 1, 2004, Entity A is formed to purchase a building, 95 percent of which is financed by debt and 5 percent by equity. The lenders will have recourse only to the building in the event that Entity A does not make the required debt payments.
b. On the same day, Entity B enters into a five-year market-rate lease for the building from Entity A that includes a guarantee of a portion of the building's residual value.~~ The present value of the minimum lease payments, including the residual value guarantee, is less than 90 percent of the fair value of the building.~~
c. There are no other interests in Entity A.
d. The appropriate discount rate is assumed to be 5 percent.

> > Example 3: Determining the Variability to Be Considered

810-10-55-55 The following Cases illustrate the application of the guidance in paragraphs 810-10-25-21 through 25-36 for determining the variability to be considered in the following situations:

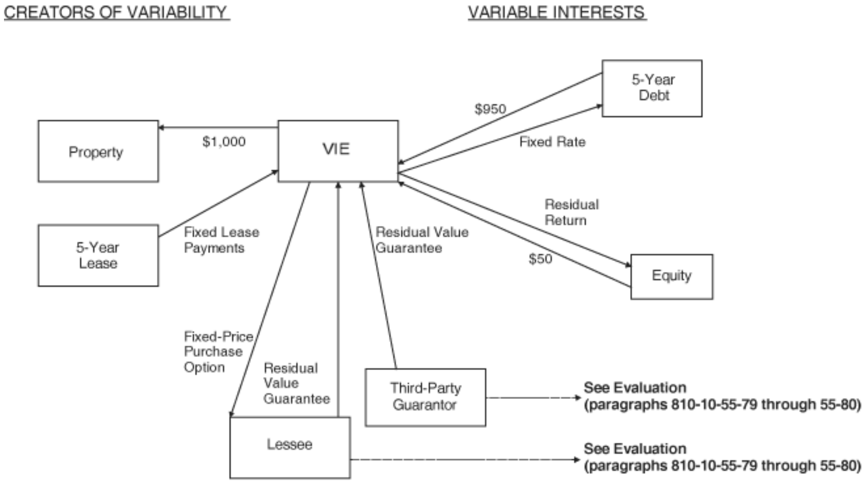
a. Financial VIE primarily financed by fixed-rate debt, holding investments in longer-term fixed-rate debt (Case A)
b. Financial VIE primarily financed by fixed-rate debt, holding investments in longer-term fixed- and variable-rate debt (with a fixed-rate swap) (Case B)
c. Financial VIE primarily financed by fixed-rate debt, holding investments in foreign-currency-denominated debt (with a currency swap) (Case C)
d. Financial VIE primarily financed by floating-rate debt, holding investments in fixed-rate securities (Case D)
e. Financial VIE financed by credit-linked notes holding highly rated floating-rate investments and a credit default swap (Case E)
f. Retail-operating VIE (Case F)
g. Lessor VIE~~ (direct financing lease)~~ with single lessee~~ (operating lease)~~ (Case G)
h. VIE holding both a fixed-price forward contract to buy and a fixed-price forward contract to sell electricity (Case H).

810-10-55-56 Cases A-H share all of the following assumptions:

a. All the entities are presumed to be VIEs.
b. All variable interests are variable interests in the VIE (as a whole) rather than variable interests in specified assets of the VIE, based on the guidance in paragraphs 810-10-25-55 through 25-59.
c. A primary beneficiary has not been identified; however, the determination of the primary beneficiary should be made in accordance with the guidance in paragraphs 810-10-25-38A through 25-38G.

> > > Case G: Lessor VIE ~~(Direct Financing Lease)~~ with Single Lessee ~~(Operating Lease)~~

810-10-55-78 A VIE is created and financed with $950 of 5-year fixed-rate debt and $50 of equity. The VIE uses the proceeds from the issuance to purchase property to be leased to a lessee with a AA credit rating. The equity provides protection (up to $50) to the debt related to both credit risk and interest rate risk because the debt is paid before any cash flows are available to the equity investors. The lease has a five-year term.~~term and is classified as a direct finance lease by the lessor and as an operating lease by the lessee.~~ The lessee is required to provide a first-loss residual value guarantee for the expected future value of the leased property at the end of five years, and it has a fixed-price purchase option to acquire the property for the same amount. A third-party residual value guarantor provides a very small additional residual value guarantee to the lessor. The governing documents for the VIE do not permit the VIE to buy additional assets or sell existing assets during the five-year holding period. The VIE was formed so that the lessee will have rights to occupy and use the property ~~under an operating lease~~ and retain substantially all of the risks and rewards from appreciation or depreciation in value of the leased property. The transaction was marketed to potential investors as an investment in a portfolio of AA-rated assets collateralized by leased property that would provide a fixed-rate return to debt holders equivalent to AA-rated assets. The return to equity investors is expected to be slightly greater than the return provided to the debt investors because the equity is subordinated with respect to the obligation of the lessee to the VIE. The following diagram illustrates this situation.



810-10-55-79 The VIE is exposed to the following risks:

a. Price risk with respect to changes in fair value of the underlying property
b. Credit risk associated with possible default by the lessee of the property with respect to the lease payments
c. Interest rate risk associated with changes in the fair value of the future lease payments.

810-10-55-80 The following factors should be considered in the determination of the purpose(s) for which the VIE was created and in the determination of the variability the VIE is designed to create and pass along to its interest holders:

a. Although the lease payments are fixed, the VIE was not designed to be exposed to interim changes in fair value of those lease payments due to interest rate risk because the VIE is not expected to sell the property before maturity of the fixed-rate debt.
b. The primary purpose for which the VIE was created was to provide the lessee with use of the property for five years with substantially all of the rights and obligations of ownership.
c. The residual value guarantee effectively transfers substantially all of the risk associated with the underlying property (that is, declines in value) to the lessee. Therefore, the variability that is transferred to that interest holder is strongly indicated as variability that the VIE is designed to create and pass along to its interest holders.
d. The fixed-price purchase option effectively transfers substantially all of the rewards from the underlying property (that is, increases in value) to the lessee.

e. The VIE is designed to be exposed to the risks associated with a cumulative change in fair value of the leased property at the end of five years as well as credit risk from possible default by the lessee with regard to ~~minimum~~ lease payments.
f. The VIE was marketed to potential investors as an investment in a portfolio of AA-rated assets collateralized by leased property that would provide a fixed-rate return to debt holders equivalent to AA-rated assets.
g. The role of the residual value guarantee and fixed-price purchase option in the design of the VIE, regardless of their legal form or accounting classification, dictates whether those interests shall be treated as creating risk for the VIE or absorbing risk from the VIE. Therefore, price risk with respect to changes in fair value of the underlying property is a relevant risk for the VIE.~~VIE, even though the lessor VIE records a direct financing lease receivable, rather than the property itself, on its balance sheet for accounting purposes.~~

Based on this analysis, it can be determined that the VIE was designed to create and pass along the risk in (a) in the preceding paragraph to the third-party guarantor and the lessee (with respect to the residual value guarantee and fixed-price purchase option) and the risk in (b) in the preceding paragraph to the note and equity holders, all of which are the VIE's variable interest holders.

> > Example 4: Implicit Variable Interests

810-10-55-87 This Example illustrates the guidance in paragraphs 810-10-25-48 through 25-54.

810-10-55-88 One of the two owners of Manufacturing Entity is also the sole owner of Leasing Entity, which is a VIE. The owner of Leasing Entity provides a guarantee of Leasing Entity's debt as required by the lender. Leasing Entity owns no assets other than the manufacturing facility being leased to Manufacturing Entity. The lease, with market terms, contains no explicit guarantees of the residual value of the real estate or purchase options and is therefore not considered a variable interest under paragraph 810-10-55-39. The lease ~~meets the classification requirements for an operating lease and~~ is the only contractual relationship between Manufacturing Entity and Leasing Entity.

810-10-55-89 Manufacturing Entity should consider whether it holds an implicit variable interest in Leasing Entity. Although the lease agreement itself does not contain a contractual guarantee, Manufacturing Entity should consider whether it holds an implicit variable interest in Leasing Entity as a result of the leasing arrangement and the relationship between it and the owner of Leasing Entity. For example, Manufacturing Entity would be considered to hold an implicit variable interest in Leasing Entity if Manufacturing Entity effectively guaranteed the owner's investment in Leasing Entity. The guidance in paragraphs 810-10-25-48 through 25-54 shall be used only to evaluate whether a variable interest exists under the Variable Interest Entities Subsections and shall not be used in the evaluation of lease classification in accordance with Topic 842. ~~840. Paragraph 840-10-25-26 addresses leases between related parties.~~ Manufacturing Entity may be expected to make funds available to Leasing Entity to prevent the owner's guarantee of Leasing Entity's debt from being called on, or Manufacturing Entity may be expected to make funds available to the owner to fund all or a portion of the call on Leasing Entity's debt guarantee. The determination as to whether Manufacturing Entity is effectively guaranteeing all or a portion of the owner's investment or would be expected to make funds available and, therefore, an implicit variable interest exists, shall take into consideration all the relevant facts and circumstances. Those facts and circumstances include, but are not limited to, whether there is an economic incentive for Manufacturing Entity to act as a guarantor or to make funds available, whether such actions have happened in similar situations in the past, and whether Manufacturing Entity acting as a guarantor or making funds available would be considered a conflict of interest or illegal.

> > Example 5: Identifying a Primary Beneficiary

810-10-55-93 The following cases are provided solely to illustrate the application of the guidance in paragraphs 810-10-25-38A through 25-38G related to the identification of a primary beneficiary:

a. Commercial mortgage-backed securitization (Case A)
b. Asset-backed collateralized debt obligation (Case B)
c. Structured investment vehicle (Case C)
d. Commercial paper conduit (Case D)
e. Guaranteed mortgage-backed securitization (Case E)
f. Residential mortgage-backed securitization (Case F)
g. Property lease entity (Case G)
h. Collaboration—Joint venture arrangement (Case H)
i. Furniture manufacturing entity (Case I).

> > > Case G: Property Lease Entity

810-10-55-172 A VIE is created and financed with $950 of 5-year fixed-rate debt and $50 of equity. The VIE uses the proceeds from the issuance to purchase property to be leased to a lessee with an AA credit rating. The equity is subordinate to the debt because the debt is paid before any cash flows are available to the equity investors. The lease has a five-year term. ~~term and is classified as a direct finance lease by the lessor and as an operating lease by the lessee.~~ The lessee~~, however,~~ is considered the owner of the property for tax purposes and, thus, receives tax depreciation benefits.

810-10-55-173 The lessee is required to provide a first-loss residual value guarantee for the expected future value of the leased property at the end of five years (the option price) up to a specified percentage of the option price, and it has a fixed-price purchase option to acquire the property for the option price. If the lessee does not exercise the fixed-price purchase option at the end of the lease term, the lessee is required to remarket the property on behalf of the VIE. If the property is sold for an amount less than the option price, the lessee is required to pay the VIE the difference between the option price and the sales proceeds, which is not to exceed a specified percentage of the option price. If the property is sold for an amount greater than the option price, the lessee is entitled to the excess of the sales proceeds over the option price. A third-party residual value guarantor provides a very small additional residual value guarantee to the lessor VIE.~~VIE, which allows the lessor to achieve direct financing lease treatment.~~

810-10-55-174 The governing documents for the VIE do not permit the VIE to buy additional assets or sell existing assets during the five-year holding period, and the terms of the lease agreement and the governing documents for the VIE do not provide the equity holders with the power to direct any activities of the VIE. The VIE was formed so that the lessee would have rights to use the property under a ~~an operating~~ lease and would retain substantially all of the risks and rewards from appreciation or depreciation in value of the leased property.

80. Supersede paragraph 810-10-60-4 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Relationships

~~> Leases~~

810-10-60-4 Paragraph superseded by Accounting Standards Update 201X-XX. ~~For leases sold by a manufacturer to a leasing subsidiary, see paragraph 840-30-45-4.~~

Amendments to Subtopic 815-10

81. Amend paragraphs 815-10-15-63 and 815-10-15-79 through 15-81, with a link to transition paragraph 842-10-65-1, as follows:

Derivatives and Hedging—Overall

Scope and Scope Exceptions

> Instruments

> > Instruments Not Within Scope

> > > Derivative Instruments That Impede Sale Accounting

815-10-15-63 A derivative instrument (whether freestanding or embedded in another contract) whose existence serves as an impediment to recognizing a related contract as a sale by one party or a purchase by the counterparty is not subject to this Subtopic. ~~For example, the existence of a guarantee of the residual value of a leased asset by the lessor may be an impediment to treating a contract as a sales-type lease, in which case the contract would be treated by the lessor as an operating lease. Another~~ An example is the existence of a call option enabling a transferor to repurchase transferred assets that is an impediment to sales accounting under Topic 860. Such a call option on transferred financial assets that are not readily available would prevent accounting for that transfer as a sale. The consequence is that to recognize the call option would be to count the same thing twice. The holder of the option already recognizes in its financial statements the assets that it has the option to purchase.

> > > Leases

815-10-15-79 Leases that are within the scope of Topic 842 ~~840~~ are not derivative instruments subject to this Subtopic, although a derivative instrument embedded in a lease may be subject to the requirements of paragraph 815-15-25-1.

> > > Residual Value Guarantees

815-10-15-80 Residual value guarantees that are subject to the requirements of Topic 842 on leases~~840~~ are not subject to the requirements of this Subtopic.

815-10-15-81 A third-party residual value guarantor shall consider the guidance in this Subtopic for all residual value guarantees that it provides to determine whether they are derivative instruments and whether they qualify for any of the scope exceptions in this Subtopic. The guarantees described in Topic 842~~paragraph 840-10-15-20~~ for which the exceptions of paragraphs 460-10-15-7(b) and 460-10-25-1(a) do not apply are subject to the initial recognition, initial measurement, and disclosure requirements of Topic 460.

82. Amend paragraph 815-10-55-60, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Scope Application to Certain Contracts

> > > Take-or-Pay Contracts

815-10-55-60 Whether a **take-or-pay contract** is subject to this Subtopic depends on its terms. For example, if the product to be delivered is not readily convertible to cash and there is no net settlement option, the contract fails to meet the net settlement criterion in paragraph 815-10-15-83(c) and is not subject to the requirements of this Subtopic. In certain circumstances, a take-or-pay contract may represent or contain a lease that should be accounted for in accordance with Topic 842 on leases.~~840.~~ (Paragraph 815-10-15-79 explains that leases subject to that Topic are not subject to this Subtopic.)

Amendments to Subtopic 815-15

83. Amend paragraph 815-15-25-22 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Derivatives and Hedging—Embedded Derivatives

Recognition

> > > Variable Lease Payments ~~Contingent Rentals~~ Based ~~an~~on a Variable Interest Rate

815-15-25-22 The obligation to make future payments for the use of leased assets and the adjustment of those payments to reflect changes in a variable-interest-rate index are considered to be clearly and closely related. Thus, leases that include variable lease payments~~contingent rentals~~ based on changes in the prime rate would not have the ~~contingent-rental-related~~variable-lease-payment-related embedded derivative separated from the host contract.

84. Amend paragraphs 815-15-55-4 and 815-15-55-7 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Scope—Features Involving Certain Currencies—Certain Insurance Contracts

815-15-55-4 Insurance contracts are **financial instruments** that are not covered by the scope exception in the paragraph 815-15-15-10 that applies to nonfinancial contracts; however, that paragraph applies to this situation in which a normal insurance contract involves payment in the functional currency of either of the two parties to the contract. The insurance contracts described in this guidance ~~are similar to operating leases, which~~ are covered by the exception in paragraph 815-15-15-10, because ~~neither contract gives~~the insurance contracts do not give rise to a recognized asset or liability that would be measured under Subtopic 830-20 until an amount becomes receivable or payable under the contract. Therefore, as discussed in paragraph 815-15-15-20, the exception in paragraph 815-15-15-10 also applies to insurance contracts that involve payment of losses in the functional currency of either of the two parties to the contract.

> > Applying the Bifurcation Criteria

> > > Applying the Separate Instrument Criterion

> > > > Variable Lease Payments ~~Contingent Rentals~~ Based on Related Sales

815-15-55-7 Lease contracts that include variable lease payments~~contingent rentals~~ based on certain sales of the lessee would not have the ~~contingent-rental-related~~variable-lease-payment-related **embedded derivative** separated from the host contract because, under paragraph 815-10-15-59(d), a non-exchange-traded contract whose **underlying** is specified volumes of sales by one of the parties to the contract would not be subject to the requirements of Subtopic 815-10.

Amendments to Subtopic 815-20

85. Amend paragraph 815-20-25-12(b), with a link to transition paragraph 842-10-65-1, as follows:

Derivatives and Hedging—Hedging—General

Recognition

> Eligibility of Hedged Items and Transactions

> > Hedged Item Criteria Applicable to Fair Value Hedges Only

815-20-25-12 An asset or a liability is eligible for designation as a hedged item in a fair value hedge if all of the following additional criteria are met:

b. The hedged item is a single asset or liability (or a specific portion thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof), in which circumstance:
   1. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities shall share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio shall be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk. See the discussion beginning in paragraph 815-20-55-14 for related implementation guidance. An entity may use different stratification criteria for the purposes of Topic 860 impairment testing and for the purposes of grouping similar assets to be designated as a hedged portfolio in a fair value hedge.
   2. If the hedged item is a specific portion of an asset or liability (or of a portfolio of similar assets or a portfolio of similar liabilities), the hedged item is one of the following:
      i. A percentage of the entire asset or liability (or of the entire portfolio). An entity shall not express the hedged item as multiple percentages of a recognized asset or liability and then retroactively determine the hedged item based on an independent matrix of those multiple percentages and the actual scenario that occurred during the period for which hedge effectiveness is being assessed.
      ii. One or more selected contractual cash flows, including one or more individual interest payments during a selected portion of the term of a debt instrument (such as the portion of the asset or liability representing the present value of the interest payments in the first two years of a four-year debt instrument).
      iii. A put option or call option (including an interest rate cap or price cap or an interest rate floor or price floor) embedded in

an existing asset or liability that is not an embedded derivative accounted for separately pursuant to paragraph 815-15-25-1.

iv. The~~ residual value in a~~ lessor's residual asset~~net investment~~ in a Type A ~~direct financing or sales-type ~~lease.

86. Amend paragraph 815-20-55-11, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> > > > Application of the Definition of Firm Commitment

815-20-55-11 A firm commitment that represents an asset or liability that a specific accounting standard prohibits recognizing (such as ~~a noncancelable operating lease or ~~an unrecognized mortgage servicing right) may nevertheless be designated as the hedged item in a fair value hedge.

Amendments to Subtopic 820-10

87. Amend paragraph 820-10-15-2, with a link to transition paragraph 842-10-65-1, as follows:

Fair Value Measurement—Overall

Scope and Scope Exceptions

> Other Considerations

> > Topics and Subtopics Not within Scope

820-10-15-2 The Fair Value Measurement Topic does not apply as follows:

a. To accounting principles that address share-based payment transactions (this includes Subtopic 505-50 and all Subtopics in Topic 718 except for 718-40, which is within the scope of Topic 820)
b. To Sections, Subtopics, or Topics that require or permit measurements that are similar to fair value but that are not intended to measure fair value, including both of the following:
    1. Sections, Subtopics, or Topics that permit measurements that are determined on the basis of, or otherwise use, vendor-specific objective evidence of fair value
    2. Topic 330.

c. To accounting principles that address fair value measurements for purposes of lease classification or measurement in accordance with Topic 842 on leases.~~840.~~ This scope exception does not apply to assets acquired and liabilities assumed in a business combination or an **acquisition by a not-for-profit entity** that are required to be measured at fair value in accordance with Topic 805, regardless of whether those assets and liabilities are related to leases.

Amendments to Subtopic 825-10

88. Amend paragraph 825-10-15-5, with a link to transition paragraph 842-10-65-1.

Financial Instruments—Overall

Scope and Scope Exceptions

Fair Value Option

> Instruments

825-10-15-5 No entity may elect the fair value option for any of the following financial assets and financial liabilities:

a. An investment in a subsidiary that the entity is required to consolidate
b. An interest in a variable interest entity (VIE) that the entity is required to consolidate
c. Employers' and plans' obligations (or assets representing net overfunded positions) for pension benefits, other postretirement benefits (including health care and life insurance benefits), postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements, as defined in Topics 420; 710; 712; 715; 718; and 960.
d. Financial assets and financial liabilities recognized under leases as defined in Topic 842. ~~Subtopic 840-10.~~ (This exception does not apply to a guarantee of a third-party lease obligation or a contingent obligation arising from a cancelled lease.)
e. Deposit liabilities, withdrawable on demand, of banks, savings and loan associations, credit unions, and other similar depository institutions
f. Financial instruments that are, in whole or in part, classified by the issuer as a component of shareholder's equity (including temporary equity) (for example, a convertible debt instrument with the scope of

the Cash Conversion Subsections of Subtopic 470-20 or a convertible debt security with a noncontingent beneficial conversion feature).

Amendments to Topic 840

89. Supersede Topic 840, Leases, with a link to transition paragraph 842-10-65-1.

Amendments to Subtopic 845-10

90. Supersede paragraph 845-10-30-20 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Nonmonetary Transactions—Overall

Initial Measurement

Barter Credit Transactions

~~> Transfers of Operating Leases for Barter Credits~~

845-10-30-20 Paragraph superseded by Accounting Standards Update 201X-XX. ~~If an exchange involves the transfer or assumption of an operating lease for barter credits, impairment of that lease shall be measured as the amount of the remaining lease costs (discounted rental payments and unamortized leasehold improvements) in excess of the discounted amount of probable sublease rentals for the remaining lease term.~~

Amendments to Subtopic 860-10

91. Amend paragraph 860-10-05-7, with a link to transition paragraph 842-10-65-1, as follows:

Transfers and Servicing—Overall

Overview and Background

> Types of Transfers

> > Securitizations

860-10-05-7 An originator of a typical securitization (the transferor) transfers a portfolio of financial assets to a securitization entity, commonly a trust. Financial assets such as mortgage loans, automobile loans, trade receivables, credit card receivables, and other revolving charge accounts are financial assets commonly transferred in securitizations. Securitizations of mortgage loans may include pools of single-family residential mortgages or other types of real estate mortgage loans, for example, multifamily residential mortgages and commercial property mortgages. Securitizations of loans secured by chattel mortgages on automotive vehicles as well as other equipment (including Type A~~direct financing or sales-type~~ leases) also are common.

92. Amend paragraph 860-10-15-4, with a link to transition paragraph 842-10-65-1, as follows:

Scope and Scope Exceptions

> Transactions

860-10-15-4 The guidance in this Topic does not apply to the following transactions and activities:

a. Except for transfers of servicing assets (see Section 860-50-40) and for the transfers noted in the following paragraph, transfers of nonfinancial assets
b. Transfers of unrecognized financial assets, for example, ~~minimum~~ lease payments to be received under ~~operating~~ Type B leases
c. Transfers of custody of financial assets for safekeeping
d. Contributions (for guidance on accounting for contributions, see Subtopic 958-605)
e. Transfers of ownership interests that are in substance sales of real estate (For guidance related to transfers of investments that are in substance a sale of real estate, see Topics 845 and 976. For guidance related to ~~sale-leaseback~~sale and leaseback transactions involving real estate, including real estate with equipment, such as manufacturing

facilities, power plants, and office buildings with furniture and fixtures, see Subtopic 842-40 on sale and leaseback transactions~~840-40~~.)

f. Investments by owners or distributions to owners of a business entity
g. Employee benefits subject to the provisions of Topic 712
h. Subparagraph superseded by Accounting Standards Update 201X-XX. ~~Leveraged leases subject to Topic 840~~
i. Subparagraph superseded by Accounting Standards Update 201X-XX. ~~**Money-over-money** and wrap lease transactions involving nonrecourse debt subject to Topic 840.~~

93. Amend paragraphs 860-10-55-5 through 55-6 and its related heading, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Scope

> > > Application of the Term Financial Asset

860-10-55-5 The following implementation guidance addresses whether certain instruments are financial assets, the transfer of which is subject to the guidance in this Subtopic, specifically:

a. ~~Minimum lease~~ Lease payments~~ and guaranteed residual values~~ under certain leases
b. Securitized stranded costs
c. Judgment from litigation
d. Forward contract on a financial instrument
e. Ownership interest in a consolidated subsidiary by its parent if the subsidiary holds nonfinancial assets
f. Investment in a nonconsolidated investee.

> > > > ~~Minimum~~ Lease Payments ~~and Guaranteed Residual Values~~ under Certain Leases

860-10-55-6 ~~Sales-type and direct financing receivables secured by leased equipment, referred to as gross investment in lease receivables, are made up of two components: minimum lease payments and residual values. Minimum lease~~Lease payments for Type A leases involve~~are~~ requirements for lessees to pay cash to lessors and meet the definition of a financial asset. Thus, transfers of ~~minimum~~ lease payments for Type A leases are subject to the requirements of this Subtopic. ~~Residual values represent the lessor's estimate of the salvage~~

~~value of the leased equipment at the end of the lease term and may be either guaranteed or unguaranteed. Residual values meet the definition of financial assets to the extent that they are guaranteed at the inception of the lease. Thus, transfers of residual values guaranteed at inception also are subject to the requirements of this Subtopic. Unguaranteed residual values do not meet the definition of financial assets, nor do residual values guaranteed after inception, and transfers of them are not subject to the requirements of this Subtopic.~~

Amendments to Subtopic 860-20

94. Supersede paragraph 860-20-55-26 and amend its related heading and supersede paragraphs 860-20-55-58 through 55-59 and their related heading and amend paragraph 860-20-55-27, with a link to transition paragraph 842-10-65-1, as follows:

Transfers and Servicing—Sales of Financial Assets

Implementation Guidance and Illustrations

> Implementation Guidance

> > Sales or Securitizations of Certain Lease ~~Financing~~ Receivables

860-20-55-26 Paragraph superseded by Accounting Standards Update 201X-XX. ~~A transferor of lease financing receivables shall allocate the gross investment in receivables between minimum lease payments, residual values guaranteed at inception, and residual values not guaranteed at inception using the individual carrying amounts of those components at the date of transfer. Those transferors also shall record a servicing asset or liability in accordance with Subtopic 860-50, if appropriate.~~

860-20-55-27 See paragraph 860-10-55-6 for further discussion of certain lease ~~financing~~ receivables.

> Illustrations

~~**> > Example 5: Transfer of Lease Financing Receivables with Residual Values**~~

860-20-55-58 Paragraph superseded by Accounting Standards Update 201X-XX. ~~This Example illustrates the guidance in paragraph 860-20-25-1. At the beginning of the second year in a 10-year sales-type lease, Entity E transfers for $505 a~~

~~nine-tenths participating interest in the minimum lease payments to an independent third party, and the transfer is accounted for as a sale. Entity E retains a one-tenth participating interest in the minimum lease payments and a 100 percent interest in the unguaranteed residual value of leased equipment, which is not subject to the requirements of this Subtopic as discussed in paragraph 860-10-55-6 because it is not a financial asset and, therefore, is excluded from the analysis of whether the transfer of the nine-tenths participating interest in the minimum lease payments meets the definition of a participating interest. The servicing asset has a fair value of zero because Entity E estimates that the benefits of servicing are just adequate to compensate it for its servicing responsibilities. The carrying amounts and related gain computation are as follows.~~

~~Carrying Amounts~~

~~Minimum lease payments~~		~~$ 540~~
~~Unearned income related to minimum lease payments~~		~~370~~
~~Gross investment in minimum lease payments~~		~~910~~
~~Unguaranteed residual value~~	~~$ 30~~	
~~Unearned income related to unguaranteed residual value~~	~~60~~	
~~Gross investment in unguaranteed residual value~~		~~90~~
~~Total gross investment in financing lease receivable~~		~~$ 1,000~~

~~Gain on Sale~~

~~Cash received~~		~~$ 505~~
~~Nine-tenths of carrying amount of gross investment in minimum lease payments~~	~~$ 819~~	
~~Nine-tenths of carrying amount of unearned income related to minimum lease payments~~	~~333~~	
~~Net carrying amount of minimum lease payments sold~~		~~486~~
~~Gain on sale~~		~~$ 19~~

860-20-55-59 Paragraph superseded by Accounting Standards Update 201X-XX. ~~The following journal entry is made by Entity E.~~

~~**Journal Entry**~~

~~Cash~~	~~$ 505~~	
~~Unearned income~~	~~333~~	
~~Lease receivable~~		~~$ 819~~
~~Gain on sale~~		~~19~~

~~To record sale of nine-tenths of the minimum lease payments at the beginning of Year 2~~

Amendments to Subtopic 908-360

95. Amend paragraph 908-360-55-1, with a link to transition paragraph 842-10-65-1, as follows:

Airlines—Property, Plant, and Equipment

Implementation Guidance and Illustrations

> Implementation Guidance

> > Purchase Incentives

908-360-55-1 Paragraph 605-50-45-2 states, in part, that **cash consideration** (including a sales incentive) given by a vendor to a customer is presumed to be a reduction of the selling prices of the vendor's products or services. Accordingly, the credit received as a purchase incentive from an aircraft manufacturer to induce a purchase or lease of that manufacturer's aircraft should~~shall~~ be applied as a reduction of the purchase price for the aircraft that is owned or as a reduction of the right-of-use asset for an aircraft that is leased when a right-of-use asset should be recognized in accordance with Topic 842 on leases. ~~under a capital lease, or, in the case of an aircraft under an operating lease, amortized over the life of the related aircraft.~~

Amendments to Subtopic 942-230

96. Amend paragraphs 942-230-55-2 and 942-230-55-4 through 55-5, with a link to transition paragraph 842-10-65-1, as follows:

Financial Services—Depository and Lending—Statement of Cash Flows

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Statement of Cash Flows Under the Direct Method for a Financial Institution

942-230-55-1 This Example illustrates the guidance in paragraphs 230-10-45-25 through 45-26 and 230-10-45-28 through 45-32 for a statement of cash flows under the direct method for a financial institution. The Example is intended as an illustration only. Also, the illustration of the reconciliation of net income to net cash provided by operating activities may provide detailed information in excess of that required for a meaningful presentation. Other formats or levels of detail may be appropriate for particular circumstances.

942-230-55-2 Presented below is a statement of cash flows for Financial Institution, Inc., a U.S. corporation that provides a broad range of financial services. This statement of cash flows illustrates the direct method of presenting cash flows from operating activities, as encouraged in paragraph 230-10-45-25.

FINANCIAL INSTITUTION, INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 19X1

Cash flows from operating activities:		
Interest received	$ 5,350	
Fees and commissions received	1,320	
Proceeds from sales of trading securities	20,550	
Purchase of trading securities	(21,075)	
Financing revenue received under leases	52 ~~60~~	
Interest paid	(3,925)	
Cash paid to suppliers and employees	(795)	
Income taxes paid	(471)	
Net cash provided by operating activities		$1,006 ~~$1,014~~
Cash flows from investing activities:		
Proceeds from sales of investment securities	2,225	
Purchase of investment securities	(4,000)	
Net increase in credit card receivables	(1,300)	
Net decrease in customer loans with maturities of 3 months or less	2,250	
Principal collected on longer term loans	26,550	
Longer term loans made to customers	(36,300)	
Purchase of assets to be leased	(500) ~~(1,500)~~	
Principal payments received under leases	79 ~~107~~	
Capital expenditures	(450)	
Proceeds from sale of property, plant, and equipment	260	
Net cash used in investing activities		(11,186) ~~(12,158)~~
Cash flows from financing activities:		
Net increase in demand deposits, negotiable order of withdrawal accounts, and savings accounts	3,000	
Proceeds from sales of certificates of deposit	63,000	
Payments for maturing certificates of deposit	(61,000)	
Net increase in federal funds purchased	4,500	
Net increase in 90-day borrowings	50	
~~Proceeds from issuance of nonrecourse debt~~	~~600~~	
~~Principal payment on nonrecourse debt~~	~~(20)~~	
Proceeds from issuance of 6-month note	100	
Proceeds from issuance of long-term debt	1,000	
Repayment of long-term debt	(200)	
Proceeds from issuance of common stock	350	
Payments to acquire treasury stock	(175)	
Dividends paid	(240)	
Net cash provided by financing activities		10,385 ~~10,965~~
Net decrease in cash and cash equivalents		205 ~~(179)~~
Cash and cash equivalents at beginning of year		6,700
Cash and cash equivalents at end of year		$6,905 ~~$ 6,521~~
Reconciliation of net income to net cash provided by operating activities:		
Net income		$ 1,056
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	$ 100	
Provision for probable credit losses	300	
Provision for deferred taxes	58	
Loss on sale of investment securities	75	
Gain on sale of equipment	(50)	
Increase in trading securities (including unrealized appreciation of $25)	(700)	
Increase in taxes payable	175	
Increase in interest receivable	(150)	
Increase in interest payable	75	
Decrease in fees and commissions receivable	20	
Increase in accrued expenses	55	
Total adjustment		(42)
Net cash provided by operating activities		$ 1,014
Supplemental schedule of noncash investing and financing activities:		
Conversion of long-term debt to common stock		$ 100 ~~500~~

942-230-55-3 Disclosure of accounting policy.

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

942-230-55-4 Summarized below is financial information for the current year for Financial Institution, Inc., which provides the basis for the statement of cash flows presented in paragraphs 942-230-55-2 through 55-3.

FINANCIAL INSTITUTION, INC.
STATEMENT OF FINANCIAL POSITION

	1/1/X1	12/31/X1	Change
Assets:			
Cash and due from banks	$ 4,400	$3,505 ~~$3,121~~	$(895) ~~$(1,279)~~
Federal funds sold	2,300	3,400	1,100
Total cash and cash equivalents	6,700	6,905 ~~6,521~~	205 ~~(179)~~
Trading securities	4,000	4,700	700
Investment securities	5,000	6,700	1,700
Credit card receivables	8,500	9,800	1,300
Loans	28,000	35,250	7,250
Allowance for credit losses	(800)	(850)	(50)
Interest receivable	600	750	150
Fees and commissions receivable	60	40	(20)
Lease assets ~~Investment in direct financing lease~~	-	421	421
~~Investment in leveraged lease~~		~~392~~	~~392~~
Plant, property, and equipment, net	525	665	140
Total assets	$ 52,585	$64,381 ~~$64,389~~	$11,796 ~~$11,804~~
Liabilities:			
Deposits	$ 38,000	$ 43,000	$ 5,000
Federal funds purchased	7,500	12,000	4,500
Short-term borrowings	1,200	1,350	150
Interest payable	350	425	75
Accrued expenses	275	330	55
Taxes payable	75	250	175
Dividends payable	-	80	80
Long-term debt	2,000	2,700 ~~2,300~~	700 ~~300~~
Deferred taxes	-	58	58
Total liabilities	49,400	60,193 ~~59,793~~	10,793 ~~10,393~~
Stockholders' equity:			
Common stock	1,250	1,700 ~~2,100~~	450 ~~850~~
Treasury stock	-	(175)	(175)
Retained earnings	1,935	2,663 ~~2,671~~	728 ~~736~~
Total stockholders' equity	3,185	4,188 ~~4,596~~	1,003 ~~1,411~~
Total liabilities and stockholders' equity	$ 52,585	$64,381 ~~$64,389~~	$11,796 ~~$11,804~~

FINANCIAL INSTITUTION, INC.
STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 19X1

Revenues:		
Interest income	$ 5,500	
Fees and commissions	1,300	
Net gain on sales of trading and investment securities	75	
Unrealized appreciation of trading securities	25	
Lease income	52 ~~60~~	
Gain on sale of equipment	50	
Total revenues		$7,002 ~~$7,010~~
Expenses:		
Interest expense	4,000	
Provision for probable credit losses	300	
Operating expenses	850	
Depreciation	100	
Total expenses		5,250
Income before income taxes		1,752 ~~1,760~~
Provision for income taxes		704
Net income		$1,048 ~~$1,056~~

942-230-55-5 The following transactions were entered into by Financial Institution, Inc., during 19X1 and are reflected in the preceding financial statements:

a. Financial Institution sold trading securities with a carrying value of $20,400 for $20,550 and purchased trading securities for $21,075. Financial Institution recorded unrealized appreciation on trading securities of $25. Financial Institution also sold investment securities with a book value of $2,300 for $2,225 and purchased new investment securities for $4,000.
b. Financial Institution had a net decrease in short-term loans receivable (those with original maturities of 3 months or less) of $2,250. Financial Institution made longer term loans of $36,300 and collected $26,550 on those loans. Financial Institution wrote off $250 of loans as uncollectible.
c. Financial Institution purchased property for $500 to be leased under a Type A lease. ~~direct financing lease.~~ The first annual rental payment of $131 was collected. The portion of the rental payment representing interest income totaled $52.
d. Subparagraph superseded by Accounting Standards Update 201X-XX.~~Financial Institution purchased equipment for $1,000 to be leased under a leveraged lease. The cost of the leased asset was financed by an equity investment of $400 and a long-term nonrecourse bank loan~~

~~of $600. The first annual rental payment of $90, of which $28 represented principal, was collected and the first annual loan installment of $74, of which $20 represented principal, was paid. Pretax income of $8 was recorded.~~

e. Financial Institution purchased new property, plant, and equipment for $450 and sold property, plant, and equipment with a book value of $210 for $260.
f. Customer deposits with Financial Institution consisted of the following.

	1/1/X1	12/31/X1	Increase
Demand deposits	$ 8,000	$ 8,600	$ 600
Negotiable order of withdrawal accounts and savings accounts	15,200	17,600	2,400
Certificates of deposit	14,800	16,800	2,000
Total deposits	$ 38,000	$ 43,000	$ 5,000

Sales of certificates of deposit during the year totaled $63,000; certificates of deposit with principal amounts totaling $61,000 matured. For presentation in the statement of cash flows, Financial Institution chose to report gross cash receipts and payments for both certificates of deposit with maturities of three months or less and those with maturities of more than three months.

g. Short-term borrowing activity for Financial Institution consisted of repayment of a $200 90-day note and issuance of a 90-day note for $250 and a 6-month note for $100.
h. Financial Institution repaid $200 of long-term debt and issued 5-year notes for $600 and 10-year notes for $400.
i. Financial Institution issued <u>$450</u> ~~$850~~ of common stock, <u>$100</u> ~~$500~~ of which was issued upon conversion of long-term debt and $350 of which was issued for cash.
j. Financial Institution acquired $175 of treasury stock.
k. Financial Institution declared dividends of $320. The fourth quarter dividend of $80 was payable the following January.
l. Financial Institution's provision for income taxes included a deferred provision of $58.
m. In accordance with the definition of the term **cash**, interest paid includes amounts credited directly to demand deposit, negotiable order of withdrawal accounts, and savings accounts.

Amendments to Subtopic 954-470

97. Amend paragraph 954-470-25-1, with a link to transition paragraph 842-10-65-1, as follows:

Health Care Entities—Debt

Recognition

> Financing Authorities

954-470-25-1 When a financing authority issues tax-exempt bonds or similar debt instruments and uses the proceeds for the benefit of a health care entity, the obligation shall be reported as a liability in the entity's balance sheet if the health care entity is responsible for repayment. In some cases, this obligation may take the form of a liability arising from a ~~capital~~ lease. If a health care entity has no obligation to make payments of principal and interest on the debt or ~~capital or operating~~ lease payments on related buildings or equipment, the entity shall not reflect the liability on its balance sheet. In such circumstances, proceeds from the bond issue shall be reported as **contributions** from the sponsoring entity.

98. Amend paragraph 954-470-40-1, with a link to transition paragraph 842-10-65-1, as follows:

Derecognition

954-470-40-1 In a crossover refunding, because the old bonds are not defeased until the crossover date, no immediate gain or loss shall be recognized. If the retirement dates of the old debt have been established, the call premium, unamortized premium or discount, and initial issue costs shall be recognized systematically in the income statement over the remaining life of the old debt as an adjustment of the cost of borrowing related to the old debt. In addition, the income earned on the funds used to consummate the **{add glossary link}**advance refunding**{add glossary link}** and the interest expense on both the old and new debts shall be recognized in the income statement. The funds used to consummate the advance refunding shall be reported as an asset and both the old and new debts shall be reported as liabilities. The assets and liabilities shall not be offset.

Amendments to Subtopic 958-805

99. Amend paragraph 958-805-25-9, with a link to transition paragraph 842-10-65-1, as follows:

Not-for-Profit Entities—Business Combinations

Recognition

Merger of Not-for-Profit Entities

> Classifying or Designating Assets and Liabilities in a Merger

958-805-25-9 In some situations, GAAP provides for different accounting depending on how an entity classifies or designates a particular asset or liability. Paragraphs 805-20-25-7 through 25-8 provide examples of such classifications and designations. The new NFP shall carry forward into the opening balances in its financial statements (see paragraph 958-805-45-2(a)) the merging entities' classifications and designations unless either of the following situations applies:

a. The merger results in a modification of a contract in a manner that would change those previous classifications or designations; for example, if the provisions of a lease are modified in a way that would require the revised agreement to be considered a new agreement under Topic 842 on leases~~paragraph 840-10-35-4~~
b. Reclassifications are necessary to conform accounting policies in accordance with paragraph 958-805-30-2.

Amendments to Subtopic 958-810

100. Amend paragraph 958-810-25-10, with a link to transition paragraph 842-10-65-1, as follows:

Not-for-Profit Entities—Consolidation

Recognition

> Special-Purpose-Entity Lessors

958-810-25-8 Notwithstanding the guidance in this Subtopic, an NFP that is engaged in leasing transactions with a special-purpose-entity (SPE) lessor shall consider whether it should consolidate such lessor. Specifically, such an NFP shall consolidate an SPE lessor if all of the following conditions exist:

a. Substantially all of the activities of the SPE involve assets that are to be leased to a single lessee.
b. The expected substantive residual risks and substantially all the residual rewards of the leased asset(s) and the obligation imposed by the underlying debt of the SPE reside directly or indirectly with the lessee through means such as any of the following:
    1. The lease agreement

2. A residual value guarantee through, for example, the assumption of first-dollar-of-loss provisions
3. A guarantee of the SPE's debt
4. An option granting the lessee a right to do either of the following:
   i. To purchase the leased asset at a fixed price or at a defined price other than fair value determined at the date of exercise
   ii. To receive any of the lessor's sales proceeds in excess of a stipulated amount.

c. The owner (or owners) of record of the SPE has not made an initial substantive residual equity capital investment that is at risk during the entire **lease term**. This criterion shall be considered met if the majority owner (or owners) of the lessor is not an independent third party, regardless of the level of capital investment.

958-810-25-9 To satisfy the at-risk requirement in item (c) in the preceding paragraph, an initial substantive residual equity capital investment shall meet all of the following conditions:

a. It represents an equity interest in legal form.
b. It is subordinate to all debt interests.
c. It represents the residual equity interest during the entire lease term.

958-810-25-10 If all of the conditions in paragraph 958-810-25-8 exist, the assets, liabilities, results of operations, and cash flows of the SPE shall be consolidated in the lessee's financial statements. This conclusion shall be applied to SPEs that are established for both the construction and subsequent lease of an asset for which the lease would meet all of the conditions in paragraph 958-810-25-8. In those cases, the consolidation by the lessee shall begin at the **{remove glossary link}lease inception{remove glossary link}** rather than the beginning of the lease term. For related implementation guidance, see paragraphs 958-810-55-7 through 55-16.~~55-16 and 958-840-55-1.~~

101. Amend paragraphs 958-810-55-7 and 958-810-55-14, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Special-Purpose-Entity Lessors

958-810-55-7 For an NFP that is engaged in leasing transactions with a special-purpose-entity (SPE) lessor, this implementation guidance addresses the following matters:

a. Multiple properties within a single SPE lessor

b. Multitiered SPE structures
c. Payments to equity owners of an SPE during the **lease term**
d. Fees paid to owners of record of an SPE
e. Source of initial minimum equity investment
f. Payment to owners of record of an SPE before the lease term
g. Subparagraph superseded by Accounting Standards Update 201X-XX. ~~Interest-only payments.~~

> > > Fees Paid to Owners of Record of an SPE

958-810-55-14 ~~Paragraph 840-10-25-6(e) states that, for a lessee, minimum lease payments include fees that are paid by the lessee to the owners of the special-purpose entity for structuring the lease transaction. Paragraph 840-10-25-6(e) states that such fees shall be included as part of minimum lease payments (but shall not be included in the fair value of the leased property) for purposes of applying the 90 percent test in paragraph 840-10-25-1(d).~~ With respect to the SPE and the application of the guidance in paragraph 958-810-25-8, the fees paid by the lessee to the owners of the SPE shall be considered a return of the owners' initial equity capital investment. To the extent that the fees reduce the equity capital investment below the minimum amount required, the owners of record would not be considered to have a substantive residual equity capital investment that is at risk during the entire term of the lease.

Amendments to Subtopic 958-840

102. Supersede Subtopic 958-840, Not-for-Profit Entities—Leases, with a link to transition paragraph 842-10-65-1.

Amendments to Subtopic 970-10

103. Amend paragraph 970-10-15-8, with a link to transition paragraph 842-10-65-1, as follows:

Real Estate—General—Overall

Scope and Scope Exceptions

Real Estate Project Costs

> Transactions

970-10-15-8 The guidance in the Real Estate Project Costs Subsections does not apply to the following transactions and activities:

a. Real estate developed by an entity for use in its own operations, other than for sale or rental. In this context, real estate developed by a member of a consolidated group for use in the operations of another member of the group (for example, a manufacturing facility developed by a subsidiary for use in its parent's operations) when the property is reported in the group's consolidated financial statements. However, this does not include property reported in the separate financial statements of the entity that developed it.
b. Initial direct costs of ~~sales-type, operating, and other types of~~ leases, which are defined in Topic 842. ~~840.~~ The accounting for initial direct costs of leases is prescribed in that Topic.
c. Costs directly related to manufacturing, merchandising, or service activities as distinguished from real estate activities.

Amendments to Subtopic 970-340

104. Amend paragraph 970-340-25-16, with a link to transition paragraph 842-10-65-1, as follows:

Real Estate—General—Other Assets and Deferred Costs

Recognition

Real Estate Project Costs

> Costs Incurred to Sell and Rent Real Estate Projects, Including Initial Rental Operations

> > Costs Incurred to Rent Real Estate Projects

970-340-25-16 If **costs incurred to rent real estate projects**, other than initial direct costs, under ~~operating~~ leases are related to and their recovery is reasonably expected from future rental operations, they shall be capitalized. Examples are costs of model units and their furnishings, rental facilities, semipermanent signs, grand openings, and unused rental brochures. Costs that do not meet the criteria for capitalization shall be expensed as incurred, for example, rental overhead. Initial direct costs are defined in Topic 310 and the accounting for initial direct costs is prescribed in Topic 842 on leases.~~Subtopic 840-20.~~

105. Amend paragraph 970-340-35-2, with a link to transition paragraph 842-10-65-1, as follows:

Subsequent Measurement

Real Estate Project Costs

> Determining Amounts to Be Capitalized or Expensed

> > Costs Incurred to Rent Real Estate Projects

970-340-35-2 Capitalized rental costs directly related to revenue from a specific ~~operating~~ lease shall be amortized over the lease term. Capitalized rental costs not directly related to revenue from a specific ~~operating~~ lease shall be amortized over the period of expected benefit. The amortization period shall begin when the project is substantially completed and held available for occupancy. See paragraphs 970-605-25-1 through 25-2 for the definition of substantially completed and held available for occupancy.

Amendments to Subtopic 974-840

106. Supersede Subtopic 974-840, Real Estate—Real Estate Investment Trusts—Leases, with a link to transition paragraph 842-10-65-1.

Amendments to Subtopic 978-330

107. Amend paragraph 978-330-35-6, with a link to transition paragraph 842-10-65-1, as follows:

Real Estate—Time-Sharing Activities—Inventory

Subsequent Measurement

> Operations During Holding Periods

978-330-35-6 If rental activities occur other than during the holding period, the corresponding units shall be depreciated and those activities shall be accounted for as rental operations in accordance with <u>Topic 842 on leases.</u> ~~Subtopic 840-20.~~

Amendments to Subtopic 978-605

[Note: The FASB's project on revenue recognition released an Exposure Draft that would change this Subtopic. Because that guidance is not final, the proposed amendments in this Exposure Draft on leases are to current U.S. GAAP.]

108. Amend paragraph 978-605-25-5, with a link to transition paragraph 842-10-65-1, as follows:

Real Estate—Time-Sharing Activities—Revenue Recognition

Recognition

> Profit Recognition Issues

> > Transfer of Title

978-605-25-5 ~~Paragraph 840-10-25-1(a) requires that title must be transferred to recognize a sale of real estate.~~ For purposes of recognizing profit on time-sharing transactions under Subtopic 360-20, it is necessary that ~~such~~ transfer <u>of title</u> be nonreversionary. A **contract-for-deed** arrangement meets this criterion.

Amendments to Subtopic 978-840

109. Supersede Subtopic 978-840, Real Estate—Time-Sharing Activities—Leases, with a link to transition paragraph 842-10-65-1.

Amendments to Subtopic 980-250

110. Amend paragraph 980-250-55-3, with a link to transition paragraph 842-10-65-1, as follows:

Regulated Operations—Accounting Changes and Error Corrections

Implementation Guidance and Illustrations

> Implementation Guidance

> > Accounting Changes

980-250-55-3 If a regulated entity changes accounting methods and the change does not affect costs that are allowable for rate-making purposes, the regulated entity would apply the change in the same manner as would an unregulated entity.~~ Capitalization of leases with no income statement effect (see paragraphs 980-840-45-1 through 45-4) is an example of that type of change.~~ If a regulated entity changes accounting methods and the change affects **allowable costs** for rate-making purposes, the change generally would be implemented in the way that it is implemented for regulatory purposes. A change in the method of accounting for research and development costs, either from a policy of capitalization and amortization to one of charging those costs to expense as incurred or vice versa, is an example of that type of change.

Amendments to Subtopic 980-340

111. Amend paragraph 980-340-25-4, with a link to transition paragraph 842-10-65-1, as follows:

Regulated Operations—Other Assets and Deferred Costs

Recognition

> Effects of Regulation

> > Phase-In Plans

980-340-25-4 The following Examples illustrate various circumstances that may or may not constitute phase-in plans:

a. Subparagraph superseded by Accounting Standards Update 201X-XX.~~Example 1 (see paragraph 980-340-55-9) illustrates a sale with leaseback as a capital lease.~~
b. Subparagraph superseded by Accounting Standards Update 201X-XX.~~Example 2 (see paragraph 980-340-55-12) illustrates a sale with leaseback as an operating lease.~~
c. Subparagraph superseded by Accounting Standards Update 201X-XX.~~Example 3 (see paragraph 980-340-55-15) illustrates a sale with leaseback with profit recognition accelerated.~~
d. Example 4 (see paragraph 980-340-55-18) illustrates the modified depreciation method.

e. Example 5 (see paragraph 980-340-55-21) illustrates deferred costs before a rate order is issued.
f. Example 7 (see paragraph 980-340-55-39) illustrates a phase-in plan for two plants completed at different times that share common facilities.

112. Supersede paragraphs 980-340-55-9 through 55-17 and their related headings, with a link to transition paragraph 842-10-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

~~**> > Example 1: Sale with Leaseback—Capital Lease**~~

980-340-55-9 Paragraph superseded by Accounting Standards Update 201X-XX.~~This Example illustrates the guidance in paragraphs 980-340-25-2 through 25-3.~~

980-340-55-10 Paragraph superseded by Accounting Standards Update 201X-XX.~~Utility B sells its interest in a newly completed electric generating plant for an amount equal to its cost and leases that interest back under a lease that requires equal annual payments. The sale meets the criteria of Section 360-20-40 for recognition as a sale, and the leaseback meets the criteria of Subtopic 840-30 for a capital lease. Utility B's regulator includes the lease rentals in allowable cost as they accrue. In the past, Utility B's regulator has treated other leases entered into by Utility B in the same manner, but those leases were for much less significant items of equipment—not for an interest in an electric generating plant.~~

980-340-55-11 Paragraph superseded by Accounting Standards Update 201X-XX.~~The rate-making method described is a phase-in plan under the definition in this Subtopic. Generally accepted accounting principles (GAAP) applicable to entities in general require a capital lease to be accounted for much like a purchase of the leased property. The resulting expense related to the lease consists of interest on the remaining lease obligation and depreciation based on the method used for similar owned property. In the early years of a lease, the lease rentals included in allowable cost as they accrue are significantly less than the sum of interest on the lease obligation and depreciation on the leased asset. Thus, significant deferrals will result. The method also defers recognition of expenses compared with the methods of expense recognition used by Utility B's regulator for similar assets of Utility B prior to 1982 because Utility B's interests in electric generating plants were included in **allowable costs** in the past based on current provisions for depreciation and for the cost of capital invested in the plants. The use of this rate-making method in the past for leases of equipment does not change this conclusion. The definition is based on the method of rate-~~

~~making used prior to 1982 for similar allowable costs. Similar allowable costs would be those resulting from electric generating plants.~~

~~> > Example 2: Sale with Leaseback—Operating Lease~~

980-340-55-12 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u>~~This Example illustrates the guidance in paragraphs 980-340-25-2 through 25-3.~~

980-340-55-13 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u>~~Utility C sells its interest in a newly completed electric generating plant for an amount equal to its cost and leases that interest back under a lease that requires equal annual payments. The sale meets the criteria of Section 360-20-40 for recognition as a sale, and the leaseback meets the criteria of Subtopic 840-20 for an operating lease. Utility C's regulator includes the lease rentals in allowable cost as they accrue. In the past, Utility C's regulator has treated other leases entered into by Utility C in the same manner, but those leases were not for an interest in an electric generating plant.~~

980-340-55-14 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u>~~The rate-making method applied to Utility C is not a phase-in plan under the definition in this Subtopic because it recognizes rent expense for rate-making purposes in the same way as that expense would be recognized for entities in general for this type of lease.~~

~~> > Example 3: Sale with Leaseback—Profit Recognition Accelerated~~

980-340-55-15 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u>~~This Example illustrates the guidance in paragraphs 980-340-25-2 through 25-3.~~

980-340-55-16 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u>~~Utility D sells its interest in a 5-year-old electric generating plant for an amount that exceeds its undepreciated cost by $500,000 and leases that interest back. The leaseback term is 20 years, and there are no renewal options. The sale meets the criteria of Section 360-20-40 for recognition as a sale with full profit recognition, and the leaseback meets the criteria of Subtopic 840-20 for an operating lease. Utility D's regulator includes the lease rentals in allowable cost as they accrue and orders Utility D to amortize the profit, for rate-making purposes, over 10 years. The sale occurred at a time when Utility D was about to place a newly completed plant in service. Utility D has not had any similar transactions in the past.~~

980-40-55-17 <u>Paragraph superseded by Accounting Standards Update 201X-XX.</u>~~The rate-making method described is a phase-in plan under the definition in this Subtopic. GAAP applicable to entities in general require a profit on a sale-~~

~~leaseback transaction to be amortized over the term of the leaseback. Amortization of that profit, for rate-making purposes, over 10 years when GAAP applicable to entities in general require amortization over the 20-year leaseback term is equivalent to a deferral of allowable costs. In view of the timing of the rate order on the sale-leaseback transaction, the presumption is that the order was issued in connection with the newly completed plant. The method cannot be compared with methods in use prior to 1982 because Utility D has had no previous transactions of this type.~~

Amendments to Subtopic 980-605

113. Amend paragraph 980-605-15-3, with a link to transition paragraph 842-10-65-1, as follows:

[Note: The FASB's project on revenue recognition released an Exposure Draft that would change this Subtopic. Because that guidance is not final, the proposed amendments in this Exposure Draft on leases are to current U.S. GAAP.]

Regulated Operations—Revenue Recognition

Scope and Scope Exceptions

> Transactions

980-605-15-3 As described in paragraph 980-605-25-9, the scope of this Subtopic excludes long-term power supply contracts <u>if they are within the scope of Topic 842 on leases.</u>~~that would qualify for lease accounting pursuant to Topic 840.~~

114. Amend paragraph 980-605-25-10, with a link to transition paragraph 842-10-65-1, as follows:

Recognition

> Long-Term Power Sales Contracts

980-605-25-10 For ~~a discussion of~~ the considerations required to determine whether a long-term power sales contract arrangement contains a lease, see <u>Topic 842 on leases.</u>~~Subtopic 840-10.~~

Amendments to Subtopic 980-840

115. Supersede Subtopic 980-840, Regulated Operations—Leases, with a link to transition paragraph 842-10-65-1.

Amendments to Subtopic 985-605

116. Amend paragraphs 985-605-25-32 and 985-605-25-39 through 25-40, with a link to transition paragraph 842-10-65-1, as follows:

[Note: The FASB's project on revenue recognition released an Exposure Draft that would change this Subtopic. Because that guidance is not final, the proposed amendments in this Exposure Draft on leases are to current U.S. GAAP.]

Software—Revenue Recognition

Recognition

> The Vendor's Fee Is Fixed or Determinable and Collectibility Is Probable

> > Factors that Affect the Determination of Whether a Fee Is Fixed or Determinable and Collectible

985-605-25-32 The following guidance addresses various considerations related to whether a fee is fixed or determinable and collectible, specifically:

a. Extended payment terms (see paragraphs 985-605-25-33 through 25-35)
b. Reseller arrangements (see paragraph 985-605-25-36)
c. Customer cancellation privileges (see paragraph 985-605-25-37)
d. **{add glossary link}**Fiscal funding clauses**{add glossary link}** (see paragraphs 985-605-25-38 through 25-40).

> > > Fiscal Funding Clauses

985-605-25-38 Fiscal funding clauses sometimes are found in software license arrangements in which the licensees are governmental units. Such clauses generally provide that the license is cancelable if the legislature or funding authority does not appropriate the funds necessary for the governmental unit to fulfill its obligations under the licensing arrangement.

985-605-25-39 ~~Consistent with paragraph 840-10-25-3, a~~A software licensing arrangement with a governmental unit containing a fiscal funding clause shall be evaluated to determine whether the uncertainty of a possible license arrangement cancellation is a remote contingency. The evaluation of whether the level of uncertainty of possible cancellation is remote shall be consistent with Topic 450, which defines remote as relating to conditions in which the chance of the future event or events occurring is slight.

985-605-25-40 If the likelihood of cancellation is assessed as remote, the software licensing arrangement shall be considered noncancelable. Such an assessment shall include the factors discussed in paragraphs 985-605-25-33 through 25-34. If the likelihood is assessed as other than remote, the license shall be considered cancelable, thus precluding revenue recognition. A fiscal funding clause with a customer other than a governmental unit that is required to include such a clause creates a contingency that precludes revenue recognition until the requirements of the clause and all other provisions of this Subtopic have been satisfied.

The amendments in this proposed Update were approved for publication by four members of the Financial Accounting Standards Board. Messrs. Linsmeier, Schroeder, and Siegel voted against publication of the amendments. Their alternative views are set out at the end of the basis for conclusions.

Members of the Financial Accounting Standards Board:

Leslie F. Seidman, *Chairman*
Daryl E. Buck
Russell G. Golden
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information, Basis for Conclusions, and Alternative Views

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Exposure Draft. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. This basis for conclusions discusses the following matters:

a. Background (paragraphs BC3–BC10)
b. The lessee and lessor accounting models (paragraphs BC11–BC78)
c. Scope (paragraphs BC79–BC101)
d. Identifying a lease (paragraphs BC102–BC118)
e. Classification of leases (paragraphs BC119–BC127)
f. Recognition and the date of initial measurement (paragraphs BC128–BC133)
g. Measurement: lessee (paragraphs BC134–BC189)
h. Presentation: lessee (paragraphs BC190–BC200)
i. Disclosure: lessee (paragraphs BC201–BC210)
j. Measurement: lessor—Type A leases (paragraphs BC211–BC267)
k. Presentation: lessor—Type A leases (paragraphs BC268–BC272)
l. Measurement: lessor—Type B leases (paragraphs BC273–BC278)
m. Disclosure: lessor (paragraphs BC279–BC284)
n. Sale and leaseback transactions (paragraphs BC285–BC292)
o. Related party leases (paragraph BC293)
p. Short-term leases (paragraphs BC294–BC298)
q. Effective date (paragraphs BC299–BC300)
r. Transition (paragraphs BC301–BC317)
s. Application to nonpublic entities (paragraphs BC318–BC322)
t. Cost-benefit considerations (paragraphs BC323–BC341)
u. Consequential amendments (paragraphs BC342–BC352)
v. Alternative views (paragraphs BC353–BC404).

Background

Why the Need to Change Existing Accounting?

BC3. The existing accounting model for leases under IFRS and U.S. GAAP requires lessees and lessors to classify their leases as either capital leases or operating leases and account for those leases differently. For example, it does not require lessees to recognize assets and liabilities arising from operating leases, but it does require lessees to recognize assets and liabilities arising from capital leases. The IASB and the FASB initiated a joint project to improve the financial reporting of leasing activities under IFRS and U.S. GAAP in light of criticisms that the existing accounting model for leases fails to meet the needs of users of financial statements. In particular:

a. Many, including the U.S. Securities and Exchange Commission (SEC) in its report on off-balance sheet activities issued in 2005 and a number of academic studies published over the past 15 years, have recommended that changes be made to the existing lease accounting requirements to ensure greater transparency in financial reporting and to better address the needs of users of financial statements. Many users often adjust the financial statements to capitalize a lessee's operating leases. However, the information available in the notes to the financial statements is often insufficient for users to make reliable adjustments to a lessee's financial statements. The adjustments made can vary significantly depending on the assumptions made by different users.
b. The existence of two very different accounting models for leases in which assets and liabilities associated with leases are not recognized for most leases but are recognized for others means that transactions that are economically similar can be accounted for very differently. That reduces comparability for users and provides opportunities to structure transactions to achieve a particular accounting outcome.
c. Some users have also criticized the existing requirements for lessors because they do not provide adequate information about a lessor's exposure to credit risk (arising from a lease) and exposure to asset risk (arising from its retained interest in the underlying asset), particularly for leases of assets other than property that are currently classified as operating leases.

BC4. The Boards decided to address those criticisms by developing a new approach to lease accounting that requires an entity to recognize assets and liabilities for the rights and obligations created by leases. The new approach would require a lessee to recognize assets and liabilities for all leases with a maximum possible term (including any options to extend) of more than 12 months. This approach should result in a more faithful representation of a lessee's financial position and, together with enhanced disclosures, greater transparency of a lessee's financial leverage. The new approach also proposes changes to lessor accounting that, in the Boards' view, would more accurately reflect the leasing activities of different lessors.

The Project to Date

BC5. In March 2009, the Boards published a joint Discussion Paper, *Leases: Preliminary Views*. The Discussion Paper set out the Boards' preliminary views on lessee accounting, proposing a "right-of-use" accounting model. Feedback on the Discussion Paper was generally supportive of the right-of-use model for lessees in which a lessee would recognize a right-of-use asset and a lease liability at the commencement date of the lease. The Discussion Paper did not discuss lessor accounting in any detail.

BC6. In August 2010, the Boards published a joint Exposure Draft, *Leases* (2010 Exposure Draft). The Boards developed their 2010 Exposure Draft after considering the 302 comment letters received on the Discussion Paper, as well as input obtained from their International Working Group on Lease Accounting and from others who were interested in the financial reporting of leases. The 2010 Exposure Draft further developed the right-of-use accounting model proposed for lessees in the 2009 Discussion Paper. The 2010 Exposure Draft also set out changes to lessor accounting by proposing a dual lessor accounting model in which a lessor would recognize a lease receivable and derecognize a portion of the underlying asset for some leases and would continue to recognize the underlying asset for others. The Boards decided to include lessor accounting in the proposals in response to comments from respondents to the Discussion Paper. Those respondents recommended that the Boards develop accounting models for lessees and lessors on the basis of a consistent rationale. The Boards also saw merit in developing lessor accounting proposals at the same time as developing proposals on the recognition of revenue.

BC7. The Boards received 786 comment letters in response to the 2010 Exposure Draft from entities and organizations from a range of industries, including nonpublic entities. Concerns raised about the application of the proposed model to nonpublic entities were discussed separately by the FASB.

BC8. The Boards also consulted extensively on the proposals in the 2010 Exposure Draft. Roundtable discussions were held in Hong Kong, the United Kingdom, and the United States. Workshops were organized in Australia, Brazil, Canada, Japan, South Korea, the United Kingdom, and the United States. Members of the Boards also participated in conferences, working group meetings, discussion forums, and one-to-one discussions that were held across all major geographical regions. While redeliberating the proposals in the 2010 Exposure Draft in 2011 and 2012, the Boards conducted targeted outreach on specific issues with more than 100 organizations. The purpose of the targeted outreach was to obtain additional feedback to assist the Boards in developing particular aspects of the revised proposals. The targeted outreach meetings involved working group members, representatives from accounting firms, local standard setters, users of financial statements, and preparers, particularly those from industries most affected by the lease accounting proposals.

BC9. The main feedback received on the proposals included in the 2010 Exposure Draft was as follows:

a. There was general support for the recognition of the assets and liabilities arising from a lease by lessees. That was consistent with comments received on the Discussion Paper.
b. Some respondents supported the effects of the proposed right-of-use model on a lessee's profit or loss in which a lessee would recognize separately amortization of the right-of-use asset and interest on the lease liability. They noted that leases are a source of financing for a lessee and should be accounted for accordingly. However, others disagreed because they said that the approach did not properly reflect the economics of all lease transactions. In particular, some respondents referred to shorter-term property leases as examples of leases that, in their view, were not financing transactions from either the lessee's or lessor's perspective.
c. Many respondents disagreed with the lessor accounting proposals:
    1. Some were concerned that the dual accounting model proposed for lessors was not consistent with the single accounting model proposed for lessees.
    2. Many did not support the performance obligation approach. According to that approach, a lessor would recognize a lease receivable and a liability at the commencement date and also would continue to recognize the underlying asset. Those respondents indicated that, in their view, the approach would artificially inflate a lessor's assets and liabilities.
    3. Some supported applying the derecognition approach to all leases. According to that approach, a lessor would derecognize the underlying asset and recognize a lease receivable and a retained interest in the underlying asset (referred to as a residual asset) at the commencement date. However, many disagreed with the proposal to prevent a lessor from accounting for the effects of the time value of money on the residual asset.
    4. Others said that the existing lessor accounting requirements work well in practice and supported retaining those requirements.
d. Almost all respondents were concerned about the costs and complexity of the proposals, in particular the proposals on measurement of the lessee's lease liability and the lessor's lease receivable. The 2010 Exposure Draft had proposed that an entity would make an estimate of all variable lease payments to be made, not only during the noncancellable period of a lease but also during any optional extension periods that the entity considered more likely than not to occur. Some

questioned whether lease payments to be made during optional extension periods would meet the definition of an asset (for the lessor) or a liability (for the lessee). Others indicated that it would be extremely difficult in many cases to make a reliable estimate of variable lease payments if the amounts to be paid were dependent on future sales or use of the underlying asset. Because of the amount of judgment involved, many indicated that the cost of including variable lease payments and payments to be made during extension periods in the measurement of lease assets and lease liabilities would outweigh the benefit for users of financial statements.

e. Many respondents also were concerned about the breadth of the scope of the proposals, indicating that the proposed definition of a lease had the potential to capture some service contracts.

BC10. The Boards addressed those concerns during the redeliberations of the proposals in the 2010 Exposure Draft. A summary of the changes that the Boards have made to the 2010 proposals is presented in the appendix to this basis for conclusions. The changes have resulted in revised proposals in this Exposure Draft on the lessee accounting model, the lessor accounting model, measurement of lease assets and lease liabilities, and the scope of the proposals. The Boards concluded that the revised proposals are sufficiently different from those published in the 2010 Exposure Draft to warrant reexposure.

The Lessee and Lessor Accounting Models

BC11. All contracts create rights and obligations for the parties to the contract. The model proposed in this Exposure Draft considers the rights and obligations created by a lease (defined as a contract that conveys the right to use an asset [the underlying asset] for a period of time in exchange for consideration) (see paragraphs BC102–BC106 for more information on the proposed definition of a lease). The model reflects that, at the commencement date, a lessee obtains a right to use the underlying asset for a period of time, and the lessor has provided or delivered that right. Consequently, the Boards have referred to the model as a right-of-use model.

BC12. A lessee has a right to use the underlying asset during the lease term and an obligation to make payments to the lessor for providing the right to use the asset. The lessee also has an obligation to return the underlying asset in a particular condition to the lessor at the end of the lease term. Similarly, the lessor has a right to receive payments from the lessee for providing the right to use the underlying asset. The lessor also retains rights associated with the underlying asset. Having identified the rights and obligations that arise from a lease for the lessee and lessor, the Boards then considered which of those rights and obligations should be recognized as assets and liabilities by the lessee and lessor.

Rights and Obligations Arising from a Lease That Create Assets and Liabilities for the Lessee

Right to Use the Underlying Asset

BC13. The IASB's *Conceptual Framework for Financial Reporting (Conceptual Framework)* defines an asset as "a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity." FASB Concepts Statement No. 6, *Elements of Financial Statements*, states that "assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events." The main characteristics of both definitions of an asset are that the entity controls an economic resource or benefit, the resource or benefit arises from a past event, and future economic benefits are expected to flow to the entity. The Boards concluded that a lessee's right to use the underlying asset meets the definition of an asset for the following reasons:

a. The lessee controls the right to use the underlying asset during the lease term because the lessor is unable to have access to the resource without the consent of the lessee (or breach of contract). Once the asset is delivered, the lessor is unable to retrieve or otherwise use the underlying asset during the lease term, despite being the legal owner of the underlying asset.
b. The lessee's control of the right of use also is demonstrated by its ability to determine how and when it uses the underlying asset and, thus, how it generates future economic benefits from that right of use. For example, assume a lessee leases a truck for 4 years, for up to a maximum of 160,000 miles over the lease term. Embedded in the right to use the truck is a particular volume of economic benefits or service potential that is used up over the period of time that the truck is driven by the lessee. Upon delivery of the truck to the lessee, the lessee can decide how it wishes to use up or consume the economic benefits embedded in its right of use. It could decide to drive the truck constantly during the first two years of the lease, using up all of the economic benefits in those first two years. Alternatively, it could use the truck only during particular months in each year or decide to use it evenly over the four-year lease term.
c. In some leases, a lessee's right to use an asset includes some restrictions on its use. For example, in the truck example in (b) above, the lessee cannot drive the truck for more than 160,000 miles over the 4-year lease term. Some may think that those restrictions result in the lessee not having control of the right to use the underlying asset. However, the Boards have concluded that, although those restrictions may affect the value of and payments for the right-of-use asset, they do not affect the recognition of the right-of-use asset. That is consistent

with the recognition of other assets. It is not unusual for particular restrictions to be placed on the use of owned assets as well as leased assets. For example, assets that are used as security for particular borrowings may have restrictions placed on their use by the lender, or a government may place restrictions on the use or transfer of assets in a particular region for environmental or security reasons. Those restrictions do not necessarily result in the owner of such assets losing control of those assets—the restrictions may simply affect the economic benefits that will flow to the entity from the asset and that will be reflected in the price that the entity is willing to pay for those economic benefits.

d. The lessee's control of the right of use arises from a past event—the signing of the lease and the underlying asset being made available for use by the lessee. Some have suggested that the lessee's right to use an asset is conditional on the lessee making payments during the lease term. In other words, if the lessee does not make payments, it may forfeit its right to use the asset (which is similar to the situation that would arise if an entity failed to make payments on an installment purchase). However, unless the lessee breaches the contract, the lessee has an unconditional right to use the underlying asset.

BC14. Consequently, the Boards concluded that the lessee's right to use the underlying asset meets the definition of an asset in the IASB's *Conceptual Framework* and in Concepts Statement 6**.**

Obligation to Make Lease Payments

BC15. The *Conceptual Framework* defines a liability as "a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits." Concepts Statement 6 states that "liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events." The main characteristics of both definitions of a liability are that the entity has a present obligation that arises from a past event and the obligation is expected to result in an outflow of economic benefits. The Boards concluded that the lessee's obligation to make lease payments meets the definition of a liability for the following reasons:

a. The lessee has a present obligation to make lease payments once the underlying asset has been delivered (or made available) to the lessee. That obligation arises from a past event—the signing of the lease and the underlying asset being delivered (or made available) for use by the lessee. The lessee has no contractual right to cancel the lease and avoid the contractual lease payments (or termination penalties) before the end of the lease term. In addition, unless the lessee breaches the contract, the lessor has no contractual right to take possession of, or prevent the lessee from using, the underlying asset until the end of the lease term.

b. The obligation results in a future outflow of economic benefits from the lessee—typically contractual cash payments in accordance with the terms and conditions of the lease.

BC16. Consequently, the Boards concluded that a lessee's obligation to make lease payments meets the definition of a liability in the *Conceptual Framework* and in Concepts Statement 6.

Obligation to Return the Underlying Asset to the Lessor

BC17. The lessee controls the use of the underlying asset during the lease term and has an obligation to return the underlying asset to the lessor at the end of the lease term. That is a present obligation that arises from a past event (the signing of the lease and the underlying asset being made available for use by the lessee).

BC18. It might appear that there is an outflow of economic benefits at the end of the lease term because the lessee must surrender the underlying asset, which often will still have some economic potential. However, the Boards concluded that there is no outflow of economic benefits from the lessee when it returns the leased item, other than incidental costs, because the lessee does not control the economic benefits associated with the asset that it returns to the lessor. Even if the lessee has physical possession of the underlying asset, it has no right to obtain the remaining economic benefits associated with the underlying asset once the lease term expires (ignoring any options to extend the lease or purchase the underlying asset). In that case, the position of the lessee at the end of the lease term is like that of an asset custodian. The lessee is holding an asset on behalf of a third party, the lessor, but has no right to the economic benefits embodied in that asset at the end of the lease term.

BC19. Consequently, the Boards concluded that the lessee's obligation to return the underlying asset does not meet the definition of a liability in the *Conceptual Framework* and in Concepts Statement 6.

Why Leases Are Different from Service Contracts for the Lessee

BC20. The Boards have concluded that leases create rights and obligations that are different from those that arise from service contracts. That is because the lessee obtains and controls the right-of-use asset at the time that the underlying asset is delivered to (or made available for use by) the lessee, as described in paragraph BC13.

BC21. When the lessor delivers (or makes available) the underlying asset for use by the lessee, the lessor has fulfilled its obligation to transfer the right to use that asset to the lessee—the lessee now controls that right of use. Consequently, the lessee has an unconditional obligation to pay for that right of use. After the lessor makes the underlying asset available for use by the lessee, the lessee cannot return the underlying asset to the lessor before the end of the lease without breaching the contract (or incurring termination penalties). Similarly, unless the lessee breaches the contract, the lessor cannot retrieve the underlying asset from the lessee before the end of the lease.

BC22. In contrast, in a typical service contract, the customer does not obtain an asset that it controls at commencement of the contract. Instead, the customer obtains the service only at the time that the service is performed. The vendor has remaining obligations until it has provided the services to its customer. Consequently, the customer typically has an unconditional obligation to pay only for the services provided to date. In addition, although fulfillment of a service contract may require the use of assets, fulfillment typically does not require the delivery of an identified asset.

BC23. Accordingly, the Boards have concluded that the nature of the rights and obligations that arise at commencement of a typical service contract is different from the nature of the rights and obligations that arise at commencement of a lease.

Rights and Obligations Arising from a Lease That Creates Assets and Liabilities for the Lessor

Lease receivable

BC24. When the lessor makes the underlying asset available for use by the lessee, the lessor has fulfilled its obligation to transfer the right to use that asset to the lessee—the lessee controls the right of use. Accordingly, the lessor has an unconditional lease receivable. The lessor controls that right—for example, it can decide to sell or securitize that right. The right arises from a past event (the signing of the lease and the underlying asset being made available for use by the lessee) and is expected to result in future economic benefits (typically cash from the lessee) flowing to the lessor.

BC25. Consequently, the Boards concluded that the lessor's lease receivable meets the definition of an asset in the *Conceptual Framework* and in Concepts Statement 6. See paragraphs BC64–BC74 for a discussion of the Boards' conclusions on the recognition of lease receivables by a lessor.

Rights Retained in the Underlying Asset

BC26. Although the lessor transfers the right to use the underlying asset to the lessee at the commencement date, the lessor has the right to the underlying asset at the end of the lease term (and retains some rights to the underlying asset during the lease term, for example, the lessor retains title to the asset). Consequently, the lessor retains some of the potential economic benefits embedded in the underlying asset.

BC27. The lessor controls the rights it retains in the underlying asset. A lessor can often, for example, sell the underlying asset (with the lease attached) or agree at any time during the initial lease term to sell or release the underlying asset at the end of the lease term. The lessor's rights to the underlying asset arise from a past event—the purchase of the underlying asset or signing of the head lease, if the lessor is a sublessor. Future economic benefits from the lessor's retained rights in the underlying asset are expected to flow to the lessor, assuming that the lease is for anything other than the full economic life of the asset. The lessor would expect to obtain economic benefits either from the sale, re-lease, or use of the underlying asset at the end of the lease term.

BC28. Consequently, the Boards concluded that the lessor's rights retained in the underlying asset meet the definition of an asset in the *Conceptual Framework* and in Concepts Statement 6. See paragraphs BC64–BC74 for a discussion of the Boards' conclusions on the recognition of a lessor's rights retained in the underlying asset.

The Lessee Accounting Model

BC29. Having concluded that the lessee's right to use the underlying asset meets the definition of an asset and the lessee's obligation to make lease payments meets the definition of a liability, the Boards considered whether requiring a lessee to recognize that asset and liability for all leases would improve financial reporting to such an extent that the benefits from the improvements would outweigh the costs associated with such a change.

BC30. On the basis of comments from respondents to both the Discussion Paper and the 2010 Exposure Draft and from participants at consultation meetings (including meetings with users of financial statements) (as described in paragraph BC9), the Boards concluded that there would be significant benefits from requiring a lessee to recognize a right-of-use asset and a lease liability for all leases (except short-term leases), particularly for users of financial statements and others who have raised concerns about the extent of off-balance sheet financing for operating leases. The Boards have considered the costs associated with that proposed change throughout their redeliberations and have simplified the proposals included in the 2010 Exposure Draft to address concerns about costs (see paragraphs BC136–BC143, BC148–BC155, and BC294–BC298 on the lease term, variable lease payments, and short-term leases). The costs and benefits of the lease accounting proposals are discussed in paragraphs BC323–BC341.

Amounts Recognized in Profit or Loss

BC31. The right-of-use asset is a nonfinancial asset that the Boards are proposing to measure at cost. Cost for a right-of-use asset is the present value of lease payments, plus any initial direct costs incurred by the lessee.

BC32. Accordingly, a lessee subsequently measures the right-of-use asset at cost, less accumulated amortization and any impairment. The Discussion Paper and the 2010 Exposure Draft proposed that a lessee amortize the right-of-use asset similarly to other nonfinancial assets, that is, on a systematic basis reflecting the pattern in which the lessee is expected to consume the right-of-use asset's future economic benefits. That would typically result in the lessee recognizing amortization of the right-of-use asset on a straight-line basis over the lease term.

BC33. The lease liability is a financial liability that the Boards are proposing to measure at cost. Cost for a lease liability is the present value of the lease payments. Interest (or the unwinding of the discount) would be allocated to each period to produce a constant periodic rate of interest on the remaining balance of the liability. That measurement is similar to the measurement of other similar financial liabilities. The Discussion Paper and the 2010 Exposure Draft also proposed this measurement basis for the lessee's lease liability, which would typically result in the lessee recognizing decreasing interest costs over the lease term as the lessee makes lease payments reducing the liability balance.

BC34. The Boards received differing views on the effects of the proposed right-of-use model on a lessee's profit or loss:

a. Some agreed with the Boards' proposals in the 2010 Exposure Draft. They noted that every lessee obtains an asset (the right to use the underlying asset) at the commencement date and has an obligation to pay for that right. Accordingly, a lessee should account for the transaction no differently from acquiring any other nonfinancial asset and separately financing that purchase, which would result in the recognition of interest on the liability and amortization of the asset.
b. Others disagreed with the Boards' proposals. They noted that, in a typical lease, the lessee receives equal benefits from use of the underlying asset and pays equal amounts in each period. The result of separately recognizing interest on the lease liability and amortization of the right-of-use asset, which would typically result in higher total lease expense in the earlier years of the lease and lower total lease expense in the later years of the lease, does not, in their view, reflect the economics of receiving equal benefits for equal payments over the life

of the lease. They suggested a single lessee accounting model (excluding contracts that transfer control of the underlying asset to the lessee) that would allocate the total cost of the lease to each period to reflect the pattern in which the lessee consumes benefits from use of the underlying asset.

c. Others said that because leases vary widely ranging from those for almost all of the life of the underlying asset to those for a very short portion of the life of the underlying asset, a single expense recognition pattern would not best reflect the economics of all lease transactions. They suggested that the Boards propose different accounting models for different populations of leases.
d. Others said that a single expense recognition pattern may not best reflect the economics of all lease transactions. Nonetheless, they supported the lessee accounting model proposed in the 2010 Exposure Draft because they thought it would be less complex and less costly to apply than multiple models. They noted the benefits of removing the need for a lease classification test and having only one method of accounting for all leases from an administrative perspective. They also questioned whether multiple expense recognition patterns would increase the usefulness of information provided to users of financial statements.

BC35. On the basis of that feedback, the Boards first concluded that it would be inappropriate to measure the lease liability for any lease on a different basis from that used to measure other similar financial liabilities. Users of financial statements confirmed that the recognition of the lease liability would be most beneficial to their analyses if measured on a basis similar to that used for other financial liabilities (that is, on a basis similar to the effective interest method).

BC36. The Boards then considered various ways of amortizing the right-of-use asset, and presenting that amortization, to address concerns raised about the effects on profit or loss as proposed in the 2010 Exposure Draft. The approaches considered included the following:

a. Interest-based amortization (often referred to as annuity amortization) in which the right-of-use asset would be amortized taking into account the time value of money. If a lessee expects to derive the same level of benefits from the right-of-use asset over the lease term, this approach views those same benefits to be worth relatively more in the later years of a lease as a result of the time value of money. Consequently, the amortization charge would typically increase over the lease term. This approach would result in a lessee recognizing a total lease expense, consisting of interest on the liability and amortization of the right-of-use asset, on a straight-line basis if lease payments were even or relatively even over the lease term. The total lease expense would vary, however, in each period if lease payments were uneven. The Boards rejected this approach for a number of reasons:

1. Such an amortization or depreciation method is currently prohibited in U.S. GAAP and is not generally permitted to be applied under IFRS, although not specifically prohibited. The Boards were concerned about the consequences of requiring such a method only for right-of-use assets when the method is not applied to other nonfinancial assets including property, plant, and equipment.
2. Some users of financial statements expressed concern about a model that would result in a lack of comparability between the lease and purchase of an asset. For example, some airline analysts were concerned that a 20-year lease of an aircraft would be accounted for differently from the purchase of a similar aircraft.
3. Some preparers expressed concerns about the costs associated with applying such an approach. They thought that this approach would be more costly to apply than the proposals in the 2010 Exposure Draft because it would require more extensive systems changes. Some thought that they could account for right-of-use assets within their existing systems for property, plant, and equipment if the right-of-use asset were amortized similarly to other nonfinancial assets.

b. An amortization approach that looked through to consumption of the underlying asset. This approach was based on the "whole asset" approach as described in the Discussion Paper. The whole asset approach is based on the premise that, during the lease term, the leased item is under the control of the lessee. Accordingly, a lessee would recognize the leased item as its asset and recognize an obligation to return the item to the lessor at the end of the lease term, in addition to an obligation to make lease payments. If the lease was for substantially all of the leased item's expected economic life, the obligation to return the item would be relatively insignificant. In contrast, if the lease was for a short portion of the leased item's life (and the item was expected to retain virtually all of its value over the lease term), the obligation to return the item would be significant. Under the approach considered by the Boards during their deliberations in 2012, the lessee would consider the right-of-use asset to be a combination of the underlying asset less an obligation to return that asset to the lessor. The pattern of the amortization charge, and consequently the lease expense recognized by the lessee in each reporting period, would vary depending on the extent to which the economic benefits embedded in the underlying asset would be consumed by the lessee. For instance, if a lessee was expected to consume almost all of the economic benefits embedded in the underlying asset (for example, because the lease term is for almost all of the economic life of the asset), the approach would produce a lease expense similar to the expense recognized under current lessee accounting for capital leases. In contrast, if the lessee was expected to consume very little, if any, of the economic benefits embedded in the underlying asset (for example, because the underlying asset would retain virtually all of its value over the lease term), the approach would produce a lease expense similar to the expense recognized under current lessee accounting for operating leases (when lease payments are relatively even over the lease term). Although some Board members favored this approach because it would reflect the way in which many leases are priced, the Boards rejected the approach on the basis of feedback from preparers that indicated that the approach would be prohibitively costly to apply because of the judgment required and the volume of leases that exist.

c. An approach that would result in the recognition of a single lease expense recognized on a straight-line basis over the lease term. Virtually all lessees that predominantly lease property (that is, land and/or buildings) supported this approach, as did some users of financial statements that analyze entities that predominantly lease property. In their view, recognizing lease expenses for property leases on a straight-line basis reflects the nature of the transaction. For example, when entering into a typical five-year lease of retail space, some noted that the lessee was simply paying rent to use the retail space, which should be recognized on a straight-line basis. Although the Boards were persuaded by this argument in the context of most leases of property (as described in paragraphs BC40–BC63), the Boards rejected this approach for *all* leases. If applied to all leases, the approach would fail to address concerns raised by some users about the comparability of accounting when leasing or purchasing assets. For example, under this approach, it would be unlikely for a lessee to account for the financing inherent in a 20-year lease of an aircraft in its statement of comprehensive income.

BC37. During redeliberations, the Boards consulted extensively on the approach to lease expense recognition and took into account comments made on that issue by respondents to the 2010 Exposure Draft. That consultation emphasized that different stakeholders have very different views about the economics of lease transactions. Some view all leases as financing transactions. Others view almost no leases as financing transactions. Finally, in others' view, the economics are different for different leases.

BC38. Some Board members expressed a preference to retain a single lessee accounting model that would require a lessee to amortize the right-of-use asset consistent with other nonfinancial assets and measure the lease liability consistent with other similar financial liabilities. Because it would be impossible to develop lessee accounting proposals to which all stakeholders would agree, the Boards noted that such an approach would provide a coherent accounting model that would be easy to understand and that the approach would reduce complexity by removing the need for a lease classification test and systems that could deal with two lessee accounting approaches.

BC39. However, in light of all of the feedback received, and because of the wide variety of leases (which range from those that provide the underlying asset to the lessee for almost all of the underlying asset's economic life to those that provide the underlying asset to the lessee for very little of the underlying asset's economic life), the Boards concluded that amortizing the right-of-use asset consistent with other nonfinancial assets would not provide the best reflection of the nature of *all* leases. At the same time, the Boards also were aware that a single approach that attempted to capture the differing economics embedded in all leases would be impracticable (as explained in paragraph BC36(b)).

Determining Whether and How to Classify Leases

BC40. When considering whether and how to distinguish between different leases, the Boards focused on identifying when, if ever, presenting a single lease expense (recognized on a straight-line basis) would provide better information to users of financial statements than separately presenting amortization of the right-of-use asset and interest on the lease liability. The Boards concluded that this would be the case when such an expense recognition pattern would better reflect the economics of the lease.

BC41. The terms and conditions of the lease and the nature of the underlying asset play an important role in understanding the economics of a lease. Although a lessee is accounting for the right-of-use asset and not the whole underlying asset, the rights the lessee obtains in a lease are inevitably linked to the underlying asset. A lessor often prices and assesses the returns it generates from its leasing activities with reference to the value of the underlying asset.

BC42. The Boards concluded that a single lease expense would provide better information about leases for which the lessee pays only for the use of the underlying asset and is expected to consume only an insignificant amount of the economic benefits embedded in the underlying asset itself. Consequently, the Boards decided that the factor that would be used to distinguish between different leases is the level of the lessee's consumption of the economic benefits embedded in the underlying asset.

BC43. The rationale for the classification principle proposed to distinguish between different leases is based on the fact that the lessee has the right to use *all* of the underlying asset during the period of the lease—that is, by definition, the lessee controls the use of the underlying asset during the lease term. Accordingly, from an economic perspective, and subject to market constraints, a lessor would generally price a lease to ensure that it obtains a desired return on its total investment in the underlying asset and also to recover an amount representing the portion of the underlying asset that the lessee is expected to consume during the lease term.

BC44. When there is no expected decline in the value or service potential of the asset (that is, when the lessee is not expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset), the lease payments made by the lessee would represent amounts paid to provide the lessor with a return on its investment in the underlying asset, that is, a charge for the use of the asset by the lessee. That return or charge would be expected to be even, or relatively even, over the lease term. In many respects for such a lease, the payments made by the lessee could be viewed as somewhat similar to an entity paying interest on an interest-only loan. That is because the lessee “borrows” the underlying asset, uses it during the lease term while paying the lessor even (or relatively even) lease payments for that use (providing the lessor with a constant return on its investment in the asset), and returns the underlying asset to the lessor with virtually the same value or service potential as it had at the commencement date. In the case of a lease, however, the asset “loaned” to the lessee is a tangible asset rather than a financial asset.

BC45. In contrast, when the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset, the lessor would charge the lessee for recovery of that portion of the underlying asset that the lessee is expected to consume during the lease term, as well as obtaining a return on its investment in the asset. The lease payments and, thus, the right-of-use asset, would incorporate the acquisition of the portion of the underlying asset that the lessee is expected to consume. When that is the case, the Boards concluded that accounting for the right-of-use asset similar to other nonfinancial assets (such as property, plant, and equipment) would provide the most useful information to users of financial statements about the nature of such leases.

BC46. For example, if a lessee leases a car for three years and that car has an economic life of seven years, the lessee would be expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset during the three-year lease term. From an economic perspective (and subject to market constraints), the lessor would be expected to charge the lessee to recover (a) an amount representing the portion of the car expected to be consumed by the lessee over the three-year lease term and (b) an amount providing the lessor with a return on its investment in the portion of the car that is not consumed by the lessee. For that reason, the lease payments made, and the right-of-use asset acquired, by the lessee would effectively incorporate the acquisition of the portion of the car that the lessee consumes during the lease term.

BC47. In contrast, if a lessee leases 2 floors of an office building for 2 years and that building has an economic life of 50 years, the lessee is consuming an insignificant portion of the economic benefits embedded in the underlying asset. That is because the office building would be expected to lose very little, if any, of its overall service potential during the two-year lease term. From an economic perspective (and subject to market constraints), the lessor would be expected to charge the lessee only to use the office space over the lease term (providing the lessor with a return on its investment in the building); the lessor would not require recovery of any of its investment in the building because the building would be expected to retain virtually all of its value or service potential over the lease term.

BC48. Using this rationale, the Boards are proposing two approaches to the recognition and measurement of expenses arising from a lease:

a. For some leases (Type A leases), a lessee would be required to recognize and present amortization of the right-of-use asset consistently with depreciation and amortization of other nonfinancial assets and the unwinding of the discount on the lease liability consistently with interest or the unwinding of the discount on other financial liabilities measured on a discounted basis.
b. For other leases (Type B leases), a lessee would be required to amortize the right-of-use asset so that the lessee recognizes a *single lease expense* (combining amortization of the right-of-use asset and the unwinding of the discount on the lease liability) on a straight-line basis.

BC49. The principle for deciding which of the two approaches applies is similar to the principle behind the whole asset approach described in paragraph BC36(b). However, whereas the whole asset approach would have resulted in a range of expense recognition profiles depending on the level of consumption of the underlying asset, the approach proposed by the Boards would result in only two expense recognition profiles.

Application of the classification principle

BC50. As described in paragraphs BC40–BC49, the classification principle based on consumption refers to the expected decline in the economic benefits embedded in the underlying asset during the lease term. Applying that principle without additional requirements might have forced entities to obtain information about or estimate the market value of assets being leased, not only at the commencement date but possibly also at the end of the lease term for some leases. In response to requests to reduce complexity and the cost of implementing the proposals where possible, the Boards decided to simplify the requirements in this Exposure Draft by proposing to apply the classification principle largely on the basis of the nature of the underlying asset (that is, property [land and/or a building] and assets other than property [for example, equipment or vehicles]).

BC51. In the Boards' view, applying the classification principle based on the nature of the underlying asset would make the classification proposals much simpler to apply. Although the Boards acknowledge that applying the principle in the manner proposed would not always result in conclusions that are consistent with the principle (that is, there may be some leases of property classified as Type B leases for which the lessee expects to consume more than an insignificant portion of the property), in the Boards' view, the proposed approach will result in most leases being classified according to that principle. That is because property typically has a relatively long life, and a large proportion of the lease payments for some property leases relates to the land element inherent in property leases. That land element has an indefinite life, and the economic benefits embedded in the land would not be expected to be consumed over the period of a lease.

BC52. In contrast, the Boards concluded that the opposite is true for most leases of assets other than property, such as equipment and vehicles. Equipment and vehicles are depreciating assets whose value not only declines over their economic lives but generally declines faster in the early years of their lives than in the later years. Accordingly, in the Boards' view, a lessee will generally consume more than an insignificant portion of the economic benefits embedded in the underlying asset for most equipment and vehicle leases.

BC53. The Boards decided, however, that an entity should not classify leases by considering only the nature of the underlying asset. That is to ensure that the conclusions reached more closely reflect the classification principle. For leases of property, the Boards decided to include classification criteria that are based on the indicators that exist in IAS 17, *Leases*, for finance leases—that is, those indicators that refer to the economic life and fair value of the underlying asset when assessing whether a lease transfers substantially all the risks and rewards incidental to ownership of the underlying asset to the lessee. For leases of assets other than property, an entity would also classify a lease with reference to the economic life and fair value of the underlying asset. However, the criteria proposed directly relate to the classification principle based on insignificant consumption of the underlying asset.

BC54. Using the economic life and fair value indicators that exist in IAS 17 as the basis for determining when a lease of property is a Type A lease captures those leases of property for which it is clear that recognizing amortization of the right-of-use asset and interest on the lease liability would provide better information about the nature of the lease. For example, a manufacturer may enter into a 20-year lease of a manufacturing plant with a financial institution lessor in which the lessee is expected to consume substantially all of the economic benefits embedded in the plant, and the purpose of the transaction for both the lessee and the lessor is the provision of finance to the lessee. In addition, many stakeholders are familiar with applying those indicators, which would reduce costs and complexity when implementing the leases proposals.

BC55. Some have questioned why the approach proposed for classifying property leases is based on such high thresholds when assessing the lease relative to the economic life and fair value of the underlying asset. They note that the IAS 17 principle, that is, transfer of substantially all the risks and rewards incidental to ownership, would appear to relate to leases for which the lessee consumes almost all of the economic benefits embedded in the underlying asset rather than leases for which the lessee consumes more than an insignificant portion of the underlying asset. The Boards note, however, that when classifying property leases, the economic life of the property is considered to be the remaining economic life of the building. For a property lease for which a significant part of that property's value is derived from its location, a lessee is unlikely to consume more than an insignificant portion of the economic benefits embedded in the entire property (including the land) unless the lease term is for at least a major part of the remaining economic life of the building. Accordingly, although the wording of the classification criteria for property leases (that is, a major part of the remaining economic life and substantially all of the fair value) would appear to establish a line that is different from the classification principle (that is, "more than an insignificant portion"), applying the economic life criterion on the basis of the major part of the remaining economic life of the building in a property lease and the fair value criterion on the basis of substantially all of the fair value of the underlying asset is expected to result in conclusions that are consistent with the classification principle in most instances.

BC56. For example, assume a lessee leases a new office building for 15 years. The lease also incorporates the land on which the building is constructed and the location (that is, the land element of the lease) represents a substantial proportion of the fair value of the property. The economic life of the building is estimated to be 50 years. When applying the requirements in paragraph 842-10-25-7 of this Exposure Draft, an entity would conclude that the lease of the office building should be classified as a Type B lease (that is, the lease term is not a major part of the remaining economic life of the building and the lease payments would not represent substantially all of the fair value of the property). Even though 15 years would be more than an insignificant portion of the life of the building (when considered in isolation), the conclusion that the lease is classified as a Type B lease would be consistent with the consumption principle. That is because the lessee would not be expected to consume more than an insignificant portion of the economic benefits embedded in the property over the 15-year lease term—the land element would be expected to retain all of its service potential over the lease term and the service potential of the building would be expected to decline more rapidly nearing the end of its life rather than in the early years of its life.

BC57. The Boards are not proposing to classify leases of assets other than property on the basis of the indicators in IAS 17. That is because, when applied to equipment and vehicle leases, those indicators would *not* reflect the consumption principle proposed by the Boards (as described in paragraphs BC60–BC62).

Other approaches considered for classifying leases

BC58. The Boards also considered classifying leases on the basis of:

a. The lessee's business purpose for entering into a lease.

b. The principle in IAS 17 (that is, identifying when a lessor transfers substantially all the risks and rewards incidental to ownership of the underlying asset to the lessee).

BC59. Using the lessee's business purpose would have the advantage of reflecting a lease in a lessee's financial statements on the basis of how the lessee views its business purpose for entering into the lease. However, the Boards rejected this approach for comparability reasons. Because leases would be classified based on each lessee's assessment of its business purpose, the judgment applied by management might vary by lessee. That would make it more difficult for users of financial statements to understand when and how management has applied its judgment when classifying leases, both within the same entity and between entities.

BC60. Some Board members supported the use of the principle in IAS 17. They view the primary improvement in this Exposure Draft to be the recognition of lease assets and lease liabilities. Those Board members note that in the face of diverse views about the effects of the proposed right-of-use model on a lessee's profit or loss, a practical solution would be to retain the existing lease classifications. That approach would be familiar to preparers and would distinguish the effects of the model on a lessee's profit or loss based on the extent of the risks and rewards relating to the underlying asset conveyed through the lease.

BC61. However, the Boards decided against this approach, noting that the risks and rewards principle in IAS 17 was intended to distinguish between leases that are considered to be economically similar to the purchase of the underlying asset by the lessee and those that are not. The objective of this project is not to distinguish between leases that are economically similar to purchases and other leases.

BC62. In addition, when determining how to classify leases, the Boards wanted to identify leases for which presenting a single lease expense, recognized on a straight-line basis, would provide better information to users of financial statements. The Boards concluded that using the principle in IAS 17 would not achieve that objective for assets other than property. For example, if a lessee was to classify all leases that are operating leases in IAS 17 as Type B leases, a lessee would be likely to present a single lease expense for a 20-year lease of a vessel or an aircraft rather than presenting amortization and interest on those transactions. In those situations, users of financial statements have indicated that it would improve financial reporting to not only recognize assets and liabilities for such leases, but also account for the leases on a basis similar to the purchase of property, plant, and equipment that is financed. Accordingly, those users supported the presentation of amortization and interest relating to those leases. Consequently, the Boards rejected using the IAS 17 risks and rewards principle to classify all leases.

BC63. Nonetheless, the Boards decided to use some of the indicators supporting the principle in IAS 17 when classifying property leases because that would, in most cases, result in lease classification conclusions that reflect the consumption principle proposed by the Boards when applied to leases of property (as described in paragraphs BC51–BC56).

The Lessor Accounting Model

BC64. Having concluded that the lessor's lease receivable and rights retained in the underlying asset both meet the definition of an asset (as described in paragraphs BC24–BC28), the Boards considered whether requiring a lessor to recognize those assets for all leases would improve financial reporting to such an extent that the benefits from the improvements would outweigh the costs associated with such a change.

BC65. When considering lessor accounting, the Boards noted the importance of considering the accounting for the underlying asset. In contrast to the lessee accounting model, which needs to address only the lessee's rights and obligations arising from the lease, the lessor accounting model needs to address the accounting for the underlying asset as well as the lessor's rights and obligations arising from the lease. The accounting for the underlying asset could affect the assessment of the rights and obligations that should be recognized by the lessor.

BC66. In the 2010 Exposure Draft, the Boards proposed that a lessor would recognize a lease receivable for all leases. That is consistent with a lessee recognizing a lease liability for all leases.

BC67. If the lessor retained exposure to significant risks or benefits associated with the underlying asset, the Boards proposed that a lessor would continue to recognize the underlying asset as its asset, as well as recognize a lease receivable. The lessor also would recognize a liability. This approach was described as the performance obligation approach in the 2010 Exposure Draft. Under this approach, the lease was considered to create an asset, the lease receivable, and a liability, the obligation to permit the lessee to use the underlying asset over the lease term. The asset and the liability created by the lease would be separate from the underlying asset itself. The lessor would retain control of the underlying asset and would continue to recognize it.

BC68. If the lessor did not retain exposure to significant risks or benefits associated with the underlying asset, the Boards proposed that a lessor would derecognize the portion of the underlying asset relating to the right-of-use asset transferred to the lessee and recognize the lease receivable. The rights retained in the underlying asset would be reclassified as a residual asset. That approach was described as the derecognition approach in the 2010 Exposure Draft.

BC69. There was very little support for the performance obligation approach from respondents to the 2010 Exposure Draft or from participants at outreach meetings. Many viewed the approach as inappropriately inflating a lessor's assets and liabilities. Many questioned how one set of cash flows—the cash flows to be received from the lessee—could relate to both the lease receivable and the underlying asset. Many also questioned how the obligation to permit the lessee to use the asset would meet the definition of a liability. Having delivered the underlying asset to the lessee, the lessor typically would have nothing further to do in relation to the right-of-use asset other than comply with the terms and conditions of the contract. For many leases, the lessor must give the lessee "quiet enjoyment" of the underlying asset, unless the lessee breaches the contract. Many respondents did not view complying with the terms and conditions of a contract as an obligation that should give rise to a liability. There would appear to be no expected outflow of future economic benefits from the lessor, which is an essential component of the definition of a liability.

BC70. Some supported applying the derecognition approach to all leases. Others thought that the existing lessor accounting requirements were not "broken" and questioned whether the benefit of changing lessor accounting would outweigh any costs associated with that change. Others were concerned about the lack of consistency between the lessee accounting proposals (a single lessee accounting model) and the lessor accounting proposals (a dual lessor accounting model) as proposed in the 2010 Exposure Draft. Many suggested that the Boards make the lessor proposals consistent with the revenue recognition proposals, the lessee accounting proposals or, ideally, both.

BC71. On the basis of this feedback, the Boards decided to change the lessor accounting proposals as follows:

a. A lessor would determine the appropriate lessor accounting approach using the same classification requirements as are proposed for lessee accounting. The rationale used for having two different expense recognition patterns for the lessee would be the same as that used for having two different lessor accounting approaches (as described in paragraphs BC40–BC63).
b. If a lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset, the lessor would account for the transfer of the right-of-use asset to the lessee as the sale of that portion of the underlying asset that the lessee is expected to consume. Accordingly, the lessor would derecognize the underlying asset and recognize a lease receivable and a residual asset, which would be measured on a cost basis. The lessor also would recognize any profit relating to the lease at the commencement date.
c. If a lessee is not expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset, the lessor would account for the lease similar to existing operating lease accounting. Accordingly, the lessor would not derecognize the

underlying asset and would recognize rental income over the lease term, typically on a straight-line basis.

BC72. As noted in paragraph BC24, at the commencement date, the lessor transfers the right to use the underlying asset to the lessee, which the lessee recognizes as an asset. Although the lessor may have an obligation to provide other services to the lessee (for example, to maintain or service the asset), those obligations are separate from the lease itself and are accounted for separately (as described in paragraphs BC112–BC116). After making the underlying asset available for use by the lessee, the lessor has performed its obligation under the contract and has an unconditional right to receive lease payments from the lessee. Accordingly, to be consistent with the right-of-use model, a lessor would recognize a lease receivable.

BC73. However, the Boards decided not to propose the recognition of a lease receivable and derecognition of a portion of the underlying asset for all leases and, in particular, not for most property leases, for a number of reasons:

a. When the lessee is expected to consume very little, if any, of the economic benefits embedded in the underlying asset, the right-of-use asset transferred to the lessee does not represent the sale of any significant portion of the underlying asset (as described in paragraphs BC43–BC47). The lessor "loans" the underlying asset to the lessee, allowing the lessee to use its asset during the lease term, subject to market constraints, and charges the lessee for that use on the basis of a desired return on its investment in the asset. The lessee then returns the asset to the lessor in virtually the same condition as it was at the commencement date. In that circumstance, the economic benefits embedded in the underlying asset are not expected to change to any real extent over the lease term because the lessor is expected to get back virtually the same asset that it gave up at the commencement date. Accordingly, the Boards have concluded that when there is little or no consumption of the underlying asset (that is, when the economic benefits embedded in the underlying asset are not expected to change significantly over the lease term), more useful information would be provided by continuing to recognize the underlying asset rather than by recognizing a lease receivable and a residual asset, which would result in accounting for the lease as the sale of a portion of the underlying asset. A lessor would reflect better the economics of the transaction by recognizing rental income over the lease term.
b. Discussions with lessors indicate that there are two different lessor business models:
    1. The leasing activities of some lessors are primarily about providing finance to lessees. Such lessors would typically have no ongoing involvement with the underlying asset while it is the subject of a lease or, if they do, that involvement is priced separately from the lease. Most equipment and vehicle lessors tend to have such a

business model. The Boards concluded that accounting for a lease as the sale of a portion of the underlying asset with financing would appropriately reflect such a lessor's business model.

2. Other lessors manage the underlying asset throughout the lease term and over the economic life of the asset. In those lessors' views, they are not primarily in the business of providing finance to lessees. Instead, their aim is to generate cash flows from the underlying asset on an ongoing basis by managing the asset over a period typically longer than any one lease term. Most property lessors tend to have such a business model. The Boards concluded that accounting for a lease by recognizing the lease payments received as rental income over the lease term would appropriately reflect such a lessor's business model.

c. The underlying asset in most property leases meets the definition of investment property in IAS 40, *Investment Property*. Lessors of investment property applying IFRS must either measure their investment property at fair value or, if measured at cost, disclose the fair value of the investment property. Some users of financial statements have confirmed that the fair value of an entire investment property gives them more useful information than other measurements. Rental income and changes in fair value are inextricably linked as integral components of the performance of the lessor, and having both pieces of information (that is, rental income and fair value changes) results in a lessor reporting performance in a meaningful way. Consequently, the Boards concluded that the recognition of a lease receivable and a residual asset (measured on a cost basis) for each portion of an investment property leased to a different tenant would not provide more useful information for investment property than what is provided under existing requirements.

d. The approach would be extremely complicated to apply when one asset is leased to multiple parties concurrently.

BC74. For those reasons, the Boards decided not to propose any significant changes to the existing lessor accounting requirements for property leases.

Other Approaches Considered for Lessor Accounting

BC75. When developing the lessor accounting proposals, the Boards considered a number of alternatives.

BC76. In the 2010 Exposure Draft, the Boards proposed a performance obligation approach for some leases. On the basis of the feedback received from respondents (summarized in paragraph BC69), the Boards rejected this approach when redeliberating those proposals.

BC77. The Boards also considered a net asset and liability approach in which the lessor would recognize a lease receivable and an obligation to permit the lessee to use the underlying asset, and present those amounts together on a net basis in the lessor's statement of financial position. Such an approach would address the main concern raised by respondents about the performance obligation approach, namely that it would artificially inflate a lessor's assets and liabilities. However, the Boards concluded that the benefits of applying such an approach did not outweigh the costs when compared with existing operating lease accounting. That is because the net asset and liability approach and operating lease accounting would result in a lessor recognizing the same amounts in its statement of financial position and in profit or loss for virtually all leases currently classified as operating leases. However, the net asset and liability approach would be more complex and costly to apply.

BC78. The Boards also considered whether to retain the existing lessor accounting requirements, that is, operating lease accounting and finance lease accounting. Some respondents to the 2010 Exposure Draft had suggested that the existing lessor accounting requirements were not fundamentally flawed and would result in useful information. However, the Boards concluded that proposing changes to the accounting for leases would improve financial reporting in the light of the changes being proposed to lessee accounting because of the following:

a. In the Boards' view, the changes being proposed for lessors with leases of assets other than property will improve financial reporting. For example, a financial institution lessor (leasing equipment or vehicles) would be expected to recognize interest income over the lease term of all of its leases over 12 months, reflecting that the lessor is primarily engaged in providing finance to lessees. According to existing requirements, that lessor is likely to account for some of those leases as financing transactions (that is, finance leases) and some as operating leases (recognizing rental income on a straight-line basis, rather than interest income). In addition to recognizing interest income, a manufacturer lessor (leasing equipment or vehicles) is likely to recognize revenue and cost of sales at the commencement date, similar to how the lessor recognizes revenue and cost of sales on sales of similar assets. The manufacturer lessor would, however, only recognize revenue and profit relating to the right-of-use asset transferred to the lessee, rather than revenue and profit on the entire leased asset. That accounting would reflect that a manufacturer lessor often uses leasing as an alternative means of realizing value from assets that it would otherwise sell. According to existing requirements, that lessor is likely to account for some of its leases as finance leases and some as operating leases resulting in very different accounting outcomes, even though it is likely to price all of its leases in a similar way.

b. Without any change to lessor accounting, an entirely different rationale would be used to support the lessee and the lessor accounting proposals. Respondents to both the Discussion Paper and the 2010 Exposure Draft had requested consistency in the rationale supporting both the lessee and lessor models, with many noting subleases as a reason for this request.
c. It would be difficult, if not impossible, not to make *any* changes to lessor accounting in light of the changes being made to lessee accounting, for example, changes to variable lease payments and the definition of a lease. Consequently, if any improvements could be made to lessor accounting, it would be appropriate to make those improvements at this time.

Scope

BC79. The Discussion Paper and the 2010 Exposure Draft set out the Boards' preliminary view that the scope of the proposed requirements should be based on the scope of the existing leases requirements. For the FASB, that is Topic 840 of the Codification, and for the IASB, it is IAS 17. Topic 840 applies to leases of property, plant, and equipment. IAS 17 applies to all leases, with specified exclusions. Those exclusions result in a similar scope to that of Topic 840.

BC80. In this Exposure Draft, the Boards propose the following scope exceptions:

a. Leases to explore for or use natural resources, such as minerals, oil, and natural gas. That is because accounting practices for assets relating to exploration and evaluation are diverse and differ from the accounting for other types of assets. Furthermore, the accounting for assets related to the exploration and use of natural resources is specified in IFRS 6, *Exploration for and Evaluation of Mineral Resources,* or Topic 930, Extractive Activities—Mining, and Topic 932, Extractive Activities—Oil and Gas.
b. Leases of biological assets (including plants and living animals) to ensure that requirements relating to biological assets are found in a single standard. Leases of timber are specifically excluded from the FASB's Exposure Draft to be consistent with the scope exclusion that currently exists in Topic 840. The scope exclusion for leases of timber is not necessary in the IASB's Exposure Draft because IAS 41, *Agriculture*, defines biological assets to include trees in a forest, which encompasses timber (before it is harvested).
c. Under IFRS, service concession arrangements within the scope of IFRIC 12, *Service Concession Arrangements*. The IASB decided to clarify that service concessions are not within the scope of this Exposure Draft, consistent with the conclusions in IFRIC 12 that such arrangements do not meet the definition of a lease.

Intangible Assets

BC81. Consistent with the 2010 Exposure Draft, the FASB's Exposure Draft proposes to exclude leases of intangible assets from its scope. The IASB's Exposure Draft does not permit lessors, or require lessees, to apply the lease accounting proposals to leases of intangible assets. The Boards acknowledged that there is no conceptual basis for excluding leases of intangible assets. However, the Boards concluded that a separate and comprehensive review of the accounting for intangible assets should be performed before requiring leases of intangible assets to be accounted for under the proposed leases requirements. Many respondents to the 2010 Exposure Draft agreed with this proposal.

BC82. IAS 17 excludes licensing agreements from its scope, rather than all leases of intangible assets. A few respondents to the 2010 Exposure Draft who apply IAS 17 to leases of intangible assets raised concerns about that scope exclusion, which they interpreted as preventing the application of the proposed leases requirements to leases of intangible assets. They were of the view that applying the lease proposals would provide users of financial statements with better information about those types of transactions in the absence of any other requirements that specifically address the accounting for such leases.

BC83. In response to that feedback, the IASB decided to clarify that a lessee need not apply the lease proposals to leases of intangible assets, rather than stating that such leases are excluded from the scope of this Exposure Draft. That is because the IASB did not want to prevent a lessee from applying the proposals to leases of intangible assets. In the IASB's view, a lessee could apply the proposals to leases of intangible assets by applying IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, in the absence of another standard that includes specific requirements on leases of intangible assets. That would not be the case for a lessor because the revenue recognition proposals specifically address the accounting for leases of intangible assets from a lessor's perspective.

Onerous Contracts

BC84. The IASB's 2010 Exposure Draft proposed that a lessee should apply IAS 37, *Provisions, Contingent Liabilities and Contingent Assets,* to leases between the date of inception and the commencement date, if the lease meets the definition of an onerous contract in IAS 37. The IASB did not consider it necessary to develop separate requirements for such contracts and directed entities to apply IAS 37 if the contract is onerous. Except for short-term leases, after the commencement date, the costs of meeting an obligation under the lease and the economic benefits expected from the lease would be accounted for according to the proposals in this Exposure Draft. Accordingly, the lease proposals, and not IAS 37, would apply to a lease from the commencement date.

BC85. On reconsideration, the Boards confirmed those conclusions that if a lease is onerous between the date of inception and the commencement date, an entity should account for it in accordance with IAS 37 or Topic 450, Contingencies. The Boards decided not to include any particular exclusion for such onerous contracts in the scope section of this Exposure Draft because it would potentially be misleading. The proposals include a requirement to disclose information about leases before the commencement date if they create significant rights and obligations for the lessee. In addition, the Boards noted that an entity would be required to apply the requirements in other IFRSs or U.S. GAAP in any event, without the need to mention it specifically in this Exposure Draft.

Subleases

BC86. In the Boards' view, leases of right-of-use assets (that is, subleases) should be accounted for in the same way as other leases. Accordingly, this Exposure Draft proposes that subleases are within its scope.

BC87. In addition, the Boards decided that an entity should account for a head lease and a sublease as two separate contracts. Even if entered into at close to the same date, each contract is generally negotiated separately, with the counterparty to the sublease being a different entity from the counterparty to the head lease. Because of this, the obligations that arise from the head lease for the lessee are generally not extinguished by the terms and conditions of the sublease.

BC88. The Boards decided that when classifying a sublease, an entity should evaluate the lease with reference to the underlying asset, rather than the right-of-use asset arising from the head lease. A lessee in a sublease may not know the terms and conditions of the head lease and, accordingly, the proposed approach should be easier to apply than referring to the right-of-use asset arising from the head lease. In addition, the Boards noted that it may be difficult to understand and explain why a lessor would account for similar leases differently. That could occur if an entity were required to refer to the right-of-use asset when classifying a sublease. For example, if subleases were classified with reference to the right-of-use asset, a lessor that leases two similar properties on similar terms for five years could account for those leases differently if the lessor owned one of the properties and leased the other.

Inventory

BC89. The 2010 Exposure Draft did not specifically exclude leases of inventory from its scope. Some respondents questioned whether, what is sometimes referred to as "leased inventory" would be within the scope of the lease proposals. "Leased inventory" is sometimes used to describe purchases of nondepreciating spare parts, operating materials, and supplies that are associated with leasing another underlying asset. The Boards decided not to specifically exclude leases of inventory from the scope of this Exposure Draft. The Boards note that few of these transactions, if any, would meet the definition of a lease and, therefore, a scope exception would not be necessary. In addition, in the Boards' view, it is unlikely that an asset will simultaneously meet the definition of an underlying asset and inventory from a lessee's perspective. That is because a lessee is unlikely to be able to hold an asset that it leases (and that is owned by another party) for sale in the ordinary course of business or for consumption in the process of production for sale in the ordinary course of business.

Noncore Assets

BC90. Assets that are not essential to the operations of an entity are sometimes of less interest to users of financial statements because those assets often are less material to the entity. Accordingly, the costs associated with recognizing and measuring the assets and liabilities arising from leases of noncore assets could outweigh the benefits to users. For example, information about assets and liabilities arising from the lease of a delivery van is important to assess the operations of a delivery company, but it may not be important in assessing the operations of a financial institution, which uses the van to deliver stationery to its retail banking locations. Consequently, the Boards considered whether to exclude leases of noncore assets from this Exposure Draft.

BC91. Although some Board members favored such an approach, the Boards noted the following difficulties with excluding leases of noncore assets from the scope of the proposals:

a. Defining *core* and *noncore* would be extremely difficult. For example, would office buildings used by a financial institution be a core asset, and would the conclusion be different if the financial institution has retail banking operations? Would an entity consider some offices or cars to be core assets and others noncore? If core assets were defined as those essential or crucial to the operations of an entity, it could be argued that every lease would be a lease of a core asset. Otherwise, why would an entity enter into the lease?
b. Different entities might interpret the meaning of noncore assets differently, thereby reducing comparability for users of financial statements.
c. Neither IFRS nor U.S. GAAP distinguishes core and noncore purchased assets for the purposes of recognition. Because of that, it would be difficult to justify distinguishing a right-of-use asset relating to a core asset from one that relates to a noncore asset.

BC92. Consequently, the Boards are not proposing any distinction in accounting on the basis of whether the underlying asset is core to an entity's operations.

Long-Term Leases of Land

BC93. A long-term lease of land is sometimes regarded as being economically similar to the purchase or sale of the land and, therefore, some suggested that such leases should be excluded from the scope of this Exposure Draft. However, the Boards are not proposing to specifically exclude long-term leases of land from the scope of this Exposure Draft for the following reasons:

a. There is no conceptual basis for differentiating long-term leases of land from other leases. If the contract does not transfer control of the land to the lessee but gives the lessee the right to control the use of the land throughout the lease term, the contract is a lease and should be accounted for as such.
b. Inevitably, any definition of a long-term lease of land would be arbitrary.
c. A very long term lease of land (for example, a 99-year or 999-year lease) could be classified as a Type A lease because the present value of the lease payments could represent substantially all of the fair value of the land. In this case, the accounting applied by the lessee and lessor would be similar to accounting for the purchase or sale of the land.

Leases of Investment Property at Fair Value (IASB Only)

BC94. The IASB's 2010 Exposure Draft proposed to exclude leases of investment property measured at fair value from its scope. That was because investment property analysts had informed the IASB that the requirements in IAS 40 provide useful information about the leasing activities of a lessor, especially when the fair value model is used. In particular, analysts said that both total rental income and fair value changes are important measures of performance of the lessor. Analysts would no longer have obtained total rental income information under the lessor accounting proposals in the 2010 Exposure Draft.

BC95. This Exposure Draft, however, does not exclude leases of investment property from its scope because of the changes proposed to the lessor accounting model and because most leases of investment property are expected to be classified as Type B leases. For Type B leases, the IASB proposes that a lessor of investment property applying IFRS would apply IAS 40 when accounting for its investment property and apply the proposed leases requirements when accounting for the lease. That is similar to how IAS 17 and IAS 40 currently interact. Accordingly, a user of financial statements would obtain fair value information about the investment property, which is required by IAS 40, and information about rental income earned by the lessor, which is required by this Exposure Draft.

Embedded Derivatives

BC96. The Boards considered whether an entity should be required to account for embedded derivatives within a lease separately, as it does in accordance with

IAS 39, *Financial Instruments: Recognition and Measurement*, or IFRS 9, *Financial Instruments*, or Topic 815, Derivatives and Hedging. The Boards noted that some variable lease payments that depend on an index or a rate, which the Boards propose to include in the measurement of lease payments, could meet the definition of an embedded derivative.

BC97. The proposals would not, in themselves, require variable lease payments that depend on an index or a rate to be measured at fair value. If the Boards did not retain the current requirements to account for embedded derivatives separately, unrelated derivative contracts could be bundled with leases to avoid measuring such embedded derivatives at fair value. Consequently, the Boards decided to retain the requirement to assess leases for embedded derivatives and, if they exist, to require the embedded derivatives to be separated from the lease and accounted for in accordance with IAS 39, IFRS 9, or Topic 815.

Costs Incurred Relating to the Construction or Design of an Underlying Asset

BC98. The 2010 Exposure Draft did not address issues specific to contracts often referred to as "build-to-suit" leases. Some respondents to the 2010 Exposure Draft questioned whether requirements on build-to-suit leases should be included in the leases proposals.

BC99. Existing U.S. GAAP provides requirements relating to a lessee's involvement in the construction of an asset that the lessee will lease when constructed (such contracts are typically build-to-suit leases). Those requirements were initially written to address situations in which a lessee might attempt to keep assets "off balance sheet" by leasing an asset that it had constructed but avoiding applying the sale and leaseback requirements that would typically require the lessee to recognize the asset. In such transactions, the lessor sometimes would be a variable interest entity.

BC100. The Boards considered but decided not to carry forward the requirements in U.S. GAAP to this Exposure Draft on how to account for costs incurred by a lessee relating to the construction or design of an asset for the following reasons:

a. Costs incurred relating to the construction or design of an asset would not meet the definition of lease payments or initial direct costs. Consequently, in the absence of specific requirements relating to a lessee's involvement in the construction of an asset, the lessee would apply other applicable IFRSs or U.S. GAAP to determine how to account for those costs. For example, the lessee would consider whether to apply the requirements on inventory or property, plant, or equipment or financial instruments when accounting for the costs incurred. In turn, the lessee may consider whether the lessor is a customer and, consequently, whether to apply the revenue recognition requirements. If the lessee controls the underlying asset before the commencement date, the lessee would then apply the sale and leaseback requirements when accounting for the transaction. The Boards noted that this approach would result in a lessee accounting for costs incurred relating to the construction of an asset consistently with how other entities account for similar costs and consistently with how the lessee accounts for similar costs not associated with a lease.

b. The existing requirements were written to address "off balance sheet" concerns at a time when leases classified as operating leases were not recognized in a lessee's statement of financial position. The Boards noted that the changes proposed in this project to require a lessee to recognize lease assets and lease liabilities and the changes proposed to sale and leaseback accounting, together with more recent changes to the consolidation requirements for variable interest entities in both IFRS and U.S. GAAP, would reduce the need for specific requirements in this area. For example, regardless of whether the lessee is considered to control the asset during construction, the lessee will recognize a right-of-use asset at the commencement date.

c. This decision is consistent with the Boards' proposals on sale and leaseback transactions, which would eliminate the requirements in U.S. GAAP that often would prevent sale and leaseback accounting for many real estate transactions. Instead, an entity would apply the revenue recognition proposals to sale and leaseback transactions to determine whether a sale has occurred (as described in paragraphs BC285–BC292).

BC101. Nonetheless, on the basis of the feedback received from some respondents, the Boards decided that it would be helpful to specifically state in this Exposure Draft that a lessee would apply other applicable IFRSs or U.S. GAAP when accounting for costs incurred relating to the construction or design of an underlying asset.

Identifying a Lease

Definition of a Lease

BC102. The 2010 Exposure Draft retained the existing definition of a lease and the requirements included in IFRIC 4, *Determining whether an Arrangement contains a Lease,* and in Topic 840, but with some minor changes to the wording of those requirements. Those requirements require an entity to determine whether a contract contains a lease by assessing whether the fulfillment of the contract depends on the use of a specific asset (the underlying asset) and the contract conveys the right to control the use of the underlying asset to the lessee.

BC103. Respondents to the 2010 Exposure Draft, as well as participants at workshops in 2010, expressed the following concerns about the proposed definition of a lease:

a. Although respondents generally agreed with the definition of a lease as the right to use an asset, many were concerned that the requirements supporting the definition would capture contracts that they perceived to be service contracts.
b. Some common contracts were identified as being difficult to assess under the existing requirements (for example, season tickets for sporting events, outsourcing contracts, charter arrangements in the shipping and oil and gas industries, and power purchase arrangements). Respondents noted that the distinction between a lease and a service is not so critical under existing requirements because the accounting for operating leases and services is the same. That would change, however, under the proposals for which meeting the definition of a lease results in a lessee recognizing lease assets and lease liabilities.
c. Questions were raised about how to apply some of the existing requirements. For example, could the underlying asset be a portion of a larger asset and, if so, when? How would one interpret “output” when there were outputs that had economic value but were not physical (for example, renewable energy credits)? There are difficulties in applying the pricing criteria in IFRIC 4 and in Topic 840 in a number of situations.
d. Some questioned why the control criteria used to define a lease were different from the control principle being proposed in the revenue recognition project.

BC104. The Boards decided to retain the definition of a lease in IFRIC 4 and Topic 840. They also affirmed that considering whether the customer (lessee) obtains the right to control the use of an underlying asset would be an appropriate way to determine whether a contract contains a lease. However, the Boards decided to change the proposed application guidance supporting the definition to align the concept of control more closely with the control principle in the revenue recognition project and in consolidation requirements and to address practice issues that were raised about the definition of a lease in IFRIC 4 and Topic 840.

BC105. More specifically, the Boards decided the following about the definition of a lease:

a. To retain the requirement that fulfillment of the contract must depend on a specified or an identified asset. The Boards considered whether the requirement should be changed to widen the definition to incorporate the right to use an asset of a particular specification. However, having considered feedback from participants at targeted outreach meetings, the Boards decided to retain the current requirement for the following reasons:

1. Being able to identify *an* asset, rather than one of a number of assets of a particular specification, is fundamental to the definition of a lease. It is necessary to know what the asset is to assess whether the customer has the right to control the use of that asset, classify the lease, and determine which asset to derecognize for lessors with Type A leases.
2. In most contracts for which there is no identified asset, the customer does not have the right to control the use of an asset. Consequently, widening the definition in that respect would possibly have forced some entities to go through the process of assessing whether the customer obtains the right to control the use of an asset, only to conclude that it does not. That would potentially have increased costs for little benefit.
3. The Boards were informed that the current requirements on specified assets work well in practice.

b. To enhance the requirements on the substitutability of an asset. If a supplier has a substantive right to substitute the underlying asset at any time during the term of the contract, in the Boards' view, the contract does not contain a lease. That is because a customer would be unable to control the use of an asset if the supplier can replace the asset without requiring the customer's consent (requiring the customer's consent to enter the customer's premises would not, however, prevent the supplier from having substantive substitution rights). The Boards have included additional language to help determine when substitution rights are substantive. Their intention in doing so is to discourage the insertion of a substitution clause in a contract, which does not change the substance or character of the contract, solely to achieve a particular accounting outcome. If a substitution clause is not substantive because it does not, for all intents and purposes, change the substance of the contract, that substitution clause should not affect an entity's assessment of whether a contract contains a lease.

c. To clarify that an underlying asset must be physically distinct. Consequently, an underlying asset can be a physically distinct portion of a larger asset. It cannot, however, be a capacity portion of a larger asset because that capacity portion is not physically distinct from the remaining capacity of that asset. The Boards concluded that it would be unlikely that a customer would have the right to control the use of a capacity portion of a larger asset (for example, a 20 percent capacity portion of a pipeline). That is because decisions about the use of the asset are typically made at the larger asset level. For example, a customer taking only 20 percent of the capacity of an asset would be unlikely to have the ability to make those decisions. Widening the definition to possibly capture portions of a larger asset that are not physically distinct might have forced entities to consider whether they lease assets used to fulfill any contract for services, only to conclude that they do not. Consequently, the Boards concluded that widening the definition to include capacity portions of a larger asset would increase complexity with little benefit. Nonetheless, the Boards noted that if a customer has the ability to obtain substantially all of the economic benefits from use of an asset, the larger asset is then considered to be an identified asset and the contract would contain a lease if the customer has the right to control the use of that asset.

d. To change the application guidance for "the right to control the use of an asset" to be more consistent with the concept of control applied in other requirements and projects (that is, the consolidation requirements and revenue recognition proposals). According to the existing requirements on the definition of a lease, a customer can have the right to control the use of an asset solely on the basis of obtaining substantially all of the output from an asset, assuming that the contract is priced in a particular way. This defines "control" based on a "benefits" element only. The revenue recognition proposals and consolidation requirements, however, define control to require both a "power" element as well as a "benefits" element. The Boards decided to change the application guidance to require a customer to have not only the right to obtain substantially all of the economic benefits from use of an asset during the lease term (a "benefits" element) but also the ability to direct the use of that asset (a "power" element). The Boards concluded that to have the right to control the use of an asset, a customer must have decision-making rights over the use of the asset that give it the ability to influence the economic benefits derived from the use of the asset. Without any such decision-making rights, the customer would have no more control over the use of the asset than any customer purchasing services. If this were the case, the customer would not control the use of the asset. The change to control will narrow the scope of the proposals. Some contracts that were previously considered to be leases would no longer meet the definition. The change also removes the need to have pricing criteria, which had proved difficult to apply in practice.

e. To clarify that only the benefits arising from *use* of an asset, rather than the benefits arising from *ownership* of that asset, should be considered when assessing whether a customer has the ability to derive the benefits from use of an asset. That is because a lease does not convey ownership of an underlying asset; it conveys only the right to use that underlying asset. Accordingly, the Boards concluded that a customer should not consider benefits relating to ownership of an asset (for example, tax benefits as a result of owning an asset) when considering whether a contract contains a lease. However, the Boards concluded that a customer should consider benefits relating to the use of an asset (for example, renewable energy credits received from the use of the asset) when considering whether a contract contains a lease.

f. To include additional language addressing assets that are incidental to the delivery of services. Respondents to the 2010 Exposure Draft were concerned that the definition of a lease might capture service contracts when the delivery of the service involves the use of particular assets that could be viewed as being under the control of the customer (for example, a season ticket at sporting venues and a contract for cable television services). The Boards decided to clarify that when the use of an asset is an inseparable or nondistinct part of the overall services being provided to a customer, the customer does not obtain the right to control the use of the asset—that is, the customer is unable to derive benefits from the use of the asset when the asset has no value or use to the customer without the other deliverables in the contract. Instead, the customer receives services over the term of the contract that require the use of the asset. The Boards note that this is consistent with the proposals in the revenue recognition project. In that project, the Boards concluded that, for example, a seller would not generally recognize revenue relating to the delivery of a good that is not distinct from other services in the contract.
g. To make some other minor modifications to the requirements to address practice issues raised relating to the existing requirements.

BC106. In the Boards' view, the proposed changes about the definition of a lease provide a sound basis on which to determine whether a contract contains a lease. The Boards decided to include guidance and examples to help entities apply the proposed principle.

Cancellable Leases

BC107. The 2010 Exposure Draft stated that a lease is a contract. However, it did not include a definition of a contract. In addition, in the light of the Boards' proposals on lease term and short-term leases, some stakeholders raised questions about how to account for leases that are often referred to as "cancellable," "month to month," "at will," "evergreen," "perpetual," or "rolling." Examples of such contracts include (a) a lease that runs from the date of signing until further notice and in which both the lessee and lessor have the right to cancel with one month's notice and (b) a lease that has an initial noncancellable period of one year but that can be extended for another year if that is agreed to by both the lessee and the lessor before the end of the initial noncancellable period.

BC108. For the purposes of defining the scope of the leases proposals, the Boards decided that a contract would exist only when it creates rights and obligations that are *enforceable*. Any initial noncancellable period or notice period in a lease would meet the definition of a contract and, thus, would be included as part of the lease term. To meet the proposed definition of a contract, any options to extend or terminate the lease that are included in the lease term also must be enforceable, for example, the lessee must be able to enforce the extension of the lease beyond the noncancellable period. If optional periods are not enforceable, for example, if the lessee cannot enforce the extension of the lease without the agreement of the lessor, the lessee does not have the right to use the asset beyond the noncancellable period. Consequently, by definition, there is no contract beyond the initial noncancellable period (plus any notice period) if there are no enforceable rights and obligations existing between the lessee and lessor beyond that term. Nonetheless, when assessing the enforceability of a contract, an entity should consider whether the lessor can, by law, refuse to agree to a request from the lessee to extend the lease.

BC109. For leases for which both the lessee and lessor must agree to extend the lease beyond the noncancellable period, the maximum term of the lease would be the noncancellable period plus any notice period. Accordingly, if the noncancellable period plus any notice period is less than 12 months, that lease would meet the definition of a short-term lease. In contrast, if only one of the parties to the lease has the right to terminate the lease, or if the lessee has the right to extend the lease without the agreement of the lessor, there are enforceable rights and obligations beyond the initial noncancellable period and the parties to the lease would be required to include those optional periods in their assessment of the term.

BC110. The Boards considered whether applying enforceability to leases in this way might encourage entities to add a clause to a lease stating that the lease could be cancelled at any point, knowing that, in practice, it would not. However, the Boards are of the view that this will not be the case because there often is an economic disincentive for the lessor or lessee to agree to do so. That is because the inclusion of such a clause is likely to affect the pricing of a lease. For example, if a lessor has priced a contract assuming that the lessee will not cancel the contract, including such a clause would put the lessor at risk of being exposed to higher residual asset risk than has been anticipated when pricing the contract. In contrast, if the lessor has priced the contract assuming that the lessee will cancel the contract, the lessee would be likely to have to pay higher rentals to compensate the lessor for taking on more residual asset risk, and there would be no economic incentive to do so if the lessee does not intend to cancel the contract.

BC111. In light of the questions raised, the Boards decided to include the definition of a contract and requirements on cancellable leases in this Exposure Draft.

Separating Components of a Contract

BC112. Many contracts contain both lease and nonlease (service) components, such as a contract for a car lease that is combined with maintenance services. In addition, there are contracts that contain multiple lease components, such as a lease of a port that can incorporate the lease of land, buildings, and equipment.

BC113. Existing leases requirements provide limited guidance on how to separate lease components and nonlease (service) components of a contract, even though that separation is required. Because the Boards' proposals result in lease components of a contract being accounted for differently from nonlease components, the Boards decided to provide expanded guidance on how entities should account for contracts that contain both lease components and nonlease components.

BC114. The 2010 Exposure Draft proposed that an entity should separately account for nonlease components of a contract if those components are distinct and the entity is able to separate those components, although the IASB's and the FASB's proposals were different for lessors in particular situations. That Exposure Draft included guidance to help determine when the nonlease components of a contract would be distinct.

BC115. Almost all respondents agreed that an entity should separate lease components of a contract from nonlease components, noting that the Boards' proposals should be applied only to the lease components of a contract. However, many of those respondents found the proposals confusing or they disagreed with some aspects of those proposals. Some were concerned that, although similar, the notion of distinct in the leases proposals was not the same as the notion of distinct in the revenue recognition proposals. Others disagreed with the proposal to account for the entire contract as a lease if nonlease components were not distinct. In particular, some were concerned that property-related costs, such as maintenance, property tax, utilities, and insurance, would be considered to be nondistinct and would be included as part of the cost of the right-of-use asset. Others thought it was not helpful to have differing proposals under IFRS and U.S. GAAP in this respect.

BC116. Consequently, the Boards have changed the proposals on lease components and nonlease components in the following way and for the following reasons:

a. The objective of the project is to propose changes to the accounting for leases; it is not to propose changes to the accounting for services. The new proposals should, therefore, apply only to the lease component(s) of any contract. The accounting for services (or the service component of a contract) should be the same, regardless of whether the contract is only for services or includes the purchase or lease of an asset as well as services. Accordingly, the Boards are proposing that both a lessee and a lessor should separate each lease component from nonlease components of a contract. That is consistent with the Boards' proposals in the revenue recognition project to allocate the consideration in a contract to separate performance obligations.
b. This Exposure Draft includes requirements for determining whether a contract that contains a lease has only one lease component or multiple lease components. Those requirements are based on the requirements

included in the revenue recognition project on the identification of separate performance obligations. The Boards noted that the identification of separate lease components in a lease contract is similar to the identification of separate performance obligations in a revenue contract—in both circumstances, an entity is trying to identify whether a customer or a lessee is contracting for a number of separate deliverables or contracting for one deliverable that may incorporate a number of different assets. Accordingly, rather than developing new requirements addressing how to identify separate lease components, the Boards decided that providing requirements similar to those in the revenue recognition proposals on the identification of separate performance obligations would work well in this respect within the leases proposals.

c. In the Boards' view, it is not necessary to distinguish between distinct and nondistinct components when separating lease and nonlease components of a contract in light of the changes proposed to the definition of a lease. A contract is unlikely to contain a lease if nonlease or service components of a contract are not distinct (as defined in the 2011 proposed Accounting Standards Update, *Revenue Recognition (Topic 605): Revenue from Contracts with Customers*). That is because when service components are not distinct, a customer is unlikely to have the right to control the use of an asset. In that situation, the supplier would typically control the use of any assets used to deliver the overall service contract to the customer (as described in paragraph BC105(f)).

d. Lessors are required to separate lease components and nonlease components of a contract. In the Boards' view, a lessor should always be able to separate payments made for lease and nonlease components because it would need to have information about the value of each component, or a reasonable estimate of it, when pricing the contract. In addition, many lessors indicated in response to the 2010 Exposure Draft that they would be able to do so. The Boards decided to require a lessor to allocate the consideration in a contract to lease components and nonlease components in accordance with the revenue recognition proposals to ensure consistency for entities that are both a lessor and a seller of goods or services in the same contract. The Boards concluded that the approach applied by a lessor should be no different from how a seller would allocate consideration in a revenue contract with separate performance obligations.

e. The Boards are proposing a hierarchy of requirements that a lessee would follow when allocating consideration to different components of a contract. According to these requirements, a lessee would be required to obtain observable standalone prices for each component, if possible, and allocate any remaining consideration to components without observable prices. In setting a threshold that must be met to separate lease components and nonlease components, the Boards did not wish the threshold to be so high that a lessee would find it too difficult, or could choose whether, to separate lease components and nonlease components. Accordingly, observable is not limited to being lessor specific, and obtaining the price of similar leases, goods, or services is sufficient (that is, observable does not mean that a lessee is required to obtain the standalone price of an identical lease, good, or service component). Nonetheless, the Boards concluded that it would not be appropriate to always require a lessee to separate lease components and nonlease components. In the Boards' view, the cost of obtaining the information required to separate nonlease components that do not have observable prices would outweigh the benefit for the lessee.

Distinguishing between a Lease and a Sale

BC117. The 2010 Exposure Draft proposed some guidance to allow entities to distinguish a sale from a lease. There was little support for the guidance from respondents, with many finding it confusing and noting that it would not be necessary if the Boards defined a lease appropriately.

BC118. In light of those comments, the Boards decided that this Exposure Draft would not provide requirements for distinguishing a lease from the sale of an asset. The proposals apply to any contract that conveys the right to use an underlying asset for a period of time. They do not apply to transactions for which control of the underlying asset is transferred to the lessee—such transactions are sales within the scope of other IFRSs or U.S. GAAP (for example, the requirements for property, plant, and equipment, and revenue recognition). Distinguishing between a lease and the sale of an asset is less critical in light of the Boards' proposals on lessee and lessor accounting. Those decisions mean that the accounting for leases that are economically similar to the sale of the underlying asset would be accounted for in a similar way to the sale of that asset; that is, when a lease is such that the lessee consumes substantially all of the underlying asset, the lessee would account for it similar to the purchase of an asset that is financed, and the lessor would account for it similar to the sale of an asset for which the consideration is paid over time.

Classification of Leases

BC119. As discussed in paragraphs BC50–BC63, the Boards decided that an entity should apply the classification principle on a lessee's expected consumption of the economic benefits embedded in the underlying asset on the basis of the nature of the underlying asset (that is, property or assets other than property). In order to achieve classification conclusions that more closely reflect the classification principle, this Exposure Draft proposes, however, that an entity would also assess the lease relative to the economic life and fair value of the underlying asset.

Determining Whether the Underlying Asset Is Property or an Asset Other Than Property

BC120. Some leases, either directly or indirectly, convey the right to use more than one asset, for example, the lease of a turbine that is housed inside a building. When one lease component contains the lease of property (that is, land or a building) as well as the lease of assets other than property, it can be difficult to determine whether the lease should be considered to be a property lease or a lease of an asset other than property. That distinction is important for lease classification.

BC121. In discussing the classification of leases, the Boards first decided that an entity should not be required to subdivide one lease component into multiple elements. Such a requirement could be very onerous to apply and thus would increase costs. In addition, any subdivision within one lease component could be artificial because a lessee can benefit only from the use of the assets within the component as a whole and not individually.

BC122. Second, the Boards decided that an entity should determine whether the underlying asset is property or an asset other than property on the basis of the nature of the primary asset within a lease component. The primary asset within a lease component is the predominant asset for which the lessee has contracted for the right to use. The main purpose of any other assets that form part of the lease component often is to facilitate the lessee obtaining benefits from the use of the primary asset. The Boards note that, for most leases, this would be a relatively straight-forward assessment—that is, it is a qualitative assessment that would require entities to conclude on the most important element of a lease, which should be relatively clear for most leases. The Boards also noted that if an entity is unable to identify the primary asset, it may indicate that there is more than one lease component in the contract, which should each be classified and accounted for separately.

The Economic Life of the Underlying Asset

BC123. When classifying both property leases and leases of assets other than property, this Exposure Draft proposes that an entity should assess the lease term relative to the economic life of the underlying asset.

BC124. When classifying leases of property, the Boards decided that an entity would assess whether the lease term is for a major part of the *remaining* economic life of the underlying asset at the commencement date. The Boards decided to do so to ensure that longer-term leases of property that are entered into primarily for financing purposes would be classified as Type A leases. Without requiring the assessment of the lease term relative to the remaining economic life of the property, an entity may have classified a lease that is economically similar to purchasing the building as a Type B lease. That could have been the case if, for example, the lease were to include significant variable lease payments. The Boards concluded that it would be inappropriate for a lease of a building that is economically similar to the lessee purchasing the building to be classified as a Type B lease.

BC125. The Boards decided, however, that when classifying leases of assets other than property, an entity should assess whether the lease term is for more than an insignificant part of the *total* economic life of the underlying asset (that is, the expected economic life of the underlying asset at lease commencement assuming the asset was new at that date) for the following reasons:

a. One of the benefits of the proposed changes to lessor accounting is that the accounting would more closely reflect the business model of many lessors. Some lessors of equipment, such as a lessor of the rail cars described in (b) below, manage the assets that they lease over the economic life of the equipment, leasing the asset for relatively short periods to different lessees numerous times over the life of the asset. Such lessors are of the view that they are not primarily in the business of providing finance to lessees. Instead, their aim is to generate cash flows from the equipment on an ongoing basis by managing the asset over a period typically longer than any one lease term, similarly to many property lessors. Accordingly, if the lease is not for more than an insignificant part of the total economic life of the asset, the lessor would apply accounting that more closely reflects its business model by continuing to recognize the underlying asset and recognizing rental income over the lease term, regardless of the age of the asset being leased.
b. When the underlying asset is equipment or vehicles, a lessee would be expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset for a large proportion of leases of such assets, for example, a 4-year lease of a truck that has a 10-year economic life. However, there are some leases of longer-lived equipment or vehicles for which that would not be the case, for example, a 4-year lease of a rail car that has a 50-year economic life. If the economic life criterion referred to the remaining economic life of the asset, a lessee would be required to know how old the rail car is at the commencement date and may be required to account for a 4-year lease of a new rail car differently from a 4-year lease of, for example, a 25-year-old rail car. The Boards concluded that a lessee should account for leases of equipment or vehicles with the same lease term consistently because it would provide more useful information in these situations.

BC126. The Boards considered whether interpreting “economic life” to be the total, and not the remaining, economic life of the underlying asset that is not property would create opportunities to classify a lease as a Type B lease (and achieve a straight-line income statement recognition pattern) when it would be inappropriate to do so. In the Boards’ view, this is not a significant risk because for leases of equipment and vehicles, the lease still needs to be for an insignificant part of the total economic life of the leased equipment or vehicle to be classified as a Type B lease. An “insignificant part” is a relatively small portion of the life of such an asset, and relatively few leases of equipment or vehicles would be expected to be for an insignificant part of the life of such assets.

Reassessment of the Classification of Leases

BC127. The Boards decided that, after classifying a lease at the commencement date, an entity would not reassess that classification. Even though the lease term can change after lease commencement, the Boards do not expect it to change frequently because it would require a change (from factors other than changes in market conditions) in whether the lessee has or does not have a “significant economic incentive” to exercise an option to extend a lease, which is a relatively high hurdle. In addition, a change in the lease term may not result in a change to the classification of a lease even if an entity was required to reassess the classification of leases. For example, changing the lease term of a property lease from 10 years to 15 years may not change the classification of that lease even if reassessment of the classification was required. Accordingly, the Boards concluded that there would be little benefit in adding complexity to the requirements that, in practice, would be expected to have little effect.

Recognition and the Date of Initial Measurement

Inception versus Commencement of a Lease

BC128. The 2010 Exposure Draft proposed that a lessee and a lessor recognize lease assets and lease liabilities at the commencement date of a lease but initially measure those assets and liabilities at the date of inception of the lease.

BC129. Respondents to the 2010 Exposure Draft generally agreed that the commencement date is the appropriate date on which to recognize lease assets and lease liabilities. Although for most leases, the time between the date of inception and the commencement date is usually short, some respondents noted that there are contracts for which that is not the case (for example, some leases are signed before the underlying asset is constructed). When that is the case, the proposals raised a number of questions:

a. How should an entity account for any changes to the terms and conditions of the lease between the date of inception and the commencement date?
b. Should an entity account for the time value of money, changes in indexes, and changes in the fair value of the underlying asset between the date of inception and the commencement date? If so, how?

BC130. Recognizing assets and liabilities arising from a lease at the commencement date is consistent with the proposed right-of-use model, in which a lessee recognizes an asset representing its right to use an underlying asset for the period of the lease and a liability representing its obligation to make lease payments. A lessee does not obtain and control its right to use the underlying asset until the commencement date, that is, the date on which the lessor makes the underlying asset available for the lessee's use. Before that date, the lessor has not yet performed under the contract. Although a lessee may have an obligation to stand ready to make lease payments if the lessor performs under the contract, the lessee is unlikely to have an obligation to make lease payments before the asset is made available for its use. Similarly, from the lessor's perspective, although the lessor may have an obligation to stand ready to deliver the right to use the underlying asset from the date of inception, the lessor is unlikely to have a right to receive lease payments before the asset is made available for the lessee's use. Nonetheless, an entity could have an onerous contract liability before the commencement date, which should be accounted for consistently with other onerous contracts.

BC131. On the basis of the feedback received, the Boards decided to change the date of initial measurement to the commencement date so that entities would initially recognize and measure lease assets and lease liabilities at that date. The Boards noted that their intentions for initial measurement of lease assets and lease liabilities were that the measurement would reflect the nature of the transaction and the terms and conditions of the lease. That would require an entity to look to the terms and conditions agreed to in the contract at the date of inception. However, the Boards had not intended that an entity would recognize a gain or loss relating to changes between the dates of inception and commencement when recognizing lease assets and lease liabilities at the commencement date.

BC132. In reaching that decision, the Boards noted that aligning the date of recognition with the date of initial measurement has the following benefits:

a. It clarifies that, other than any gain or loss to be recognized by a lessor with Type A leases, a gain or loss should not arise on initial recognition of lease assets and lease liabilities by a lessee or a lessor.
b. It removes the need to add requirements (and thus potentially reduces complexity) on how to account for changes to the terms and conditions of a lease, or assumptions used in measuring lease assets and lease liabilities, between the date of inception and the commencement date. Any changes to a lease that occur after the date of inception are taken into account when initially measuring the asset and liability at the commencement date.
c. It clarifies that an entity would capitalize initial direct costs incurred before the commencement date. Some respondents to the 2010 Exposure Draft had noted that the previous proposals on initial

measurement implied that an entity would not be permitted to capitalize any initial direct costs incurred after the date of inception.

d. It is more consistent with the measurement date for other transactions, such as business combinations and the acquisition of property, plant, and equipment.

BC133. Despite the changes to the proposed date of initial measurement, the Boards noted that for some leases, the rights and obligations that arise from signing a lease could be significant. Without any disclosure, a user of financial statements would have no information about those rights and obligations before the commencement date (assuming that the entity did not have an onerous contract liability). Accordingly, this Exposure Draft proposes that a lessee should disclose information about leases that create significant rights and obligations between the date of inception and the commencement date. Those disclosures would inform users of financial statements of significant cash commitments made relating to leases for which assets and liabilities would be recognized by the lessee in future periods.

Measurement: Lessee

Measurement Bases of the Lease Liability and Right-of-Use Asset

BC134. The Boards decided to propose a cost measurement basis for the lease liability and right-of-use asset, with cost measured at the present value of the lease payments. The Boards concluded that this would provide the most useful information to users of financial statements while minimizing costs as compared with other approaches.

BC135. The Boards considered whether to refer to existing IFRSs or U.S. GAAP rather than specify in the lease proposals the initial and subsequent measurement of the lease liability and right-of-use asset. The Boards rejected that approach for a number of reasons:

a. The accounting by lessees would differ in U.S. GAAP and IFRS because the existing requirements for financial liabilities and nonfinancial assets differ in U.S. GAAP and IFRS.
b. The approach would be inconsistent with the Boards’ decision not to apply a components approach to lease accounting. For example, existing requirements on financial instruments would require separate accounting for options in a lease.
c. Leases often have unique features compared with other financial liabilities and nonfinancial assets and, therefore, should have accounting that reflects those unique features.

d. The approach would be more complex to apply, particularly when a lease contains features such as options, variable lease payments, and residual value guarantees.

Initial Measurement of the Lease Liability

Lease Term: Options to Extend or Terminate a Lease

BC136. Leases often grant the lessee a right to extend a lease beyond the initial noncancellable period or to terminate a lease before the end of the lease period. Depending on the terms and conditions of the option, a three-year lease with an option to extend for two years could be economically similar to a three-year noncancellable lease or a five-year noncancellable lease. However, a lease with options would never be exactly the same as a lease without any options.

BC137. There are a number of different ways that a lessee and lessor could reflect options that exist in leases:

a. *A components approach*, in which options in a lease are recognized and measured as separate components of the lease. The Boards rejected a components approach to lease accounting because such an approach would be complex, would ignore the interrelationship between the term of a lease and the exercise of options, and would be difficult to apply because options may be difficult to measure reliably.
b. *A disclosure approach*, in which an entity recognizes a lease liability or lease receivable for the noncancellable period and discloses the existence of any options to extend the term. Although simple to apply, the Boards rejected this approach because it would provide less useful information to users of financial statements. The measurement of lease assets and lease liabilities would ignore the existence of options, including those that are virtually certain of being exercised and, thus, would potentially misrepresent the assets and liabilities arising from a lease.
c. *A measurement approach*, in which options in a lease are included in the measurement of lease assets and lease liabilities using a particular method. That method could be, for example:
   1. A probability-weighted measurement method (in which the measurement of lease assets and lease liabilities reflects the probability of each possible lease term)
   2. A probability threshold method (in which an entity includes optional periods in the lease term if the exercise of the options meets a specified threshold, for example, reasonably certain, virtually certain, more likely than not)
   3. An economic incentive method (in which an entity includes optional periods in the lease term if an entity has an economic incentive to exercise the option).

BC138. The Discussion Paper and the 2010 Exposure Draft proposed determining the lease term on the basis of a “most likely” measurement approach, that is, the lease term would be the longest possible term that is more likely than not to occur. That is because the Boards thought that the lease term should reflect an entity’s reasonable expectation of what the term would be. The 2010 Exposure Draft also proposed that, at each reporting date, the lessee or lessor should reassess which outcome it considered to be most likely to occur on the basis of any new facts or circumstances that indicate that there would be a significant change in the recognized lease liability or lease receivable since the previous reporting period.

BC139. Many respondents to the Discussion Paper and the 2010 Exposure Draft disagreed with the proposals:

a. Some said that determining the present value of lease payments on the basis of the most likely lease term might result in the recognition of a liability (for the lessee) and an asset (for the lessor) that does not meet the definition of a liability or an asset in the Boards’ respective Conceptual Frameworks. That is because the lessee is not obliged to make lease payments and the lessor does not have a right to receive lease payments beyond the initial noncancellable period until the lessee has exercised the option.
b. Some disagreed because the approach would not distinguish between a five-year noncancellable lease and a three-year lease with an option to extend for two years that is likely to be exercised. In their view, a lessee (and a lessor) is in a different economic position when it has a five-year noncancellable lease compared with a three-year lease with an option to extend that it may or may not exercise, and that difference should be reflected in the measurement of lease assets and lease liabilities.
c. Some suggested increasing the threshold at which an entity would include options to extend in the measurement of lease assets and lease liabilities. They suggested thresholds such as “reasonably assured” (used in existing U.S. GAAP), “reasonably certain” (used in existing IFRS), and “virtually certain” (which would be a higher threshold that would almost equate to including only contractual minimum lease payments in the measurement of lease assets and lease liabilities).
d. Others suggested including options in the measurement of lease assets and lease liabilities only when a lease includes economic incentives for an entity to exercise an option.
e. Most preparers highlighted the cost and complexity of not only determining the lease term at the commencement date but also reassessing the lease term at each reporting date. Preparers reiterated this message at workshops held in 2010 to discuss the proposals.

BC140. On reconsideration, the Boards affirmed their view that the lease term should reflect an entity’s reasonable expectation of what the term would be. However, on the basis of the feedback received, they have changed the proposals so that the basis of that reasonable expectation of the lease term is linked to a lessee having a significant economic incentive to exercise an option. The Boards note that applying the concept of “significant economic incentive” would provide a threshold that is similar to the concepts of “reasonably assured” and “reasonably certain” in existing U.S. GAAP and IFRS, which the Boards understand work well in practice. However, there would need to be a significant *economic* incentive for the lessee to exercise the option in order to include optional periods in the lease term. An expectation of exercise alone (and without any economic incentive to do so) would not be sufficient. The Boards concluded that requiring an economic incentive provides a threshold that can be applied more easily because it is more objective than a threshold based solely on management’s estimates or intent.

BC141. The Boards note that including optional periods in the lease term on the basis of an entity having a significant economic incentive to exercise an option addresses the concerns that other approaches would be complex and costly to apply.

BC142. The Boards considered which factors should be considered when determining the lease term at the commencement date. The Boards concluded that at the commencement date, an entity should take into account all relevant factors (contractual, asset, entity, and market-based factors) when assessing whether an entity has a significant economic incentive to exercise an option to extend a lease. That is because many of the factors are interlinked and it would be both difficult and illogical to require an entity to consider any one factor in isolation. The factors to consider when reassessing the lease term are discussed in paragraphs BC168–BC172.

BC143. The Boards also concluded that options to extend a lease and options to terminate a lease should be accounted for in the same way. Accordingly, payments to be made during the period after which a lessee can terminate a lease are included when measuring lease assets and lease liabilities if the lessee has a significant economic incentive not to exercise the option to terminate the lease.

Discount Rate

BC144. The Discussion Paper proposed that the discount rate used to determine the lessee’s lease liability should be the lessee’s incremental borrowing rate—in other words, the rate that takes into account the credit standing of the lessee, the length of the lease, the nature and quality of the security provided, and the economic environment in which the transaction occurs.

BC145. In theory, the rate implicit in the lease should be similar to the lessee’s incremental borrowing rate. However, the rate implicit in the lease is affected by differences between the lessee’s estimate and the lessor’s estimate of the residual value of the underlying asset at the end of the lease and may be affected by taxes and other factors known only to the lessor. Thus, it may be difficult for lessees to determine the rate implicit in the lease for some leases, particularly those in which the underlying asset has a significant residual value at the end of the lease.

BC146. Some respondents to the Discussion Paper commented that the rate implicit in the lease is often relatively easy to determine and has the advantage of being specific to the transaction. In addition, some respondents said that using the lessee's incremental borrowing rate for the lease liability would not necessarily reduce complexity because the incremental borrowing rate should reflect the credit standing of the lessee as well as the security provided by the underlying asset. The degree of security could be different from lease to lease and from period to period, depending on the fair value of the underlying asset. The incremental borrowing rate also may not be readily obtainable when the lease term is long.

BC147. The Boards agreed with respondents that the rate implicit in the lease could be readily determined in some circumstances. However, there would be circumstances in which the rate implicit in the lease would be difficult for a lessee to determine. Accordingly, consistent with the 2010 Exposure Draft, this Exposure Draft proposes that a lessee should discount the lease liability using the rate the lessor charges the lessee (which would often be the rate implicit in the lease), if that rate can be readily determined. If the rate the lessor charges the lessee cannot be readily determined, the lessee would use its incremental borrowing rate.

Lease Payments

Variable Lease Payments

BC148. Some or all of the lease payments for the right to use an asset can be variable. That variability can arise because lease payments are linked to the following:

a. Price changes due to changes in an external market rate or the value of an index. For example, lease payments might be adjusted for changes in a benchmark interest rate or the Consumer Price Index.
b. The lessee's performance derived from the underlying asset. For example, a lease of retail property may specify that lease payments are based on a specified percentage of sales made from that property.
c. The use of the underlying asset. For example, a car lease may require the lessee to make additional lease payments if the lessee exceeds a specified mileage.

BC149. There are different views on whether variable payments linked to future performance or use of an asset meet the definition of a liability. Some are of the view that a lessee's liability to make, and a lessor's right to receive, variable lease payments do not exist until the future event requiring the payment occurs (that is, when the underlying asset is used or a sale is made). Accordingly, some are of the view that entities should only provide disclosure about variable lease payments linked to performance or use and should not include those payments in the measurement of lease assets and lease liabilities.

BC150. However, some note that a lessee's obligation to make, and a lessor's right to receive, variable lease payments exist at the commencement date by virtue of the lease contract. Consequently, they are of the view that all variable lease payments meet the definition of a liability for the lessee and an asset for the lessor. It is the amount of the liability or asset that is uncertain, rather than the existence of the liability or asset. Accordingly, some would suggest that lessees and lessors should estimate variable lease payments and include that estimate in the measurement of lease assets and lease liabilities.

BC151. The 2010 Exposure Draft proposed a probability-weighted estimation approach in which a lessee and lessor would include estimated variable lease payments in the measurement of lease assets and lease liabilities at the commencement date. That Exposure Draft also would have required the reassessment of estimates if there was a significant change in the measurement of the lease liability. Many respondents to that Exposure Draft disagreed with those proposals. Preparers stated that, and demonstrated at workshops why, this approach would be extremely costly to apply, especially for longer-term leases with payments linked to the lessee's performance or use of the underlying asset. They noted that the reason that they often enter into leases with variable lease payments based on performance or use is because of the uncertainty associated with that future performance or use, that is, they wish to share the risks of the uncertainty about the economic benefits to be derived from using an underlying asset with the lessor. Accordingly, it often would be difficult for a lessee to estimate variable lease payments reliably. Similarly, it often would be difficult for the lessor to estimate the future performance from or use of an asset reliably when it has little, or no, control over that use. Consequently, respondents, including some users of financial statements, questioned the reliability of the information that would be included in the measurement of lease assets and lease liabilities.

BC152. On the basis of that feedback, the Boards agreed that the cost and complexity of estimating and measuring all variable lease payments would outweigh the benefit. This Exposure Draft, therefore, proposes to include in the measurement of lease assets and lease liabilities only those variable lease payments that are in-substance fixed payments or that depend on an index or a rate. For some Board members, the decision about variable lease payments linked to future performance or use was made solely for cost-benefit reasons, that is, they are of the view that all variable lease payments meet the definition of an asset (for the lessor) and a liability (for the lessee). However, those Board members were convinced by the responses to the 2010 Exposure Draft that the costs of those proposals would outweigh the benefits, particularly because of the reliability concerns expressed about the measurement that would result from the proposals. Other Board members do not think that variable lease payments linked to future performance or use meet the definition of an asset (for the lessor) or a liability (for the lessee) until the performance or use occurs. They consider those payments to be avoidable by the lessee and, accordingly, would conclude that the lessee does not have a present obligation to make those payments. In addition, variable lease payments linked to future performance or use could be viewed as a means by which the lessee and lessor can share future profits to be derived from the use of the asset. Accordingly, those variable lease payments would not be included in the measurement of lease assets and lease liabilities.

BC153. The Boards decided to include variable lease payments that are in-substance fixed lease payments in the measurement of lease assets and lease liabilities because those payments are unavoidable and, thus, economically are indistinguishable from fixed lease payments. The Boards discussed whether to leave this as a principle or provide further requirements. They concluded that providing a principle was sufficient, rather than a list of possible scenarios, which would never capture every situation. However, the Boards decided to include some examples of the types of payments that would be considered to be in-substance fixed payments to help in applying the principle.

BC154. For similar reasons, the Boards decided to include variable lease payments that depend on an index or a rate in the measurement of lease assets and lease liabilities. Those payments meet the definition of assets (for the lessor) and liabilities (for the lessee) because they are unavoidable (that is, a lessee has a present obligation to make, and the lessor has a present right to receive, those lease payments). Any uncertainty, therefore, relates to the measurement of the asset or liability that arises from those payments and not to the existence of the asset or liability.

BC155. In the Boards' view, in principle, forecasting techniques should be used to determine the effect of changes in an index or a rate on the measurement of lease assets and liabilities. However, forecasting changes in an index or a rate requires macroeconomic information that entities may not have readily available, and forecasts often can be unreliable. In the Boards' view, the usefulness of the additional information obtained using such a forecast would not justify the costs of obtaining it. The 2010 Exposure Draft proposed using forward rates when measuring lease assets and liabilities if they are readily available. However, respondents commented that this would reduce comparability between those using forward rates and those not doing so and that determining whether a rate would be "readily available" requires judgment. Consequently, the Boards decided to require an entity to determine payments that depend on an index or a rate using the index or rate that exists at the commencement date. Subsequent measurement of variable lease payments that depend on an index or a rate is discussed in paragraphs BC173–BC175.

Residual Value Guarantees

BC156. The 2010 Exposure Draft proposed that a lessee should estimate the amount payable to the lessor under residual value guarantees and account for that amount as a lease payment. Many respondents supported those proposals, noting that the amounts payable under residual value guarantees should be included in the measurement of lease assets and lease liabilities because they are unconditional and meet the definition of a liability.

BC157. Similarly, this Exposure Draft proposes that a lessee should include the expected amount payable under residual value guarantees in the measurement of the lease liability (and the right-of-use asset). In the Boards' view, payments to be made under residual value guarantees meet the definition of a liability and are part of the cost of the right-of-use asset and, thus, should be recognized and measured as part of the lease liability and the right-of-use asset. That is because those payments cannot be avoided by the lessee—the lessee has an unconditional obligation to pay the lessor if the market price of the underlying asset moves in a particular way. Accordingly, any uncertainty does not relate to whether the lessee has an obligation. Instead, it relates to the amount that the lessee may have to pay, which can vary on the basis of movements in the market price for the underlying asset. In that respect, residual value guarantees are similar to variable lease payments that depend on an index or a rate for the lessee.

BC158. The Boards considered whether a lessee should account for residual value guarantees separately because they are linked to the value of the underlying asset and may meet the definition of a derivative. However, the Boards note that residual value guarantees are often so interlinked with other terms and conditions in a lease that it could be misleading and potentially costly to recognize such guarantees separately. That also is consistent with the Boards' decision not to adopt a components approach to lease accounting.

Options to Purchase the Underlying Asset

BC159. The Boards considered whether a purchase option is:

a. The ultimate renewal option and, thus, should be accounted for similar to other options to extend or terminate a lease. This approach would include the exercise price of a purchase option in the determination of lease payments on a basis similar to the inclusion of lease payments to be made during optional periods.
b. A means of terminating the lease that should be accounted for only when it is exercised as a sale or purchase of the underlying asset. This approach would exclude the price of a purchase option from the determination of lease payments.

BC160. The 2010 Exposure Draft viewed a purchase option as a means of terminating the lease and, thus, proposed that the price of a purchase option is not a lease payment. Respondents had mixed views about the proposal to account for purchase options only when they are exercised. Some respondents agreed with the proposals, but others proposed that the accounting for purchase options should be consistent with the accounting for options to extend or terminate a lease.

BC161. On reconsideration, the Boards decided that purchase options should be accounted for in the same way as options to extend the term of a lease (that is, the exercise price of a purchase option would be included in the measurement of lease assets and lease liabilities if the lessee has a significant economic incentive to exercise that option). That is because the Boards view a purchase option as the ultimate option to extend the lease term. A lessee that has an option to extend a lease for all of the remaining economic life of the underlying asset is, economically, in a similar position to a lessee that has an option to purchase the underlying asset. Accordingly, the Boards decided that those two options should be accounted for in the same way.

Initial Measurement of the Right-of-Use Asset

BC162. Consistent with the 2010 Exposure Draft, this Exposure Draft proposes that a lessee should measure the right-of-use asset at cost, which is the present value of the lease payments.

BC163. The Boards considered whether a lessee should initially measure the right-of-use asset at fair value because that may provide more relevant information about the economic benefits to be derived from the use of the underlying asset. However, initial measurement of a right-of-use asset at cost is consistent with the measurement of many other nonfinancial assets, such as assets within the scope of IAS 16, *Property, Plant and Equipment,* and Topic 360, Property, Plant, and Equipment, and IAS 38, *Intangible Assets,* and Topic 350, Intangibles—Goodwill and Other. Measuring right-of-use assets on a basis similar to that of the underlying asset would increase comparability of leased and owned assets and, thus, improve the information provided to users of financial statements. Furthermore, initial measurement of the right-of-use asset at cost is less complex and less costly for entities to apply than fair value measurement because there is rarely an active market for right-of-use assets. For many leases, a cost measurement basis also would provide a reasonable approximation of the fair value of the right-of-use asset at the commencement date.

Initial Direct Costs

BC164. Initial direct costs for a lessee are costs directly attributable to negotiating and arranging a lease and would not have been incurred without entering into the lease. This Exposure Draft proposes that a lessee should capitalize those costs by adding them to the carrying amount of the right-of-use asset. Capitalizing initial direct costs is consistent with the treatment of costs associated with acquiring other nonfinancial assets (for example, property, plant, and equipment and intangible assets). Maintaining consistency in the accounting for leased and owned assets increases comparability, thereby providing better information for users of financial statements.

BC165. The Boards considered whether initial direct costs incurred by lessees should be allocated between the asset and liability arising from a lease at the commencement date. However, the Boards concluded that such an approach could be costly for entities to apply with little incremental benefit for users of financial statements.

Subsequent Measurement of the Lease Liability

BC166. Consistent with the 2010 Exposure Draft, this Exposure Draft proposes that a lessee should measure lease liabilities similarly to other similar financial liabilities on an amortized cost basis, that is, the carrying amount of the lease liability is adjusted each period to reflect the unwinding of the discount on the lease liability and the payment of lease payments.

BC167. The Boards have not proposed that a lessee would be required or permitted to measure lease liabilities at fair value after initial measurement because it would be:

a. Inconsistent with the subsequent measurement of many other nonderivative financial liabilities, thus decreasing comparability for users of financial statements
b. More complex and costly for entities to apply than a cost-based approach because it requires the use of both current expected cash flows and current interest rates
c. Inconsistent with the proposal that the initial measurement of assets and liabilities arising from a lease should not be at fair value.

Reassessment of Options

BC168. In principle, the Boards are of the view that users of financial statements receive more relevant information when entities reassess options on a regular basis because reassessment reflects current economic conditions and using a lease term established at initial recognition throughout the lease could be misleading.

BC169. However, requiring reassessment at each reporting date would be costly for an entity with many leases. To address that concern, the 2010 Exposure Draft proposed that an entity would be required to reassess the lease term only when there has been a change in facts or circumstances that would indicate that there is a significant change in the lease asset or lease liability.

BC170. Respondents to the 2010 Exposure Draft expressed concern about the costs associated with such reassessment. They noted that it could be difficult to interpret when a change would be significant. Many interpreted the proposals as requiring an entity to demonstrate that there had not been a change in facts and circumstances that would indicate a significant change in the lease asset or lease liability in order to avoid having to reassess options. The costs of demonstrating that any change would not be significant could be as costly as reassessing options at each reporting date.

BC171. This Exposure Draft requires an entity to reassess options only when a lessee has, or no longer has, a significant economic incentive to exercise an option. Because the "significant economic incentive" threshold is higher than the "more likely than not" threshold proposed in the 2010 Exposure Draft, an entity should be required to remeasure lease assets and lease liabilities as a result of changes relating to options relatively infrequently, thus reducing costs associated with reassessment. In addition, the Boards decided that a change in market conditions alone (for example an option moving in or out of the money) would not trigger reassessment because of concerns about the possibility of frequent changes to the lease term as market prices increased or decreased. The Boards concluded that such an outcome would add unnecessary complexity and cost to the accounting and may not provide useful information to users of financial statements.

BC172. Although entities recognize changes in most other liabilities in profit or loss, this Exposure Draft proposes that a lessee should adjust the carrying amount of the right-of-use asset to reflect changes in the measurement of the related lease liability arising from the reassessment of the lease term or purchase options. That is because (a) a change in the lease term or the assessment of purchase options reflects the lessee's expectation that it has acquired more or less of the right to use the underlying asset and (b) in the Boards' view, the adjustments are made to measure the total costs of the asset accurately.

Reassessment of Variable Lease Payments That Depend on an Index or a Rate

BC173. Paragraph BC154 describes the Boards' reasons for requiring both lessees and lessors to include variable lease payments that depend on an index or a rate in the measurement of lease assets and liabilities.

BC174. Consistent with the 2010 Exposure Draft, this Exposure Draft proposes that an entity should reassess the measurement of lease assets and lease liabilities to reflect changes in the index or rate that is used to determine variable lease payments. In the Boards' view, reassessment is necessary to provide relevant information to users of financial statements about a lessee's lease liabilities at the reporting date. For example, without remeasurement of lease liabilities for changes in an index or a rate, the measurement of the lease liability for a 20-year property lease, for which lease payments are linked to a price index, may not provide users of financial statements with useful information about the entity's future cash outflows relating to that lease throughout the lease term.

BC175. Some of the feedback from the 2010 Exposure Draft indicated concerns about the cost of performing reassessments and questioned whether the benefits for users of financial statements would outweigh the costs for preparers. For example, some respondents noted that the total lease-related expenses recognized in profit or loss by a lessee would be substantially the same, regardless of whether the lessee remeasures the lease liability for changes to an index or a rate. However, the Boards noted that they have made significant changes to the proposals on the measurement of variable lease payments in this Exposure Draft, which are expected to reduce the costs and complexity of the proposals, as described in more detail in paragraphs BC148–BC155 (for example, an entity is not required to measure [or remeasure] variable lease payments that do not depend on an index or a rate). Consequently, the costs associated with remeasuring lease liabilities should be lower than the costs that would have arisen from the proposals in the 2010 Exposure Draft.

Reassessment of Residual Value Guarantees

BC176. The Boards decided that lessees should reassess the expected amounts payable under residual value guarantees because that provides more relevant information to users of financial statements, reflecting current economic conditions.

BC177. An increase or a decrease in the amount expected to be payable under a residual value guarantee can arise from a decrease or an increase in the expected value of the underlying asset at the end of the lease term. Accordingly, some might view adjusting the carrying amount of the right-of-use asset for any such increase or decrease as counterintuitive. However, in the Boards' view, changes in the expected amounts payable under residual value guarantees are changes to the cost of the right-of-use asset, which is consistent with including the expected amounts payable under residual value guarantees as part of the initial measurement of the right-of-use asset. The Boards noted that the proposed requirement for lessees to review right-of-use assets for impairment would ensure that assets arising from leases are not overstated.

Reassessment of the Discount Rate

BC178. The 2010 Exposure Draft proposed that neither the lessee nor the lessor would change the rate used to discount lease payments, except to reflect changes in reference interest rates when variable lease payments are determined using those reference interest rates.

BC179. Respondents to the 2010 Exposure Draft had mixed views on those proposals:

a. Some agreed that the discount rate should not be reassessed, which would be consistent with amortized cost accounting in the financial instruments and revenue recognition requirements. Many also expressed concern about the added cost and complexity of requiring the discount rate to be reassessed.
b. Others questioned why the discount rate would not be reassessed, noting that the proposals were inconsistent with requirements in other IFRSs or U.S. GAAP that require discount rates to be adjusted, such as the accounting for pensions, insurance, decommissioning liabilities, and asset retirement obligations. It might also prevent an entity from properly reflecting the change in the economics of a transaction.
c. Users of financial statements generally supported reassessment to ensure that financial information reflects management's most recent evaluation of economic circumstances and their effect on committed cash flows.

BC180. The Boards decided that, in most cases an entity should not reassess the discount rate during the lease term. That is generally consistent with amortized cost accounting. In other IFRSs or U.S. GAAP in which the discount rate is required to be reassessed, it is usually because the liability to which the discount rate relates is measured on a current measurement basis.

BC181. Nonetheless, in the Boards' view, there are some circumstances in which an entity should reassess the discount rate, for example, when there is a change in the lease term or the assessment of whether the lessee has a significant economic incentive to exercise an option to purchase the underlying asset. In the Boards' view, in those circumstances, the economics of the lease have changed and those changes should be reflected in the discount rate. For example, if an entity previously accounted for a lease on the basis that it has a remaining term of 5 years, and that remaining lease term changes to 10 years, it is appropriate to reassess the discount rate to be consistent with the change in the lease payments included in the measurement of lease assets and lease liabilities. However, the Boards decided that such a change to the discount rate would be required only if an entity had not taken into account the optionality in the contract when determining the discount rate at the commencement date. It is not necessary to update the discount rate if that rate already reflects that an entity has an option to extend or terminate the lease or to purchase the underlying asset.

Foreign Currency Exchange

BC182. The 2010 Exposure Draft did not provide specific requirements on how an entity should account for the effects of foreign currency exchange differences relating to lease liabilities (for a lessee) and lease receivables (for a lessor) that are denominated in a foreign currency. A lessee's lease liability and a lessor's lease receivable are monetary items that are required to be remeasured using exchange rates at the end of each reporting period if denominated in a foreign currency.

BC183. Some respondents suggested that an entity should recognize any foreign currency exchange differences as an adjustment to the carrying amount of the right-of-use asset. This approach would treat translation adjustments as a correction of, or update to, the cost of the right-of-use asset, which is initially measured on the basis of the initial measurement of the lease liability. Those respondents were of the view that lease payments denominated in a foreign currency are in effect another form of variable lease payments and should be accounted for similarly to variable lease payments that are determined using an index. Those respondents also questioned whether useful information would be provided as a result of the profit or loss volatility created by recognizing foreign currency exchange differences on a lessee's lease liability in profit or loss (profit or loss volatility might arise because any foreign-currency-denominated lease liability is remeasured to reflect the rate of exchange at the end of each reporting period, whereas the carrying amount of the right-of-use asset, being a nonmonetary asset, is not remeasured to reflect movements in exchange rates).

BC184. The Boards decided that any foreign currency exchange gains and losses relating to lease liabilities (for the lessee) and lease receivables (for the lessor) denominated in a foreign currency should be recognized in profit or loss. That is because this approach is consistent with existing requirements on foreign currency exchange differences. In the Boards' view, subsequent changes to a foreign exchange rate should not have any effect on the cost of a nonmonetary item, and, thus, it would be inappropriate to include such changes in the remeasurement of the right-of-use asset. Although the approach could result in volatility in profit or loss from the recognition of foreign currency exchange differences, those changes would be disclosed separately as foreign currency exchange gains or losses. Accordingly, it would be clear to users of financial statements that the gain or loss results solely from movements in exchange rates. Because the Boards' conclusion is consistent with the existing requirements for foreign currency exchange, the Boards concluded that it was unnecessary to include any specific requirements in this Exposure Draft.

Subsequent Measurement of the Right-of-Use Asset

BC185. This Exposure Draft proposes that after the commencement date, a lessee should measure the right-of-use asset at cost less accumulated amortization and impairment. For Type A leases, a lessee would determine the amortization in each period consistently with existing IFRSs and U.S. GAAP for nonfinancial assets that are measured at cost. For Type B leases, a lessee would determine the amortization in each period as the difference between the periodic lease cost, which is recognized on a straight-line basis, and the periodic unwinding of the discount on the lease liability. That approach is the result of concerns raised about the effects of the proposals in the 2010 Exposure Draft on a lessee's profit or loss. Paragraphs BC29–BC63 include a detailed discussion of the feedback received on the lessee accounting model and the basis for the Boards' proposals on the subsequent measurement of a lessee's right-of-use asset. In some circumstances, the lease cost may be initially capitalized as part of the cost to acquire or construct another asset, such as inventory, in accordance with other IFRSs or U.S. GAAP and later recognized in the income statement when that asset is disposed of or consumed. This Exposure Draft refers to recognizing lease cost rather than lease expense because any lease cost that is capitalized as part of the cost to acquire or construct an asset would not be recognized as lease expense in the statement of comprehensive income.

BC186. The Boards did not propose that a lessee should measure the right-of-use asset at fair value after initial measurement because it would be:

a. Inconsistent with the subsequent measurement of many other nonfinancial assets.
b. More complex and costly for entities to apply than a cost-based approach because it requires the use of both current expected cash flows and current interest rates. There is rarely an active market for right-of-use assets, which would add to the complexity.
c. Inconsistent with the proposal that initial measurement of assets and liabilities arising from a lease should not be at fair value.

Impairment of the Right-of-Use Asset

BC187. Consistent with the 2010 Exposure Draft, this Exposure Draft proposes that entities apply the impairment requirements of IAS 36, *Impairment of Assets,* and Topic 350.

BC188. Respondents to the 2010 Exposure Draft generally agreed with that proposal. The Boards acknowledge that this approach could result in a different measurement of right-of-use assets under IFRS and U.S. GAAP because requirements on impairment in IFRS and U.S. GAAP differ. In the Boards' view, the benefits for users of financial statements of better comparability between assets that an entity owns and those that it leases outweigh this disadvantage. In addition, it could be difficult for entities to implement an impairment model for right-of-use assets that is different from other nonfinancial assets, particularly if an entity is required to assess a group of assets (comprising both leased and owned assets) for impairment together.

Fair Value Measurement of the Right-of-Use Asset

BC189. IFRS permits the revaluation of nonfinancial assets, such as property, plant, and equipment, and also permits investment properties to be measured at fair value. U.S. GAAP does not permit the revaluation of property, plant, and equipment or fair value measurement for investment property. In the Boards' view, an entity should be permitted to measure a right-of-use asset on the same basis that it measures owned assets. Consequently, this Exposure Draft proposes the following:

a. Lessees applying IFRS would have the option to revalue right-of-use assets and the option to measure right-of-use assets that meet the definition of investment property at fair value.
b. Lessees applying U.S. GAAP would not be permitted to revalue right-of-use assets.

Presentation: Lessee

Statement of Financial Position

BC190. The Boards discussed how to present the right-of-use asset in the statement of financial position.

BC191. The Boards concluded that presenting leased and owned assets in a similar way would provide useful information to users of financial statements about the function of the underlying asset. That presentation is useful because a lessee often uses owned assets and leased assets for the same purpose and derives similar economic benefits from the use of owned assets and leased assets.

BC192. However, the Boards noted that there are differences between a right-of-use asset and an owned asset and that users of financial statements may want to know the carrying amount of each separately. For example, right-of-use assets may be viewed as being (a) less risky than owned assets because a right-of-use asset may not embed residual asset risk or (b) more risky than owned assets because the lessee may need to replace the right-of-use asset at the end of the lease term but may not be able to secure a favorable rate for the replacement lease. Accordingly, either in the statement of financial position or in the notes, this Exposure Draft proposes that a lessee should provide information about the carrying amount of right-of-use assets separately from assets that are owned.

BC193. Similarly, this Exposure Draft proposes that a lessee should present the carrying amount of the lease liability separately from other financial liabilities either in the statement of financial position or in the notes. In the Boards' view, a lease liability is a unique class of liability that is linked to a corresponding asset and may have features, such as options and variable lease payments, that differ from those in other liabilities. Thus, disclosing information about lease liabilities provides users of financial statements with information that is important to understanding the extent to which an entity uses lease arrangements and highlights the relationship between the lease liability and the right-of-use asset.

BC194. The Boards also decided to require the presentation or disclosure of right-of-use assets arising from Type A leases separately from right-of-use assets arising from Type B leases, either in the statement of financial position or in the notes. The Boards concluded that separate presentation or disclosure would be useful because those assets are measured in a different way after the commencement date.

BC195. Similarly, the Boards decided to require the presentation or disclosure of lease liabilities arising from Type A leases separately from lease liabilities arising from Type B leases. Although all lease liabilities are measured in the same way, separate presentation or disclosure would help a user to understand the liability balance to which lease expenses recognized in the statement of comprehensive income relate.

Statement of Comprehensive Income

BC196. This Exposure Draft proposes that, for Type B leases, a lessee should recognize a single lease cost that combines the amortization of the right-of-use asset and the unwinding of the discount on the lease liability. That cost would be presented as a single amount in the statement of comprehensive income. In the Boards' view, when a lessee is not expected to consume more than an insignificant portion of the underlying asset, presenting a single lease expense provides more useful information than presenting amortization and the unwinding of the discount separately. That is because, for such leases, the lessee is paying to use the underlying asset and does not acquire a significant portion of the underlying asset itself. Accordingly, the payments for use are presented as one amount and recognized on a straight-line basis (see paragraphs BC29–BC63 for further information about the basis for the Boards' decisions on the lessee accounting model).

BC197. In contrast, for Type A leases, a lessee should present amortization of the right-of-use asset and the unwinding of the discount on the lease liability (presented as interest) in separate line items, in accordance with other IFRSs or U.S. GAAP. When a lessee is expected to consume more than an insignificant portion of the underlying asset, the lessee in effect acquires a portion of the underlying asset that it is expected to consume. Accordingly, the Boards concluded that a lessee would provide more useful information by presenting amortization of the right-of-use asset in the same line item as other similar expenses (for example, depreciation on property, plant, and equipment) and interest on the lease liability in the same line item as interest on other financial liabilities.

Statement of Cash Flows

BC198. The proposals on the presentation of cash outflows in the statement of cash flows are linked to the presentation of expenses arising from a lease in the statement of comprehensive income. In the Boards' view, it would be misleading to present payments in one manner in the statement of comprehensive income and in another in the statement of cash flows.

BC199. Consequently, this Exposure Draft proposes that a lessee should classify cash repayments of the principal portion of the lease liability for Type A leases as financing activities in the statement of cash flows. Cash paid relating to interest should be classified in accordance with the existing requirements on the statement of cash flows, which is not the same in this respect in IFRS and U.S. GAAP. This approach provides comparability between interest paid for Type A leases and interest paid on other financial liabilities.

BC200. In addition, the Boards decided that cash flows from Type B leases and variable lease payments that are not included in the lease liability should be classified as operating activities because the corresponding lease expenses would be presented in line items above finance costs in profit or loss.

Disclosure: Lessee

BC201. In determining the disclosures for leases, the Boards considered the following:

a. The existing requirements in IAS 17 and Topic 840
b. IFRS 7, *Financial Instruments: Disclosures* (IAS 17 requires a lessee to comply with the disclosure requirements in IFRS 7).

BC202. When selecting the disclosure objective, the Boards considered work in other related projects. As a result, the Boards proposed that disclosures about leases should enable users of financial statements to evaluate the amount, timing, and uncertainty of cash flows arising from leases.

Reconciliation of Opening and Closing Balances

BC203. This Exposure Draft proposes that a lessee should provide a reconciliation of opening and closing balances of the lease liability because that reconciliation informs users of financial statements about changes to the liability during the reporting period. Users have indicated that such a reconciliation would provide them with information that is useful to their analyses.

BC204. The 2010 Exposure Draft proposed that the reconciliation of opening and closing balances of lease liabilities should be provided by class of underlying asset. Many respondents disagreed with the proposals for cost-benefit reasons. In response to those comments, the Boards are no longer proposing to require the reconciliation of lease liabilities by class of underlying asset because the nature of the liability does not differ on the basis of the nature of the underlying asset to which it relates.

BC205. The IASB's Exposure Draft also proposes that a lessee should provide a reconciliation of opening and closing balances of the right-of-use asset. IAS 16 requires similar information for property, plant, and equipment. Again, users of financial statements have indicated that such a reconciliation would provide them with information that is useful to their analyses. In the IASB's view, providing a reconciliation of right-of-use assets by class of underlying asset provides information about changes to the right-of-use asset that is comparable to information provided about changes in owned assets.

BC206. The FASB's Exposure Draft does not have a similar requirement for right-of-use assets because there is no requirement to provide such information for property, plant, and equipment in U.S. GAAP and, in the FASB's view, the benefits of the information would not justify the costs of providing it.

Maturity Analyses

BC207. This Exposure Draft proposes that a lessee should disclose a maturity analysis of the contractual lease payments included in lease liabilities to assist users of financial statements in understanding and evaluating the nature and extent of liquidity risks. A lessee should disclose, at a minimum, the amounts due on an annual basis for each of the first five years after the reporting date, plus a lump sum for the remaining years. Those maturity analyses are similar to the maturity analyses currently required by Topic 840 and are somewhat more detailed than the maturity analyses required by IAS 17. This proposal may result in a lessee disclosing the maturities of lease liabilities differently from the maturities of other financial liabilities (for which an entity has discretion in determining the appropriate maturity categories). However, the Boards have been informed that the detail that is currently provided about the maturities of lease payments is useful to users of financial statements and the comparability of maturity analyses for leases is more important than the comparability of disclosures about lease liabilities and other financial liabilities.

BC208. The FASB decided to require the disclosure of a maturity analysis of nonlease (for example, service) components of a contract that also contains a lease. That would provide information about the committed future cash flows of the entity based on the total future payments arising from contracts that contain a lease. For example, if an entity has an unconditional obligation to make payments of CU100 each month (CU70 for the lease and CU30 for nonlease components) for the next 5 years, then, in the FASB's view, it is more useful to provide a maturity analysis of all of those payments rather than to provide a maturity analysis relating only to lease payments of CU70 each month.

BC209. The IASB decided not to propose the disclosure of a maturity analysis of nonlease components. The IASB concluded that users of financial statements would find information about the maturities of any contractual commitments of an entity useful, regardless of what the commitments relate to. However, the IASB noted that it could be misleading to require the disclosure of contractual commitments for services only when those services are embedded within a contract that contains a lease. Similar contractual commitments relating to services that are provided as part of other contracts would not be disclosed.

Other Disclosures

BC210. The Boards also discussed, but decided not to require, the following possible disclosures because, in their view, the cost of providing these disclosures would outweigh the benefit:

a. The discount rate (or range or weighted average discount rates) used to calculate the lease liability
b. The fair value of the lease liability because doing so would reintroduce the costs and complexity that the Boards intended to avoid by not requiring such liabilities to be measured at fair value
c. The existence and principal terms and conditions, of any options for the lessee to purchase the underlying asset
d. The amount of initial direct costs capitalized as part of the right-of-use asset
e. Information about arrangements that on transition are no longer a lease
f. Disclosure of various lease expense components and corresponding cash flows.

Measurement: Lessor—Type A Leases

Initial Measurement of the Lease Receivable

BC211. The Boards decided that a lessor should initially measure a lease receivable at the present value of future lease payments, consistent with how a lessee measures a lease liability. Respondents to the 2010 Exposure Draft generally supported that approach.

Lease Term: Options to Extend or Terminate a Lease

BC212. The Boards decided that a lessor should determine the lease term in the same way as does a lessee. Although assessing the likelihood of exercise of an option may be easier for the lessee than the lessor (because the decision to extend or terminate is made by the lessee), the Boards decided that it would complicate the proposals to propose different requirements for lessees and lessors in this respect. In addition, the feedback received on the proposals in the 2010 Exposure Draft about the lease term was similar for both lessees and lessors. The reasons for the Boards' decisions on the lease term are set out in paragraphs BC136–BC143.

Discount Rate

BC213. The Boards considered whether the discount rate applied by a lessor should be the rate implicit in the lease, the lessee's incremental borrowing rate, or another rate if the lessor is unable to determine the rate implicit in the lease. The Boards rejected requiring the use of the lessee's incremental borrowing rate by the lessor because in some cases it could result in recognizing a lease receivable and a residual asset, the sum of which could be higher than the known fair value of the underlying asset at the commencement date. Nonetheless, a lessor is likely to consider the lessee's incremental borrowing rate when determining the rate it charges the lessee.

BC214. In the Boards' view, the rate implicit in the lease (that is, the rate at which the sum of the present value of lease payments plus the present value of the expected residual value of the underlying asset at the end of the lease term would equal the fair value of the underlying asset) would typically be the most appropriate rate to use for Type A leases. Using the rate implicit in the lease is consistent with the lessor accounting approach for Type A leases, which requires the lessor to recognize a lease receivable and a residual asset separately for each lease. However, the rate implicit in the lease might not always be available. For example, that might be the case for some property leases. Although relatively few property leases are likely to be classified as Type A leases, there are other Type A leases for which it may not be possible for the lessor to calculate the rate implicit in the lease.

BC215. Consequently, the Boards retained the requirement for a lessor to use the rate the lessor charges the lessee when discounting lease payments. That rate could be the rate implicit in the lease or, for example, a property yield for a property lease. However, in response to questions raised by respondents to the 2010 Exposure Draft, the Boards decided to clarify that a lessor should use the rate implicit in the lease whenever that rate is available.

Lease Payments

Variable Lease Payments

BC216. The Boards decided that a lessor should apply the same requirements when determining which variable lease payments to include in the measurement of the lease receivable as a lessee does when measuring the lease liability. Accordingly, a lessor would include in the measurement of the lease receivable only those variable lease payments that depend on an index or a rate or that are in-substance fixed payments. Although the estimation of variable lease payments to be paid in the future may be easier, or more difficult, for the lessor than the lessee in particular situations, the Boards decided that it would complicate the proposals to propose different lessee and lessor accounting for variable lease payments, that is, it would be difficult to understand why variable lease payments would represent a liability for the lessee and not an asset for the lessor or vice versa. In addition, the feedback received on the proposals in the 2010 Exposure Draft about variable lease payments was similar for both lessees and lessors. The reasons for the Boards' decisions on variable lease payments are set out in paragraphs BC148–BC155.

Residual Value Guarantees

BC217. The 2010 Exposure Draft considered a residual value guarantee to be a variable lease payment if the guarantor was the lessee. That Exposure Draft, therefore, proposed that a lessor should account for a residual value guarantee from the lessee in a similar way to other variable lease payments, that is, an estimate of the amounts to be received would be included within the measurement of the lease receivable. The 2010 Exposure Draft did not address the accounting for residual value guarantees provided by a third party because they do not form part of the lease contract between the lessee and the lessor. Accordingly, under those proposals, a lessor might have been required to account for those guarantees separately under the financial instruments requirements, potentially treating them as a derivative instrument.

BC218. Respondents to the 2010 Exposure Draft disagreed with the Boards' proposals to provide requirements only for residual value guarantees provided by lessees. Many thought it would be misleading for users of financial statements if economically similar residual value guarantees were accounted for in a different way, solely because the guarantee contract had a different counterparty. Respondents noted that existing leases requirements address the accounting for all residual value guarantees, regardless of the counterparty.

BC219. In response to this concern, this Exposure Draft now addresses accounting for all residual value guarantees, including guarantees provided by parties other than the lessee.

BC220. When considering how a lessor should account for residual value guarantees, the Boards first identified residual value guarantees that are in-substance equivalents to fixed lease payments. When a lessor enters into a contract in which any difference between a specified amount and the market value of an underlying asset at the end of the lease term is paid to, or received from, the counterparty (which would typically be the lessee in these circumstances), that specified amount is economically the same as a fixed "balloon" lease payment that is a feature of some leases. Consequently, the Boards decided that such payments, often referred to as residual value guarantees, should be accounted for similar to other fixed lease payments.

BC221. All other residual value guarantees would be excluded from the measurement of the lease receivable. Those residual value guarantees would be considered when a lessor assesses the residual asset for impairment. The Boards noted that this approach is consistent with the lessor accounting approach for Type A leases. According to that approach, a lessor should not recognize any profit relating to the residual asset until the underlying asset has been sold or released at the end of the lease term because the residual asset has not been sold when entering into the lease. Similarly, when a lessor obtains a guarantee providing protection against any decline in the market value of the underlying asset but for which the lessor has retained exposure to any upside potential, the lessor is not in the same economic position as it would be if it had sold the underlying asset or leased the asset for a longer term. Accordingly, on entering into the guarantee contract, the lessor has not sold the residual asset. Instead, the lessor has obtained more assurance about the cash flows that it will derive from the residual asset, which is relevant when assessing whether the residual asset is impaired but is not part of the lease receivable. The Boards concluded that it would be inappropriate for the lessor to recognize any profit associated with the residual asset at the time of obtaining the guarantee, which could occur if the residual value guarantee was included as part of the lease receivable. In reaching that decision, the Boards also noted that if an estimate of the residual value guarantee was to be included in the measurement of the lease receivable, a decline in the value of the underlying asset could result in the lessor recognizing a gain, which would be counterintuitive and misleading.

BC222. The Boards also considered but rejected accounting for residual value guarantees separately from a lease. The Boards noted that residual value guarantees are often so interlinked with lease payments, particularly when the guarantor is the lessee, that it could be misleading to recognize such guarantees separately.

Options to Purchase the Underlying Asset

BC223. The Boards decided that a lessor should account for options provided to the lessee to purchase the underlying asset by applying the same requirements as are applied by a lessee when accounting for those options. The reasons for the Boards' decisions on options to purchase the underlying asset are set out in paragraphs BC159–BC161.

Initial Direct Costs

BC224. This Exposure Draft proposes that a lessor should capitalize initial direct costs at the commencement date, which is consistent with the proposals in the 2010 Exposure Draft. That approach is consistent with the accounting for costs associated with similar financial assets and with the accounting for initial direct costs proposed for lessees.

BC225. In reaching this decision, however, the Boards noted that the calculation of the rate the lessor charges the lessee should not include initial direct costs because doing so could result in those costs being reflected twice in the initial measurement of the lease receivable.

Initial Measurement of the Residual Asset

BC226. When a lessor recognizes a lease receivable and a residual asset at the commencement date, the Boards considered whether the lessor should initially measure the residual asset on a current measurement basis (that is, at the present value of the estimated residual value at the end of the lease) or on a cost basis (that is, as an allocation of the previous carrying amount of the underlying asset). A difference between those two measurement bases would arise when the carrying amount of the underlying asset is different from its fair value immediately before the commencement date. The derecognition approach in the 2010 Exposure Draft had proposed that the residual asset should be initially measured on a cost basis.

BC227. The proposal to measure the residual asset on a current measurement basis might imply that the Boards considered entering into a lease to be equivalent to the sale of the underlying asset. That is because under this approach, when the carrying amount of the underlying asset is lower than its fair value, the lessor would recognize profit at the commencement date relating to both the lease receivable and the residual asset, which would be the same as (or very similar to) the profit recognized if the lessor was to sell the underlying asset.

BC228. Such an approach would have the benefit of more accurately reflecting the way in which many equipment and vehicle lessors price their leases because, in such leases, many lessors price the contract by estimating the residual value of the underlying asset at the end of the lease term and then factoring in a specified return to achieve on their investment in the underlying asset. The periodic lease payments are a function of those inputs, together with the fair value of the underlying asset at the commencement date, subject to market constraints. Measuring the residual asset on a current measurement basis also would have the potential to provide better information to users of financial statements about the residual asset because, for many leases, it would be measured at an amount that is close to fair value.

BC229. However, the Boards decided that a lessor should measure the residual asset on a cost basis. They concluded that entering into a lease is not equivalent to the sale of the underlying asset, particularly if the lease is for a short portion of the life of the underlying asset. At the commencement date, the lessor transfers the right-of-use asset to the lessee and it is appropriate to recognize any profit relating to that right-of-use asset. It would, however, be inappropriate to recognize profit associated with the residual asset before that asset is either sold or re-leased at the end of the lease term. The Boards also were concerned about the structuring opportunities that a current measurement basis for the residual asset might create. For example, they were concerned that a lessor could arrange to enter into a lease for only a few months, recognizing all of the profit associated with the underlying asset at the commencement date.

Subsequent Measurement of the Lease Receivable

BC230. Consistent with the 2010 Exposure Draft, this Exposure Draft proposes that a lessor should measure lease receivables on an amortized cost basis after initial measurement. That measurement basis is similar to, but not exactly the same as, the measurement basis applied to other financial assets within the scope of existing financial instruments requirements. For example, there are some differences in the measurement of variable lease payments under the leases proposals and how similar features would be measured for a financial asset measured at amortized cost in accordance with the financial instruments requirements. Nonetheless, this approach would result in accounting for lease receivables on a basis similar to that applied to other similar receivables. Respondents to the 2010 Exposure Draft generally agreed with this approach.

Sale of the Lease Receivable

BC231. The Boards considered whether lease receivables held for sale (or securitization) should be measured at fair value. Fair value measurement of such receivables would be consistent with the principles in existing financial instruments requirements on the measurement of financial assets held for the purposes of sale. Fair value measurement also would eliminate the recognition of gains or losses upon sale (assuming the transfer occurs at fair value) because the asset being transferred would be recognized at fair value immediately before sale.

BC232. However, the Boards decided not to require or permit a lessor to measure lease receivables held for sale at fair value for the following reasons:

a. There would be two measurement bases for lease receivables in this Exposure Draft, thus increasing complexity and reducing comparability.
b. The measurement requirements would need to specify whether a lessor would be required to measure at fair value only the part of the lease receivable being transferred or all of the cash flows included in the lease receivable, including those relating to variable lease payments and options that meet the recognition criteria according to the leases proposals. That would be relevant, for example, if a lease contains an extension option for which there is a significant economic incentive to exercise the option; however, the cash flows to be sold relate only to lease payments to be received during the noncancellable period of the lease. In that case, a part of the lease receivable (that is, the lease payments to be received during the extension period) would not be held for sale. Both alternatives (that is, measuring the entire lease receivable or only the part to be transferred at fair value) would be complicated in

this situation. Measuring only the part of the lease receivable to be transferred at fair value would require splitting the lease receivable into two parts with two different measurement bases for the same receivable. Alternatively, measuring all of the lease receivable at fair value would result in a lessor measuring lease payments not held for sale at fair value, which would be inconsistent with the Boards' other decisions on the measurement of lease payments.

c. If the fair value requirement was a "held for sale" requirement, it would not be perfectly consistent with the existing financial instruments requirements in IFRS 9 or the proposed requirements in the FASB's project on accounting for financial instruments.

d. Applying different measurement bases to different parts of a lease receivable also could introduce opportunities for structuring.

BC233. The Boards then considered whether the derecognition requirements in the financial instruments standards could be applied to lease receivables or whether proposals specific to lease receivables would need to be developed.

BC234. The Boards concluded that a lessor should apply the derecognition requirements in IAS 39, IFRS 9, or Topic 860, Transfers and Servicing, to lease receivables. Developing derecognition requirements for lease receivables would add complexity to the proposals and reduce comparability between lease receivables and other similar financial assets. The Boards did not identify any particular feature of lease receivables that would suggest that the financial instruments derecognition requirements would be inappropriate. In particular, IAS 39 or IFRS 9 and Topic 860 include requirements that address the sale of only a part of a larger financial asset.

Impairment of the Lease Receivable

BC235. Consistent with the 2010 Exposure Draft, this Exposure Draft proposes that a lessor should evaluate the lease receivable for impairment in accordance with the respective impairment models for financial assets within IFRS and U.S. GAAP.

BC236. A lease receivable meets the definition of a financial asset in IAS 39 and a loan in Topic 310, Receivables. The Boards noted that subsequently measuring the lease receivable on an amortized cost basis, and assessing it for impairment in accordance with the financial asset impairment model, would result in the lease receivable being measured on a similar basis to other financial instruments, particularly other similar receivables. The few respondents to the 2010 Exposure Draft that commented on the impairment proposals on the lease receivable generally supported using the financial asset impairment model when testing the lease receivable for impairment.

BC237. The Boards considered including impairment requirements for the lease receivable within this Exposure Draft. The advantage of such an approach would be that IFRS and U.S. GAAP preparers would subsequently measure lease receivables using the same requirements, increasing the consistency in application of lessor accounting in accordance with IFRS and U.S. GAAP. However, the Boards are both working on developing a new impairment model for financial assets, specifically addressing how that model would be applied to lease receivables. Including impairment requirements within this Exposure Draft would likely result in differences between the impairment model applied to lease receivables and the impairment model being developed for all other financial assets, which the Boards consider to be inappropriate.

BC238. As part of the impairment project, the Boards discussed how the new impairment model being developed would be applied to lease receivables. The Boards noted that the tentative decisions made in the leases project result in lease receivables being measured similarly to, but not in the same way as, financial assets at amortized cost, including some differences in the application of the effective interest method. The cash flows included in leases also could include features such as variable lease payments that would not be present in other financial assets measured at amortized cost.

BC239. Although the measurement of some lease receivables would be different from other financial assets measured at amortized cost, the Boards concluded that this was not a reason to apply a different impairment model. In the Boards' view, the same impairment model could be applied to lease receivables as long as:

a. The cash flows assessed for impairment are consistent with those included in the measurement of the lease receivable.
b. The rate used to discount the expected cash shortfalls is consistent with the rate proposed in the impairment model.

BC240. Consequently, the Boards are proposing that the new impairment models should be applied to lease receivables when those models are complete. The IASB decided, as part of the impairment project, that a lessor would be permitted to use either the full impairment model or a simplified approach (which always requires a lessor to measure lifetime expected credit losses relating to lease receivables) when measuring the impairment allowance for lease receivables. The impairment model being proposed by the FASB would always require a lessor to measure all expected losses relating to lease receivables. Additional information is available within the bases for conclusions on the IASB's Exposure Draft, *Financial Instruments: Expected Credit Losses,* and the proposed FASB Accounting Standards Update, *Financial Instruments—Credit Losses (Subtopic 825-15).*

Reassessment of Options

BC241. This Exposure Draft proposes that an entity reassess options only when there is a change in whether a lessee has, or does not have, a significant economic incentive to exercise an option. The reasons for that decision are set out in paragraphs BC168–BC172.

BC242. The Boards propose that a lessor should adjust the lease receivable and the carrying amount of the residual asset for changes arising from the reassessment of options so that the carrying amounts of the lease receivable and the residual asset reflect the relative value of what has been transferred (the lease receivable) and what has been retained (the residual asset) based on the revised assessment of the lease term or purchase options. For example, if the lease term is increased so that it represents almost all of the economic life of the underlying asset, the carrying amount of the lease receivable would increase to include the lease payments in the optional period. At the same time, the residual asset would be reduced to reflect that the carrying amount of the residual asset (that is, the underlying asset at the end of the new lease term) is now expected to be small, assuming that the residual asset is expected to have any value at the end of the new lease term. Similarly, if the lease term is shortened, the carrying amount of the lease receivable would decrease and the residual asset would increase to reflect that the lease is now expected to expire sooner than was originally anticipated.

Reassessment of Variable Lease Payments That Depend on an Index or a Rate

BC243. A change in variable lease payments that depend on an index or a rate represents a change in the total consideration that the lessor expects to receive for transferring the right to use an asset to the lessee. Accordingly, this Exposure Draft proposes that a lessor should remeasure the lease receivable for such changes in each period. A lessor should recognize those changes in the consideration received for the right-of-use asset in profit or loss in order to be consistent with the treatment of the consideration at the commencement date. The Boards considered but rejected adjusting the carrying amount of the residual asset for changes in the lease receivable arising from changes in variable lease payments that depend on an index or a rate. That is because such changes do not represent any change in the lessor's remaining rights relating to the underlying asset. Those changes relate to the right-of-use asset already transferred to the lessee and, accordingly, should be recognized in profit or loss.

Reassessment of the Discount Rate

BC244. This Exposure Draft proposes that both a lessee and a lessor should reassess the discount rate in limited circumstances, such as when there is a change to the lease term, the accounting for purchase options, or reference interest rates. The reasons for that decision are set out in paragraphs BC178–BC181.

Subsequent Measurement of the Residual Asset

Unwinding of the Discount Embedded in the Measurement of the Residual Asset

BC245. As noted in paragraphs BC226–BC229, consistent with the 2010 Exposure Draft, this Exposure Draft proposes, that a lessor should initially measure the residual asset as an allocation of the previous carrying amount of the underlying asset (that is, the present value of the estimated residual value of the underlying asset at the end of the lease term [the gross residual asset] less any unearned profit relating to the residual asset).

BC246. The 2010 Exposure Draft proposed that, other than for impairment, a lessor would not remeasure the residual asset during the lease term. Many respondents to the 2010 Exposure Draft did not agree with those proposals. They noted that prohibiting the unwinding of the time value of money (or discount) embedded in the initial measurement of the residual asset would not reflect the way in which many leases were priced and, thus, would not reflect the economics of those transactions. It would result in the lessor measuring the residual asset at an artificially low amount during the lease term and subsequently recognizing an artificially large gain if the underlying asset were sold at the end of the lease term.

BC247. In response to those comments, this Exposure Draft proposes that a lessor should unwind the discount embedded in the initial measurement of the gross residual asset over the lease term and recognize the unwinding of the discount as interest income. That is because the amounts recognized are derived from the lease—they are part of the lease payments and represent interest charged by the lessor on the residual asset during the lease term. Consequently, in the Boards' view, the proposal would result in accounting that better reflects how a Type A lease is typically priced and the return a lessor earns throughout the lease.

BC248. In a Type A lease, the lessor not only charges the lessee to recover its investment in the portion of the underlying asset that the lessee is expected to consume, but it also charges the lessee for the use of the entire underlying asset over the lease term. That is because the lessor cannot generate economic benefits from the underlying asset while the asset is subject to a lease, other than those received from the lessee. Accordingly, the lessor must obtain a return on its investment in the entire underlying asset (including the residual asset) during the lease term and would be expected to include that return in the lease payments being charged to the lessee. The discount rate (typically, the rate implicit in the lease) applied to the lease receivable and the residual asset also would be calculated in a manner that was consistent with this rationale.

BC249. In reaching this decision, the Boards noted that the measurement basis proposed for the residual asset is different from the measurement basis typically applied to other nonfinancial assets measured at cost, that is, an entity does not usually adjust the subsequent measurement of a nonfinancial asset for the effects of the time value of money when the nonfinancial asset is measured on a cost basis. However, the approach is similar to the accounting applied to the residual asset embedded in the net investment in a finance lease in IAS 17 or a direct finance or a sales-type lease in Topic 840. The Boards noted that the nature of the residual asset, and its initial measurement, is somewhat different from other nonfinancial assets. The lessor derives economic benefits from the entire underlying asset (including the residual asset) in how it has priced the lease, and it is unable to access any other economic benefits from the asset until the end of the lease term. Accordingly, it is appropriate to recognize those economic benefits derived from the lease during the lease term.

BC250. The Boards considered whether a lessor should apply a different discount rate to the lease receivable and the residual asset. That is because the nature of the risks associated with the lease receivable (mainly credit risk associated with the lessee) is different from the nature of the risks associated with the residual asset (mainly asset risk associated with the underlying asset). However, the Boards were informed that many lessors of Type A leases determine the rate they charge the lessee as a blended rate, considering the risks associated with both the lease receivable and the residual asset. Applying the same rate when measuring both assets also would be simpler to apply. Consequently, the Boards decided that a lessor should apply the rate the lessor charges the lessee when measuring both the lease receivable and the residual asset.

Variable Lease Payments That Do Not Depend on an Index or a Rate Reflected in Determining the Rate the Lessor Charges the Lessee

BC251. When determining the rate charged to the lessee, the lessor is required to take into account the terms and conditions of the lease, possibly including an expectation of variable lease payments, if the lease includes such payments. If those variable lease payments do not depend on an index or a rate or are not in-substance fixed payments (for example, if payments vary on the basis of the use of an asset), a lessor does not include the payments in the measurement of the lease receivable. Excluding those variable lease payments from the measurement of the lease receivable and reflecting them in determining the discount rate means that a portion of the initial measurement of the residual asset relates to variable lease payments to be received during the lease term (that is, the gross residual asset not only represents the present value of the expected residual value of the underlying asset at the end of the lease term, but it also represents the present value of any expected variable lease payments during the lease term). Without making any adjustments to the carrying amount of the residual asset during the lease term in this situation, the profit recognized by the lessor over the lease term would be overstated and the residual asset could possibly be impaired.

BC252. The Boards considered three ways to deal with this issue. The first approach would be to permit the lessor to include an expectation of those variable lease payments in the measurement of the lease receivable when the lessor is able to make a reliable estimate of the amounts expected to be received. That is what the 2010 Exposure Draft proposed under the derecognition approach. However, the Boards rejected that approach because it would contradict their decisions on variable lease payments and the general feedback received about the inclusion of variable lease payments in the measurement of the lessee's liability and the lessor's receivable (as described in paragraphs BC148–BC155). It also would result in a lack of comparability among lessors when accounting for variable lease payments.

BC253. The second approach would be to require a lessor to always exclude variable lease payments that do not depend on an index or a rate when determining the rate charged to the lessee. However, the Boards rejected this approach because the rate calculated would no longer be the rate the lessor charges the lessee. This approach also might produce counterintuitive results in leases that have a significant proportion of variable lease payments.

BC254. The third approach, which was chosen by the Boards, would require a lessor to derecognize a portion of the carrying amount of the residual asset during the lease term if the rate the lessor charges the lessee reflects an expectation of variable lease payments that has not been included in the lease receivable. That amount derecognized would be recognized as an expense in each period, representing the cost associated with the revenue recognized as variable lease payments are received. Because the discount rate used by the lessor already reflects the expected variable lease payments, the Boards decided that a lessor should calculate the adjustment to the residual asset on the basis of the expected variable lease payments.

BC255. To apply this approach strictly, a lessor would have been required to update its expectations of variable lease payments at the end of each reporting period and recalculate the adjustments to be made to the residual asset. However, the Boards are not proposing such an approach because it would be extremely complex to apply for possibly little benefit.

BC256. The Boards also considered whether a lessor should be required to make any adjustments to the carrying amount of the residual asset in this situation from a cost-benefit perspective. Although the accounting to be applied may appear complicated, a lessor is required to adjust the carrying amount only when variable lease payments are reflected in determining the rate the lessor charges the lessee. Information obtained about Type A leases indicates that this would not be expected to occur frequently. In addition, the information required to apply the accounting would be no different from the information that the lessor uses when pricing the lease and determining the discount rate. The adjustments to be made also are determined at the commencement date, without a requirement for reassessment during the lease term. Accordingly, there should be little additional cost associated with applying these proposals.

Impairment of the Residual Asset

BC257. This Exposure Draft proposes that a lessor should apply existing nonfinancial asset impairment requirements to the residual asset. The residual asset is a nonfinancial asset, and its value is directly linked to the value of the underlying asset. Consequently, any impairment of the residual asset would typically be caused by a decline in the value of the underlying asset, which is a nonfinancial asset. Given that the indicators of impairment would typically be the same for the residual asset and the underlying asset, the Boards concluded that it is appropriate to apply the same impairment models to both the residual asset and the underlying asset.

BC258. When a lessor has received a residual value guarantee, it could be argued that the impairment model for financial assets would be more appropriate than the impairment model for nonfinancial assets. That is because the lessor is exposed to the credit risk of the guarantor and not directly to the risk associated with any decline in value of the underlying asset.

BC259. However, the Boards noted that the essence of any impairment model, whether it relates to financial assets or nonfinancial assets, is that an entity is comparing the carrying amount of an asset with the future cash flows expected to be received. Consequently, regardless of whether the lessor applies the financial asset or nonfinancial asset impairment model, the lessor would consider all cash flows expected to be received relating to the residual asset, including those to be received from a guarantor, when testing the asset for impairment. The main difference between the impairment models relates to the indicators of impairment, that is, the factors that require a lessor to test the residual asset for impairment. When a lessor has a residual value guarantee, the guarantee becomes relevant only if the expected market value of the underlying asset falls below a specified amount. Consequently, although the lessor is exposed to the credit risk of the guarantor, that exposure would only be relevant from an impairment perspective if the value of the underlying asset has declined. Accordingly, the Boards concluded that the indicators of impairment included in the nonfinancial asset impairment model, which refer to a decline in value of the asset, also would be appropriate when a lessor has a residual value guarantee.

BC260. The Boards considered developing and applying a single impairment model to the residual asset that would be the same under both U.S. GAAP and IFRS. However, for the reasons set out in paragraph BC188, they decided to refer to the existing impairment requirements within U.S. GAAP and IFRS.

Revaluation of the Residual Asset (IASB Only)

BC261. The IASB considered whether to permit, but rejected permitting, revaluation of the residual asset because it would be inconsistent with the decision to prohibit measuring the residual asset on a current measurement basis (and thereby recognizing profit relating to the residual asset) at the commencement date. It also would be inconsistent with the decision to require a lessor to recognize the unwinding of the discount embedded in the measurement of the residual asset over the lease term as interest income. The IASB also questioned whether a lessor would ever choose to measure the residual asset at fair value, with changes in fair value being recognized as part of other comprehensive income. Such an approach would result in part of the income earned from a lease never being recognized in profit or loss.

BC262. That decision could arguably be viewed as being inconsistent with the requirements of IAS 16 and IAS 38. However, as noted above, in the IASB's view, the nature of the residual asset is different from that of other nonfinancial assets, which is reflected in the proposal to measure the residual asset on a basis different from assets within the scopes of IAS 16 and IAS 38.

Measurement of the Underlying Asset at the End of the Lease Term or Termination of a Lease

BC263. This Exposure Draft proposes that if the underlying asset is returned to the lessor before the end of the lease term (for example, because of a premature termination of the lease), a lessor should measure the returned asset by aggregating the carrying amount of the lease receivable (less any amounts still expected to be received by the lessor) and the residual asset at that date.

BC264. Although a lessor would recognize the lease receivable and residual asset separately because they have different characteristics and are different in nature, both of those assets relate to the same underlying asset. Because of that, the Boards are proposing to present the lease receivable and residual asset on an aggregated basis as "lease assets" (as described in paragraph BC268). Consistent with this rationale, the Boards decided that if a lessee returns the underlying asset before the end of the lease term, the lessor should account for the returned asset as a reclassification of those two assets (that is, the lease receivable and the residual asset). In reaching that decision, the Boards noted that the lease receivable would be required to be assessed for impairment immediately before the underlying asset is returned to the lessor, and this approach is consistent with how that impairment assessment would be performed. The Boards concluded, however, that a lessor would continue to recognize a receivable for any amounts that it expects to receive relating to the lease. Accordingly, a lessor would initially measure the returned asset at the carrying amount of the lease receivable (after impairment) and the residual asset, excluding any amounts that the lessor expects to receive, which the lessor would continue to recognize as a receivable.

BC265. The Boards considered two other alternatives for measuring the returned asset:

a. *Fair value*—a lessor would derecognize the lease receivable and the net residual asset and recognize the returned asset at fair value.
b. *Retrospective measurement*—a lessor would calculate a revised rate implicit in the lease (the rate actually earned on the shortened lease term) on the basis of the fair value of the returned asset at the time the lease terminates prematurely. According to this approach, a lessor would use the revised inputs to compute what the deferred profit on the residual asset would have been at the commencement date as if the lessor had known that the lease would terminate prematurely at the commencement date.

BC266. The Boards rejected fair value because of the following:

a. It would result in any unearned profit on the residual asset being recognized when the asset is returned and before the asset is sold or released to another party. As explained in paragraphs BC226–BC229, the Boards decided that a lessor should not recognize any profit relating to the residual asset until the asset is sold or re-leased. Applying a fair value measurement approach would be inconsistent with that requirement.
b. Although rare, it could potentially result in a lessor recognizing a gain from a repossession of the underlying asset. The Boards noted that it is counterintuitive for a lessor to recognize a gain as a result of what most would view as an unfavorable circumstance (that is, the termination of a lease before the end of the lease term).

BC267. The Boards rejected retrospective measurement because of the following:

a. The approach would be complex to apply. It requires the use of hindsight to recalculate the transaction as if the lessor had known at the commencement date that the lease would be terminated prematurely.
b. The measurement methodology is not consistent with the way in which a lessor would assess the lease receivable for impairment immediately before recognition of the returned asset.
c. Although rare, it could potentially result in a net gain from a repossession of the underlying asset in situations in which the fair value of the asset has increased over the lease term.

Presentation: Lessor—Type A Leases

Statement of Financial Position

BC268. The Exposure Draft proposes that a lessor should present lease assets (that is, the sum of the carrying amounts of lease receivables and residual assets) separately from other assets in the statement of financial position. Both the lease receivable and the residual asset relate to the same underlying asset and, thus, are linked. Consequently, the Boards concluded that it is useful to present those assets together.

BC269. Although linked, the Boards decided to require a lessor also to present or disclose the carrying amount of lease receivables and the carrying amount of residual assets separately because those assets have different natures, risks, and liquidity. Separate disclosure of those assets will improve the transparency of information provided to users of financial statements about a lessor's exposure to credit risk (relating to the lease receivable) and asset risk (relating to the residual asset).

BC270. The Boards considered presenting the residual asset as it would be presented immediately after the expiration of the lease (for example, as inventory or property, plant, and equipment). However, the Boards noted that the residual asset (that is, the rights retained in the underlying asset while the subject of a lease) did not share the same economic characteristics as similar assets that were not leased. Consequently, the Boards concluded that it would be useful to present both assets (the lease receivable and the residual asset) that relate to the same underlying asset together. For example, a lessor cannot use an asset that it owns and generally cannot sell an asset that it owns (without the lease being attached) while the asset is the subject of a lease. In the Boards' view, it would be less useful to present such an asset together with other assets that the lessor can either use in its own business or sell unencumbered at any time.

Statement of Comprehensive Income

BC271. Business models vary among lessors with Type A leases. For example, many financial institution lessors use leasing solely as a means of providing finance to lessees. Other lessors, for example, manufacturer or dealer lessors use leasing as an alternative means of realizing value from assets they would otherwise sell, and also provide finance to lessees. The Boards propose to permit a lessor to present profit recognized at the commencement date either gross or net to reflect its business model or business models (if the lessor has different leasing businesses). That would enable a lessor to present the effects of leases in a way that is consistent with how the lessor generates its income.

Statement of Cash Flows

BC272. The Exposure Draft proposes that, in the statement of cash flows, a lessor should classify lease payments received as operating activities because leasing is generally part of a lessor's revenue-generating activities.

Measurement: Lessor—Type B Leases

BC273. The Boards decided that a lessor should continue to recognize the underlying asset and recognize lease income over the lease term for Type B leases. The approach is similar to operating lease accounting in IAS 17 or Topic 840 for a lessor.

BC274. The Boards considered whether a lessor should be required to recognize a lease receivable for all leases, including Type B leases, but rejected this approach for the reasons noted in paragraphs BC72–BC76.

BC275. The Boards also decided that a lessor would recognize lease income arising from Type B leases on a straight-line basis or another systematic basis if that basis is more representative of the pattern in which income is earned from the underlying asset. In reaching that decision, the Boards considered two other alternatives:

a. Recognizing lease income on the basis of the contractual cash flows
b. Recognizing lease income on a straight-line basis.

BC276. Recognizing lease income on the basis of the contractual cash flows might be an appropriate method of recognizing lease income if the lessor measures the underlying asset at fair value, recognizing changes in fair value through profit or loss. That is because the fair value of the asset would be estimated on the basis of future cash flows, taking into account both the timing and amount of contractual cash flows as well as noncontractual cash flows. However, the Boards concluded that recognizing lease income on a contractual cash flow basis would not be appropriate when the underlying asset is measured at cost because, under such an approach, the amount of lease income recognized would be entirely dependent on the contractual timing of lease payments, rather than reflecting when the lessor has earned income.

BC277. Although, in the Boards' view, recognizing rental income on a straight-line basis often will reflect the pattern in which income is earned from the underlying asset, they noted that will not always be the case. For example, the Boards concluded that it would be simpler and more consistent with their proposals on variable lease payments to recognize lease income arising from variable lease payments for Type B leases in the period in which they are receivable, rather than on a straight-line basis. In addition, in the case of stepped rent increases (when those stepped rents are expected to compensate the lessor for increases in market rentals), the Boards agreed with some respondents to the 2010 Exposure Draft that recognizing lease income as lease payments are received would better reflect the pattern in which income is earned from the underlying asset. For such leases, although the yield that the lessor earns on the underlying asset may not change over the lease term, the amount of lease income earned in later periods may be higher, reflecting that the economic benefits derived from use of the underlying asset, which is often property in a Type B lease, have increased in value over the lease term.

BC278. Consequently, the Boards decided that a lessor would recognize rental income on a systematic basis that is not straight line if that basis was more representative of the pattern in which income is earned from the underlying asset. Nonetheless, a lessor would be expected to recognize uneven fixed lease payments on a straight-line basis when the payments are uneven for reasons other than to reflect or compensate for market rentals or market conditions (for example, when there is significant front loading or back loading of payments or when rent-free periods exist in a lease).

Disclosure: Lessor

BC279. When determining the disclosures for leases, the Boards considered the following:

a. The existing requirements in IAS 17 and Topic 840
b. IFRS 7 (IAS 17 requires a lessor to comply with the disclosure requirements in IFRS 7).

BC280. In selecting the disclosure objective, the Boards considered work in other related projects. As a result, the Boards propose that disclosures about leases should enable users of financial statements to evaluate the amount, timing, and uncertainty of cash flows arising from leases.

Reconciliation of Opening and Closing Balances

BC281. This Exposure Draft proposes that a lessor should provide reconciliations of the lease receivable and residual asset for Type A leases because those reconciliations inform users of financial statements about changes to those assets during the reporting period. Users of financial statements have informed the Boards that such reconciliations are useful in their analyses.

Information about Exposure to Residual Asset Risk

BC282. This Exposure Draft proposes that a lessor of Type A leases should provide information about how it manages its exposure to residual asset risk. Some users of financial statements informed the Boards that there is currently a lack of transparency on such information in a lessor's financial statements. Particularly for leases that are currently classified as operating leases, lessors can retain significant residual asset risk and very little, if any, information is available about that exposure to risk in financial statements. The Boards considered proposing disclosure of the fair value of the residual asset at each reporting period to address the concern raised. However, the Boards concluded that requiring fair value information at each period end could be very onerous for lessors. Although it is fundamental to a lessor's business that the lessor manage its exposure to residual asset risk, the costs associated with having to disclose, and have audited, fair value information about residual assets would potentially outweigh the benefit for users of financial statements.

Table of Income

BC283. This Exposure Draft proposes disclosure of lease income in tabular form, which will provide information about the different components of lease income recognized during the reporting period (for example, profit recognized at the commencement date and interest income). In the Boards' view, the tabular display better highlights the different nature of the components of lease income.

Maturity Analyses

BC284. This Exposure Draft also proposes that lessors should disclose a maturity analysis of the timing of the future cash flows arising from both Type A and Type B leases. In the Boards' view, such disclosure would help users of financial statements to assess the expected timing and amount of future cash flows arising from leases.

Sale and Leaseback Transactions

BC285. In a sale and leaseback transaction, one entity (the lessee) sells an asset that it owns to another party (the lessor) and immediately leases back that same asset. Existing lease accounting requirements include specific requirements on sale and leaseback transactions to determine whether, when an asset is sold and immediately leased back, an entity should account for the transaction as a sale and leaseback or account for the entire transaction as a financing arrangement. Those requirements are different under IFRS and U.S. GAAP, with more transactions being accounted for as sale and leaseback transactions under IFRS than under U.S. GAAP.

BC286. Consistent with the 2010 Exposure Draft, this Exposure Draft proposes that a transaction should be accounted for as a sale and leaseback transaction only if there is a sale of the asset that is the subject of the contract. The 2010 Exposure Draft included a list of conditions that, if they existed, would typically preclude sale and leaseback accounting. Those conditions set a higher threshold in terms of achieving sale accounting than the revenue recognition proposals.

BC287. Respondents to the 2010 Exposure Draft raised the following concerns about the proposals:

a. Many questioned why there was a need for a higher threshold in relation to sale and leaseback transactions, especially in light of the proposals in the revenue recognition project to remove the higher threshold that exists in U.S. GAAP on real estate sales. Consequently, those respondents questioned why a higher threshold for revenue recognition should be retained only within the context of sale and leaseback transactions.
b. Many were concerned about whether the sale recognition conditions in the 2010 Exposure Draft were operational. They expected the proposals

to be applied very strictly so that almost all sale and leaseback transactions would be treated as financing arrangements. Many of those respondents thought that applying sale and leaseback accounting was an appropriate way to account for those transactions.

BC288. In response to those concerns, the Boards decided that an entity would apply the control principle being developed in the revenue recognition project when assessing whether a sale has occurred in a sale and leaseback transaction. Applying the revenue recognition requirements to sale and leaseback transactions would simplify the proposals and increase comparability between sales entered into as part of sale and leaseback transactions and all other sales. That would be beneficial to both preparers and users of financial statements. In addition, some of the structuring concerns relating to sale and leaseback transactions that exist under existing IFRSs and U.S. GAAP would be reduced by the proposals in this Exposure Draft, which would require the recognition of lease assets and lease liabilities by lessees.

BC289. In applying the control principle in the revenue recognition proposals to sale and leaseback transactions, the Boards decided to clarify the following in this Exposure Draft:

a. The control principle should be applied to the entire transaction and not just the sales portion of the transaction. That is consistent with the proposals in the revenue recognition project to combine contracts that are negotiated as a package. It also would be difficult and arbitrary to bifurcate many sale and leaseback transactions into distinct sale and leaseback portions.
b. The existence of the leaseback does not, in isolation, prevent the buyer/lessor from obtaining control of the asset. That is because a lease is different from the purchase or sale of an asset in that a lease does not transfer control of the asset to the lessee; instead, it transfers the right to control the use of the asset for the period of the lease. Consequently, assuming that there are no features in a sale and leaseback transaction that would prevent sale accounting, the buyer/lessor would be considered to obtain control of the asset and immediately transfer the right to control the use of that asset to the lessee for the lease term. The lease payments received by the buyer/lessor during the lease term, together with the benefits that the lessor can generate from the residual asset after the lease term, would represent substantially all of the remaining benefits from the asset immediately before the asset is leased to the seller/lessee. Consequently, in such cases, the buyer/lessor obtains control of the asset. The Boards noted that the buyer/lessor in many sale and leaseback transactions is no different from many other lessors in terms of its control of the asset. Many lessors purchase an asset that will be the subject of a lease from a third party only when the terms and conditions of the lease have already been negotiated. The lessor may

not receive physical possession of the asset until the end of the lease term (for example, a vehicle could be delivered directly by a manufacturer to the lessee, even though the lessor purchases the vehicle from the manufacturer). In a sale and leaseback transaction, the lessor also may not receive physical possession of the asset until the end of the lease term. However, in both of those situations, the Boards concluded that it would be appropriate for the lessor to be deemed to control the asset immediately before the commencement of the lease.

c. A sale has not occurred if the leaseback is such that the seller/lessee obtains substantially all of the remaining benefits of the asset. In that case, the seller/lessee has, in effect, sold the asset and immediately repurchased it. Accordingly, a sale has not occurred and the entire transaction should be accounted for as a financing arrangement. The Boards decided to include requirements on how to apply that principle within the context of sale and leaseback transactions, which are the same as the requirements applied when classifying leases of property. Those requirements are familiar to many constituents, which will make them easier to apply and lead to more consistent application.

d. If an entity concludes that the buyer/lessor does not obtain control of the asset, the entire transaction is accounted for as a financing arrangement. On the basis of the proposals in the 2011 Revenue Recognition Exposure Draft, the inclusion of a call option or some put options in a sale and leaseback transaction would cause the transaction to be accounted for as a financing arrangement. In making that decision, the Boards noted that the application of the proposals in that Exposure Draft on repurchase agreements could have required an entity to account for some sale and leaseback transactions as a lease and leaseback. The Boards noted that applying lease and leaseback accounting in those situations would be complex and difficult to understand and, thus, the cost would outweigh any benefit. Consequently, the Boards expect that the requirements on repurchase agreements within the forthcoming standard on revenue recognition will clarify that if the buyer/lessor does not obtain control of the asset in a sale and leaseback transaction, the entire transaction is accounted for as a financing arrangement.

BC290. The lease payments and the sales price in a sale and leaseback transaction can be interdependent because they are negotiated as a package. For example, the sales price might be more than the fair value of the asset because the leaseback lease payments are above a market rate; conversely, the sales price might be less than the fair value because the leaseback lease payments are below a market rate. That could result in the misstatement of gains and losses on disposal of the asset for the lessee and the misstatement of the carrying amount of the asset for the lessor. Consequently, this Exposure Draft proposes that if the sale consideration or leaseback rentals are not at market rates, a lessee should adjust the carrying amount of the right-of-use asset to reflect current market lease payments for that asset, with a corresponding adjustment made to the gain or loss recognized on disposal of the asset. Similarly, a lessor would adjust the amounts recognized to reflect current market lease payments. In the Boards' view, such adjustments ensure that the assets, liabilities, gains, and losses recognized by both the lessee and the lessor are neither understated nor overstated. However, the FASB decided that if the transaction is between entities that are related, the lessee and the lessor should not adjust the lease assets or the lease liabilities and should make the appropriate disclosures in accordance with Topic 850, Related Party Disclosures.

BC291. The Boards considered whether the transferred asset must be an entire leased asset (a "whole asset" approach) or whether a bundle of rights and obligations associated with an asset could qualify for sale and leaseback accounting (a "partial asset" approach). For example, under a partial asset approach, in a sale and leaseback of an office building, the lessee would continue to recognize a portion of the building representing the right to use the building during the leaseback period and derecognize that portion of the building relating to the rights transferred to the lessor (for example, ownership rights and the right to use the building after the end of the leaseback period). However, the Boards decided not to propose a partial asset approach because it would be complex to apply and would not provide a proportionate benefit in improved information to users of financial statements.

BC292. This Exposure Draft proposes that lessees should disclose the main terms and conditions of sale and leaseback transactions and any gains and losses arising from those transactions. Those disclosures would inform users of financial statements about transactions that could give rise to significant nonrecurring gains and losses and cause a significant change in the capital structure of the entity.

Related Party Leases (FASB Only)

BC293. The FASB decided that the recognition and measurement requirements for all leases should be applied by lessees and lessors that are related parties on the basis of legally enforceable terms and conditions of the arrangement, acknowledging that some related party transactions are not documented and/or the terms and conditions are not at arm's length. In addition, lessees and lessors would be required to apply the disclosure requirements for related party transactions in Topic 850. Under existing U.S. GAAP, entities are required to account for leases with related parties based on the economic substance of the arrangement, which may be difficult when there are no legally enforceable terms and conditions of the arrangement. Examples of difficulties include related party leases that are month to month and related party leases that have payment amounts dependent upon cash availability. In these situations, it is difficult and costly for preparers to apply the recognition and measurement requirements. Even when applied, the resulting information often is not useful to users of financial statements.

Short-Term Leases

BC294. The 2010 Exposure Draft proposed that a lessee and lessor could elect to apply simplified accounting to leases that met the definition of a short-term lease. A lessee would not need to discount lease assets and lease liabilities arising from short-term leases. A lessor could apply an approach similar to existing operating lease accounting to short-term leases. A short-term lease was defined in the 2010 Exposure Draft as a lease that, at the commencement date, has a maximum possible lease term of 12 months or less.

BC295. Respondents to the 2010 Exposure Draft noted that the proposals for short-term leases did not offer much relief for entities because the discount element of short-term leases is often immaterial. In addition, the proposals would still require an entity to track a possibly large volume of leases with little value and to separate nonlease components from lease components for these leases, which could be cumbersome.

BC296. On reconsideration, the Boards agreed that applying the full proposals did not justify the costs. Consequently, the Boards have simplified the accounting for short-term leases to offer more relief to lessees. This Exposure Draft proposes that both lessees and lessors need not apply the proposed recognition and measurement requirements to short-term leases.

BC297. This Exposure Draft proposes that short-term leases should be defined as leases that, at the commencement date, have a maximum contractual term, including all options to extend, of 12 months or less. The Boards considered but rejected, increasing the short-term lease exemption beyond leases of 12 months because, for example, 2-year leases and 3-year leases are more likely to give rise to material assets and liabilities, and the objective of the project was to ensure greater transparency about an entity's leasing activities.

BC298. The Boards also considered defining short-term leases consistently with the definition of the lease term. According to that approach, a short-term lease would include any lease for which the lease term is 12 months or less, considering whether the lessee has a significant economic incentive to extend the lease. The Boards rejected that approach because of concerns that leases could be structured to obtain short-term lease accounting. For example, a lease that ultimately extends for 10 years or more could be structured to include a series of 1-year renewal options, which could result in the lease never being recognized on a lessee's statement of financial position. In addition, such an approach would require entities to apply more judgment than the contractual approach proposed by the Boards and, thus, would be more complex to apply. In light of the Boards' objective in including an accounting option for short-term leases, which was to provide cost relief, the Boards concluded that it would be counterintuitive to make the practical relief more complex to apply.

Effective Date

BC299. The Boards will set the effective date for the proposed requirements when they consider feedback on the proposed changes and finalize this Exposure Draft. The Boards recognize that the proposals affect almost every reporting entity. Some of those entities have many leases and the proposed changes to accounting for those leases are significant. The Boards will consider these and other relevant factors when setting the effective date to ensure that entities have sufficient time to implement the proposed changes. As part of that consideration, the Boards will consider whether to permit early application of the leases requirements.

BC300. Consequently, this Exposure Draft does not specify a possible effective date or whether the proposed requirements could be applied early.

Transition

BC301. The 2010 Exposure Draft proposed that an entity should recognize and measure all outstanding contracts that exist at the beginning of the earliest comparative period as of that date using a simplified retrospective approach.

BC302. According to that simplified approach, lessees would be required to recognize a lease liability measured at the present value of the remaining lease payments and a right-of-use asset equal to the lease liability, less any impairment adjustments. A lessee could carry forward the carrying amounts of lease assets and lease liabilities arising from leases classified as capital leases according to existing requirements if those leases did not have options, variable lease payments, term option penalties, or residual value guarantees. Transition for lessors would depend on the lessor accounting approach applied. For leases to which a lessor would apply the performance obligation approach, the lessor would measure the lease receivable and performance obligation at the present value of the remaining lease payments. For leases to which a lessor would apply the derecognition approach, the lessor would recognize a lease receivable, measured at the present value of remaining lease payments, and a residual asset, measured at fair value.

BC303. The Boards received differing views on the transition approach proposed in the 2010 Exposure Draft:

a. Some agreed with the Boards' proposals in the 2010 Exposure Draft. They noted that the simplified approach helps reduce cost for preparers while continuing to provide users with useful information.
b. Others disagreed with that approach. Many were concerned about the "front-loading effect" of interest expense for lessees at transition. They noted that the transition proposals treated all leases as new leases on the date of transition, which would increase lease-related costs

artificially in the years immediately after transition and reduce those costs artificially nearing the end of each lease. The front-loading effect that would arise from the transition proposals would be much greater than that which would arise if a lessee applied a full retrospective approach on transition. They thought that the artificial increase in interest expense immediately after transition would distort the financial information provided to users of financial statements. For that reason, many suggested that an entity should be permitted to apply a full retrospective approach.

c. Most preparers expressed concerns about the costs associated with transition, with some favoring prospective application.
d. Others thought there was a need for additional transition requirements for specific transactions, including sale and leaseback transactions and leveraged leases, and additional requirements on the discount rate to be used.

Modified Retrospective Approach

BC304. On the basis of feedback received, the Boards concluded that the simplified retrospective approach that was proposed in the 2010 Exposure Draft was not the appropriate approach, mainly because of the front-loading effects for lessees that would have distorted lease-related expenses included in profit or loss in periods after transition.

BC305. The Boards then considered other approaches to address the main concerns raised, including the following:

a. Retrospective approach
b. Modified retrospective approach
c. Prospective approach.

BC306. The Boards rejected requiring a full retrospective approach without any relief because the costs of such an approach for preparers could be significant and would be likely to outweigh the benefits. A full retrospective approach would require entities to calculate the carrying amounts of all outstanding leases at the earliest comparative period as if those leases had always been accounted for in accordance with the proposed requirements. That could be impracticable for entities that have thousands of leases. Nonetheless, the Boards did not wish to prohibit entities from applying a full retrospective approach because that approach would provide better information to users of financial statements than other approaches. Consequently, the Boards decided to permit entities to choose to apply the proposals retrospectively.

BC307. The Boards also rejected a prospective approach (that is, applying the proposals only to leases that commence after the date of transition). Although the approach would be the least costly for preparers to apply, the information provided would not be beneficial to users of financial statements, particularly for entities that enter into longer-term operating leases. For example, some entities enter into operating leases with lease terms of 20 to 25 years. For such entities, a user would not obtain a clear picture of the true effect of the leases proposals for up to 25 years after implementing the new requirements. In addition, lease income for many lessors is central to the lessor's revenue-generating activities. Consequently, it is important for users of financial statements to have information about those activities prepared on a consistent basis.

BC308. The Boards decided to propose a modified retrospective approach in this Exposure Draft because such an approach would result in an entity recognizing amounts on transition that approximate a full retrospective approach without performing all of the calculations assuming that the proposals had been applied from the beginning of every lease. This approach also would address the concerns raised in response to the 2010 Exposure Draft about the front-loading effects for lessees.

BC309. According to the modified retrospective approach, a lessee would calculate lease assets and lease liabilities in a similar manner to a full retrospective approach but would use information available to the lessee at the date of transition. A lessee also may apply hindsight on transition. To provide additional relief, the Boards decided that a lessee could calculate a discount rate on a portfolio basis for leases with similar characteristics rather than calculate a discount rate for each lease.

BC310. Although providing some relief for lessors (for example, a lessor can also use hindsight on transition), the modified retrospective approach proposed by the Boards does not provide as much relief for lessors as it does for lessees for a number of reasons:

a. A lessor's leasing activities are generally a central part of the lessor's revenue-generating activities and, accordingly, it is important that users of financial statements obtain information about those activities that is prepared on a consistent basis when the lessor first applies the proposed requirements.
b. There is little change to existing requirements for lessors of Type B leases. On transition, a lessor can carry forward its previous accounting for Type B leases. Consequently, the lessor accounting proposals affect a smaller population of leases and a smaller population of entities. In contrast, the lessee accounting proposals require significant changes for both Type A leases and Type B leases.
c. A lessor of Type A leases should be able to more easily obtain information about those leases than a lessee would. For example, the Boards are not proposing any relief for lessors on the discount rate to be applied on transition. That is because the original rate charged to the lessee is consistent with the rate applied to new leases and that rate also is likely to be available to a lessor of Type A leases.

Uneven Lease Payments

BC311. In some leases, lease payments are uneven during the lease term and there may be significant increases in payments at the beginning or end of the lease term. For such leases, the present value of the lease payments during the remaining term of the lease may not reflect the economic benefits that are available to the lessee or lessor at the date of transition. Accordingly, this Exposure Draft proposes that lessees should adjust the right-of-use asset and that lessors should adjust the carrying amount of the underlying asset derecognized for many Type A leases to reflect any adjustments for prepaid or accrued payments on transition.

Leases That Are Capital Leases According to Existing Requirements

BC312. In the 2010 Exposure Draft, the Boards proposed transition relief for capital leases that do not include features such as options, residual value guarantees, and variable lease payments. That was because, for those simple finance leases, there would be little difference between the accounting under the existing and proposed requirements, and, thus, the benefits of restating the assets and liabilities for those leases would be marginal. Some respondents to the 2010 Exposure Draft thought that the transition relief should be extended to all leases classified as capital leases. They noted that capital leases typically do not include variable lease payments or unrecognized optional lease payments and, thus, there is little difference in the accounting that would result from applying the existing and proposed requirements to all capital leases.

BC313. This Exposure Draft proposes that an entity need not remeasure the assets and liabilities arising from leases classified as capital leases in accordance with existing requirements. The Boards agreed with those respondents who noted that the cost of requiring entities to remeasure lease assets and liabilities for those leases would be likely to outweigh the benefit because the accounting under the existing and proposed requirements would be similar. In reaching that decision, the Boards also noted that the changes to the proposals on options and variable lease payments would result in proposals that are more closely aligned with the existing requirements.

BC314. The Boards decided that the best way to implement this proposal would be to:

a. Require an entity to use the carrying amounts of lease assets and liabilities under existing requirements as the carrying amounts at the date of transition to the new requirements
b. After the date of transition, apply particular requirements within the proposals that would lead to accounting that is similar to applying the existing requirements for capital leases.

Sale and Leaseback Transactions

BC315. In response to requests from respondents to the 2010 Exposure Draft, the Boards decided to provide transition requirements for sale and leaseback transactions that are consistent with the general transition proposals for lessees and lessors to the extent possible. Accordingly, because the Boards decided to provide transition relief for leases that are classified as capital leases in accordance with existing requirements, the Boards also are proposing transition relief for sale and leaseback transactions for which the entity concluded that the transaction was a sale and capital leaseback in accordance with existing requirements.

BC316. For all other sale and leaseback transactions, an entity would be required to reassess whether a sale has occurred and, if so, to apply the general transition requirements to the leaseback. This approach would provide comparability between (a) sale and leaseback transactions entered into before and after transition and (b) leases, regardless of whether the lease is part of a sale and leaseback transaction. It should, therefore, provide better information to users of financial statements than other approaches.

Leveraged Leases (FASB Only)

BC317. The existing accounting model for leveraged leases will not be retained in this Exposure Draft, and the leases proposals for lessors will be applied to all leases currently accounted for as leveraged leases. The FASB decided that all leases should be accounted for in a consistent manner and that special rules should not exist for leases with certain characteristics.

Application to Nonpublic Entities (FASB Only)

BC318. This section summarizes the FASB's considerations in modifying the application of the proposed requirements for leases for nonpublic entities. This section considers the FASB's decisions on the following topics:

a. Incremental borrowing rate
b. Disclosure.

Incremental Borrowing Rate

BC319. This Exposure Draft proposes a specified relief for lessees that are nonpublic entities that would allow an accounting policy election for the initial and subsequent measurement of all liabilities to make lease payments. Under that election, those liabilities could be discounted under the proposed provisions of this Exposure Draft using a risk-free rate determined using a period comparable to the term of the lease. The Exposure Draft would require that a nonpublic entity that chooses to apply this specified relief would be required to apply it to all leases and to disclose that it has elected to use this specified relief.

BC320. The FASB decided to provide this specified relief in response to concerns of both private companies and not-for-profit entities that it would be too costly for some entities to identify an incremental borrowing rate that takes into account the credit of the lessee and the impact of the leased asset as collateral. For certain nonpublic entities, particularly those with little or no comparable borrowings, the costs to determine and audit their incremental borrowing rate would outweigh the incremental benefits of using that rate.

BC321. The FASB considered whether to permit nonpublic lessees to use a zero discount rate. However, several FASB members were concerned that the approach would completely ignore the time value of money. Some FASB members expressed the view that it was not necessary to provide specified reliefs because the discount rate may not be as critical to determining the lease classification as it is under existing U.S. GAAP. However, the FASB decided that the use of a risk-free rate would address the input from nonpublic entities to reach a reasonable balance between the costs and benefits and would recognize the time value of money.

Disclosure

BC322. The FASB Exposure Draft proposes an exception for nonpublic entities to the requirement that a lessee provide a reconciliation of the opening and closing balances of the liabilities to make lease payments. The FASB concluded that because users of nonpublic financial statements generally have greater ability to directly access management and to obtain additional information beyond what is included in financial statements, the incremental benefits of the information provided by the reconciliations often would not justify the added costs to provide and audit that information.

Cost-Benefit Considerations (FASB Only)

BC323. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, cost is a pervasive constraint on the information that financial reporting can provide; the benefits of providing information that helps to achieve that objective should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new requirements are borne primarily by the preparer and, by extension, the preparer's investors. The Board's assessment of the costs and benefits likely to result from issuing new requirements is unavoidably more qualitative than quantitative. Objective measurement of neither the costs to implement new requirements nor quantification of the value of improved information in financial statements is possible.

BC324. Throughout its deliberations that led to this Exposure Draft, the Board considered whether the expected improvement in the usefulness of the information—improvements in its relevance and the extent to which it faithfully represents what it purports to represent—justifies the costs that stakeholders are likely to incur to prepare and use that information. On several occasions during the redeliberations process, individual Board members and staff performed outreach with stakeholders about the usefulness of the information and the costs of providing such information. The Board thinks that the proposed requirements would significantly improve financial reporting by establishing a comprehensive framework for recognizing, measuring, presenting, and disclosing in the financial statements information about an entity's rights and obligations that result from leases. The Board also decided that the expected improvement in financial reporting would be achieved at an acceptable cost. The reasons for the Board's decisions on benefits and costs, including the expected effect on the complexity of financial reporting, are included in the following paragraphs.

Gathering Information about Benefits and Costs

BC325. As part of its due process that led to this Exposure Draft, the Board conducted extensive outreach activities with investors, creditors, regulators, and other users, as well as preparers and auditors, of financial statements to obtain information about specific deficiencies in the existing accounting requirements for leases. This input was received both before the leases project was added to the Board's technical agenda and throughout the project.

BC326. The Board's outreach activities also included discussions about the potential costs and feasibility of implementing its proposals for improving the accounting for leases. For example, in 2012, individual Board members and staff met in small groups with approximately 100 stakeholders to discuss, among other things, the costs and relevance of various lease accounting models the Board was evaluating at the time. Both preparers and auditors thought the approach to lessee accounting that the Board decided to include in this Exposure Draft was among the lowest cost options that the Board was considering.

BC327. In addition to these meetings, during 2012 and 2013, individual Board members and staff participated in excess of 50 conference calls, meetings, panel discussions, webcasts, and in-person seminars with a wide variety of stakeholders that provided the Board with information about the costs and benefits associated with the leases proposals. These meetings included the FASB Advisory Groups and nonpublic entity stakeholders.

Expected Benefits of This Exposure Draft

BC328. On the basis of extensive due process and significant input received from financial statement users, the Board believes that the proposed requirements would provide users with more relevant, reliable, and timely information about leasing arrangements for both lessees and lessors than current

U.S. GAAP. The Board developed the proposed requirements to improve the transparency of information about an entity's financial leverage, which should result in more useful information being provided to users of financial statements. The proposed requirements are expected to:

a. Result in a more accurate reflection of the rights and obligations from leases by requiring entities to recognize lease assets and lease liabilities in the statement of financial position and to disclose information about lease transactions, such as variable lease payments and options to renew and terminate leases
b. Improve understanding and comparability of entities' leverage regardless of the manner they choose to finance the assets used in their businesses
c. Result in fewer instances for entities to structure leasing transactions to achieve a particular accounting outcome
d. Improve comparability of the reporting of lease arrangements by proposing a requirement that is converged with the IASB's proposals for leases.

Expected Costs of Implementation, Including Effects on Complexity

BC329. The Board expects that most of the direct costs of applying the proposed requirements are likely to be the costs of changes to systems and processes to implement the requirements. Many entities also will incur initial costs to educate employees about how to apply the new requirements, as well as how to explain the effects of the changes in accounting for leases on the entity's financial statements to users of financial statements. Once those systems and processes changes are made and the related education and explanation has been accomplished, the Board thinks that for most entities the ongoing costs of providing the information that this Exposure Draft would require are unlikely to be significantly higher than the costs of complying with current U.S. GAAP. Under current U.S. GAAP, entities are required to evaluate each lease to determine the applicable accounting model to apply (capital or operating) and to subsequently account for each lease, including meeting the ongoing disclosure requirements about cash flows from leases. An entity's approach to complying with current U.S. GAAP (for example, whether the entity accounts for leases in a manual fashion using spreadsheets or an automated fashion using software) likely will have some impact on the extent of cost increases or decreases associated with applying the new requirements on an ongoing basis.

BC330. The Board recognizes that the initial costs of preparing to comply with the requirements in this Exposure Draft are likely to be significant for many entities. During redeliberations, the Board discussed transition to the new requirements on a number of occasions. The Board decided that a modified retrospective approach for transition, as opposed to a full retrospective approach, would provide an appropriate balance between minimizing costs of transition and providing users of financial statements with comparable information.

BC331. The Board received considerable feedback on the 2010 Exposure Draft, and the Board thinks it made decisions during redeliberations that were responsive to the feedback. Throughout the course of developing the proposed requirements, the Board sought to minimize the cost of improving lease accounting requirements by:

a. Developing a lease classification test that often (but not always) would be based on the nature of the underlying asset and not requiring an entity to reassess classification after the commencement of the lease
b. Permitting an entity to make an accounting policy election to not apply the proposed approach to leases with a maximum possible term of 12 months or less
c. Excluding variable lease payments not based on an index or rate from the measurement of the lease liability and lease receivable
d. Not requiring entities to calculate an estimate of the most likely lease term
e. Not requiring entities to disclose a rollforward of right-of-use assets
f. Requiring entities to account for leases with related parties based on the legally enforceable terms of the arrangement and not make assumptions about the economic substance of the arrangement
g. Allowing nonpublic entities to make an accounting policy election to use a risk-free rate to discount lease liabilities for all leases and not requiring them to disclose a rollforward of lease liabilities
h. Providing a modified retrospective approach for transition as opposed to a full retrospective approach.

Expected Effects on Complexity of Financial Reporting about Leases

BC332. Financial reporting complexity also contributes to the cost to prepare, audit, and use financial reporting information. Throughout its deliberations, the Board considered the potential effects on complexity in financial reporting about leases. In addition, after reaching all tentative decisions included in this Exposure Draft, the Board and staff conducted an analysis of the overall effect of the resulting proposed requirements on the complexity of financial reporting about leases. The Board discussed that analysis in a public Board meeting before issuing this Exposure Draft.

BC333. The Board's view of how the requirements in this Exposure Draft would affect the complexity of financial reporting is discussed in the following paragraphs in the context of the specific features of accounting requirements that often result in complexity.

Different Accounting for Economically Similar Transactions or Events

BC334. The Board decided there should be two different expense and income recognition patterns and presentations for leases based on the application of a lease classification test. The basis for the Board's decision is discussed in paragraphs BC29–BC78. In reaching this decision, the Board was informed by all of the feedback received through comment letters and other forms of outreach performed by the Board and staff. There is a wide spectrum of views about the economics of lease transactions, and many stakeholders thought a one-model accounting approach for leases did not properly reflect the economics of some lease transactions. Consequently, these stakeholders believe a two-model approach reduces complexity in financial reporting because it better reflects the economics than a one-model approach. However, for many others, a two-model approach adds to complexity in financial reporting because they do not believe the economics of lease transactions vary significantly. After extensive due process, the Board concluded that a two-model approach was appropriate, because the Board believes that the economic effects of lease arrangments differ on the basis of the extent to which the underlying asset is consumed.

Bright-Line or Percentage Tests

BC335. The requirements in this Exposure Draft do not depend on significant bright-line or percentage tests. Current U.S. GAAP includes several bright-line tests, and the Board consciously attempted not to include bright lines in the new requirements.

Insufficient or Overly Detailed Application Guidance

BC336. In developing the proposed implementation guidance, the Board sought to strike an appropriate balance between:

a. Insufficient guidance that might result in differing judgments in economically similar circumstances, thereby reducing comparability (or consistency) and making it more difficult for users to make meaningful comparisons
b. Overly detailed application guidance that can contribute to complexity by making the requirements more difficult to understand or by becoming a set of de facto rules that preclude an entity from using its judgment to apply the requirements in ways that best represent the transaction or event.

BC337. The proposed application guidance should assist preparers in complying with the requirements. The illustrative examples were evaluated to ensure that they would reduce complexity associated with applying the requirements without inadvertently adding complexity by establishing rules not otherwise included in the guidance. In the Board's view, the proposed application guidance, considered on an overall basis, is not complex.

Excessive or Overly Prescriptive Disclosure Requirements

BC338. The Board discussed the disclosure requirements in the leases proposals at several meetings. After all substantive decisions on recognition and measurement were made, the Board reassessed the disclosure requirements. This provided the Board with an opportunity to assess the disclosure requirements in the aggregate, in light of all of the outreach and decisions on recognition and measurement. As a result of this evaluation, the Board made some changes to the disclosure requirements. The Board does not believe the disclosure requirements are excessive or overly prescriptive.

Differential Reporting for Nonpublic Entities

BC339. Different reporting requirements for nonpublic entities than for public entities sometimes are necessary to meet the informational needs of users of nonpublic entity financial statements or to reduce the cost of application in light of the perceived benefits of the reported information. Although such differences potentially benefit users, preparers, or both, they also can increase the cost of application if they make the overall requirements more difficult to read and understand.

BC340. The amendments in this Exposure Draft would result in some different requirements for nonpublic entities. Lessees that are nonpublic entities can make an accounting policy election to use a risk-free rate to discount lease liabilities for all leases. In addition, lessees that are nonpublic entities are not required to disclose a rollforward of lease liabilities. The Board decided that those differential requirements are necessary for the purposes discussed in paragraphs BC318–BC321. Because the proposed requirements are clearly described, their inclusion should not increase the cost of compliance or the overall complexity of the requirements. Rather, it should decrease costs and complexity for nonpublic entities.

Differences between U.S. GAAP and IFRS

BC341. The IASB's leases proposals and the proposed amendments to U.S. GAAP would converge as a result of joint deliberations between the FASB and the IASB. A few minor differences exist between the proposals of the Board and the IASB, primarily related to existing differences between U.S. GAAP and IFRS that are unrelated to leases (for example, accounting for impairment of nonfinancial assets).

Consequential Amendments

Business Combinations

BC342. The Boards decided that when the acquiree in a business combination is a lessee, the acquirer should measure the acquiree's lease liability at the present value of the remaining lease payments as if the acquired lease were a new lease at the date of acquisition. The acquiree's right-of-use asset should be measured at an amount equal to the lease liability, with an adjustment for any off-market terms present in the lease.

BC343. The Boards considered whether an acquirer should be required to follow the general principle in IFRS 3, *Business Combinations*, and Topic 805, Business Combinations, and measure the acquiree's right-of-use assets and lease liabilities at fair value on the date of acquisition. However, in the Boards' view, the costs associated with measuring lease assets and lease liabilities at fair value would outweigh the benefits because obtaining fair value information, particularly for the right-of-use asset, might be difficult and, thus, costly. The Boards also noted that when the acquiree is a lessee, the proposals on the measurement of lease assets and lease liabilities would result in recognizing a net carrying amount for the lease at the date of acquisition that approximates the fair value of the lease at that date.

BC344. The Boards decided that when the acquiree in a business combination is a lessor of Type A leases, an acquirer should recognize the acquiree's lease receivable at the present value of the remaining lease payments as if the acquired lease were a new lease at the date of acquisition. The acquiree's residual asset should be measured as the difference between the fair value of the underlying asset at the date of acquisition and the carrying amount of the lease receivable. The Boards considered requiring the measurement of both the lease receivable and the residual asset at fair value at the date of acquisition. However, the Boards noted that there would be costs associated with measuring each of those assets at fair value and that they had decided not to require such a measurement basis for the lease receivable and the residual asset more generally because of those costs. In addition, although the proposed initial measurement of the lease receivable and the residual asset may not represent the fair value of those assets, the sum of the initial measurement of those assets would equal the fair value of the underlying asset, which is consistent with the principles in IFRS 3 and Topic 805. Consequently, the Boards concluded that the costs of requiring an acquirer to measure the lease receivable and the residual asset at fair value would outweigh the benefits.

Transition for First-Time Adopters of IFRS (IASB Only)

BC345. The IASB considered whether the transitional relief in paragraph 842-10-65-1(b) through (g) and (k) through (v) should also apply to entities applying IFRS 1, *First-time Adoption of International Financial Reporting Standards*.

BC346. The IASB decided that a first-time adopter of IFRS should be permitted to apply the transition reliefs available to an IFRS preparer to leases currently classified as operating leases in accordance with IAS 17. This is because those first-time adopters would face issues similar to those faced by existing IFRS preparers, and the transition requirements provide some relief when first applying the new requirements.

BC347. The IASB, however, decided against permitting a first-time adopter of IFRS to apply the transitional relief in paragraph 842-10-65-1(m) through (o) and (s) through (v) to leases currently classified as finance leases. As noted above in paragraph BC312, the accounting for leases classified as finance leases in accordance with IAS 17 is similar to the proposed accounting to be applied by both lessees and lessors to those leases. For this reason, when a lease is classified as a finance lease in accordance with IAS 17, the IASB decided to permit an IFRS preparer to measure lease assets and lease liabilities at the beginning of the earliest comparative period presented at the amounts that they were previously measured in accordance with IAS 17.

BC348. However, the IASB is not aware of, nor is it possible to consider, the accounting required by every other GAAP for leases that are classified as finance leases in accordance with IAS 17. The amounts recognized in accordance with other GAAPs could be significantly different from the amounts recognized in accordance with IAS 17 and the proposals in this Exposure Draft. For example, some other GAAPs may require or permit some leases classified as finance leases in IAS 17 to be accounted for as off-balance sheet transactions. If this is the case, the IASB concluded that carrying forward that previous accounting could be misleading to users of financial statements, and result in a lack of comparability with other IFRS preparers, perhaps for many years after first implementing IFRS.

Investment Property (IASB Only)

BC349. Under existing requirements, a lessee is permitted to account for property that the lessee holds under an operating lease using the fair value model in IAS 40 if that property meets the definition of investment property. Such an election is available on a property-by-property basis.

BC350. The consequential amendments to IAS 40 in this Exposure Draft, however, propose that investment property held under any lease should be within the scope of IAS 40. This represents a change from the existing scope of IAS 40. The IASB decided to eliminate the option for investment property held under an operating lease because of the changes proposed to the lessee accounting model. The IASB has concluded that every lease creates an asset for the lessee. Accordingly, the IASB decided that any right-of-use asset arising from a lease of property that meets the definition of investment property should be accounted for as investment property. The IASB concluded that such an approach would result in greater consistency in accounting for investment property and, thus, would provide better information to users of financial statements.

Licenses of Internal-Use Software (FASB Only)

BC351. The FASB decided to remove the requirements in paragraph 350-40-25-16, which require entities to analogize to Topic 840 on leases when determining the asset acquired in a license of internal-use software. Although entities currently apply Topic 840 by analogy, that Topic is expected to change as a result of this Exposure Draft. Because licenses of internal-use software are just one of many types of licenses and this Exposure Draft does not address leases of intangible assets, the FASB decided not to develop accounting requirements for only one type of license as part of the leases project.

Variable Interests (FASB Only)

BC352. The FASB decided to amend the requirements in paragraph 810-10-55-39 because the operating lease classification is not retained in this Exposure Draft. The FASB does not intend to change current U.S. GAAP on variable interests. Regardless of lease classification under this Exposure Draft, in the FASB's view, certain features of leases, such as guarantees of residual values of leased assets and purchase options, may create a variable interest. Although the FASB notes that the lease accounting model in this Exposure Draft better reflects the rights and obligations that arise from leases than current U.S. GAAP, the objectives of variable interest entity consolidation requirements differ from the objectives of the leases proposals.

Alternative Views

BC353. Three FASB members disagree with the issuance of this Exposure Draft.

BC354. Mr. Linsmeier disagrees with issuance of this Exposure Draft because he believes it will result in financial reporting by the lessee that is so complex that it will hinder users' abilities to assess the amount, timing, and uncertainty of the cash flows arising from the lease contract. Under the proposed requirements, complexity is created for lessees in all of the following:

a. The statement of financial position, by not recognizing and measuring in the right-of-use asset or the lease liability certain renewal options and variable payments required under the contract as well as not recognizing and measuring rights and obligations of the lessee under lease contracts that either are short term or contain payments that are classified as nonlease payments. As a result, users are provided with an incomplete representation of contract assets and liabilities and are forced to seek additional information to adjust statement of financial position numbers to understand and faithfully represent the present value of cash flows committed to be paid under lease contracts.

b. The statement of comprehensive income, by requiring or permitting presentation of expenses associated with different lease contracts in the following line items: amortization expense and interest expense for Type A leases, lease expense for Type B leases, and in unspecified line items for short-term leases, variable payments, and payments for nonlease components. Thus, under the proposed requirements, to determine the aggregate income statement effects of lease contracts, users would need to understand that for each type of lease contract expense information may be provided in multiple and differing income statement line items.

c. The statement of cash flows, by requiring presentation of cash flows from lease contracts in multiple different line items in the financing and operating sections of the statement. Under the proposed requirements, repayments of principal on Type A leases would be required to be presented in the financing section. In addition, payments relating to the unwinding of the discount on Type A leases, payments on Type B leases, and payments relating to variable payments, short-term leases, and nonlease components for all leases would be required to be presented in the operating section. Thus, again, under the proposed requirements, to determine the aggregate cash flow effects of lease contracts, users would need to understand that cash flow information may be provided in up to six different line items in two different sections of the statement of cash flows.

d. The footnotes, due to the Boards' failure to require a comprehensive disclosure in one location that provides financial statement users with the information necessary to comprehend all the rights and obligations and related income and cash flow effects inherent in lease contracts, especially if that information is not presented separately as financial statement line items. That information is necessary to obtain complete information about the economic effects of leasing activities and to facilitate the understanding of the differences arising from permitting or requiring the use of three lease models in the proposed requirements (Type A, Type B, and short term).

BC355. Mr. Linsmeier believes that because the proposed requirements would result in this complexity, they do not represent an improvement to existing requirements for lessees. Current guidance requires that sufficient information be provided in the footnotes to the financial statements for users to estimate the present value of cash flows committed to under operating lease contracts (the most prevalent type of lease contract under current requirements), making it easier to find the information to make any adjustments to reported numbers necessary to reflect the economics of those lease contracts.

BC356. Mr. Linsmeier does not believe the proposed requirements represent an improvement because they complicate users' abilities to make any adjustments to reported numbers by forcing them (a) to understand which rights and obligations are and are not recognized and measured in lease assets and lease liabilities and (b) to seek and aggregate income and cash flow information from multiple line items across a wide range of different lease contracts. The adjustment process is complicated further by the failure of the proposed guidance to require presentation or disclosure of all the components that comprise the total expense incurred each period under the lease contract. Research during the standard-setting process on this project has indicated that users do not have a monolithic view about the economics of lease contracts, with some users viewing leases primarily as resulting in rental expense while other users viewing leases as financing vehicles and, finally, other users viewing leases as derivatives. That observation suggests that many users will continue to seek information to adjust reported numbers to reflect their varying views of the economics of lease contracts. The proposed requirements do not facilitate making such adjustments and, therefore, Mr. Linsmeier believes they represent a step backward from the current requirements.

BC357. Mr. Linsmeier also believes that the complexity in the proposed requirements is due to the following three fundamental decisions that are implicit in the proposed requirements:

a. Individual rights and obligations under the lease contract are treated under the proposed requirements as separate units of account for recognition, measurement and/or presentation purposes rather than consistently having the lease contract itself treated as the single unit of account. That decision permits inconsistent and incomplete recognition of all present rights and obligations under the lease contract in the right-of-use asset and the lease liability in the statement of financial position. In addition, it permits or requires the various changes in rights and obligations under a single lease contract to be presented in multiple different line items in the statements of income and cash flows. If the unit of account is the lease contract, the lease liability (asset) would recognize and measure all present obligations (rights) under the contract. Those include not just present obligations to make future fixed payments, but also present obligations to make variable payments for use of the asset during the contract term and present obligations to make payments during the contract term for the so-called "nonlease" components included in the contract. In contrast, at contract inception there is no present obligation to exercise extension or termination options. However, those options create a present right (asset) for the holder of the option, and, therefore, if the lease asset is made equal to the lease liability at initial recognition, then the option rights under the contract either must be included or excluded from both the right-of-use asset and the lease liability, creating an inherent conceptual inconsistency by either excluding the option from measurement of the lease asset or including it in the measurement of the lease liability.[1] Finally, if the unit of account is the lease contract, it permits presentation of the collective income and cash flow outcomes from leasing activity in one line item (or perhaps two line items) in the statements of income and cash flows, reducing complexity and potentially facilitating the decision usefulness of the reported information.

b. Lessor accounting under the proposed requirements is determined by applying the lessee model symmetrically to lessors without considering differences in the substance of rights and/or obligations under the lease contract associated with the residual asset for lessees as compared to lessors. Each lease contract includes an obligation at the end of the lease term for the lessee to return the underlying asset to the lessor and the symmetric right of the lessor to get the underlying asset back from the lessee. The proposed requirements for the lessee view the obligation to return the underlying asset to the lessor at the end of the lease term as nonsubstantive, merely requiring the lessee to return an asset that it never had the right to under the lease contract. The transfer to the lessor, therefore, does not involve transfer of economic resources controlled by the lessee and does not increase the value of the lessee's lease liability. In contrast, the underlying asset being returned to the lessor does have economic value to the lessor because it involves the return of the underlying asset that the lessor owns and the lessor can either subsequently re-lease or otherwise use for future economic return. The right to the return of the underlying asset to the lessor, therefore, is substantive having direct bearing on whether the lease transaction is economically beneficial to the lessor. Reobtaining a residual asset that is worth either less or more than anticipated at lease inception can make the lessor's return on the lease contract either negative or more positive, respectively. Thus, the economic benefits to the lessee and lessor associated with rights and obligations under a lease contract are not symmetric because the lessor's economic return is affected by its continuing involvement with the full underlying asset (including the residual asset), while the lessee's benefits under the lease are limited only to benefits it receives from using a portion of the lessor's underlying asset over the lease term. Mr. Linsmeier believes that difference should cause differences in the accounting required for lessees and lessors, as is discussed below.

---

[1] Mr. Linsmeier discusses his recommendation for dealing with this inconsistency later in this alternative view.

c. The proposed requirements for right-of-use assets recognized by the lessee are defined without resolving what the right-of-use asset is—the underlying tangible asset, an intangible asset, a unique asset subject to lease, or a service provided over the lease period. Yet the subsequent accounting by the lessee for Type A leases generally is prescribed to be consistent with the accounting for tangible/intangible assets and the subsequent accounting by the lessee for Type B leases generally is prescribed to be consistent with the accounting for services. The proposed requirements describe the right-of-use asset held by the lessee under the lease contract as the future economic benefits associated with the lessee's contractual right to use the underlying asset of the lessor over the lease term. The proposed guidance also would require that the lessee's right-of-use asset be presented along with similar owned assets in the property, plant, and equipment section of the statement of financial position. While the Boards recognize that there are differences between owned assets and right-of-use assets, they fail in the proposed requirements to specify what a right-of-use asset is. That decision is important because it could provide the basis for defining the subsequent accounting for the right-of-use asset. If the Boards were to decide that the right-of-use asset either represents the underlying physical asset or an intangible asset, then there may be conceptual justification for subsequent accounting that requires amortization of the right-of-use asset over the remaining contractual term in a pattern consistent with the pattern used for tangible assets or intangible assets. In contrast, if the Boards were to decide that the right-of-use asset is a service provided by the lessor to the lessee, then it could be argued that the subsequent accounting for the right-of-use asset should be the recognition of a single lease expense in the statement of income. However, a decision to view the asset as a service also might suggest that the right-of-use asset and the lease liability should be presented net on the statement of financial position.

BC358. Mr. Linsmeier believes that the right-of-use asset neither represents the underlying physical asset owned by the lessor nor an intangible asset or service because intangibles and services do not involve control over the use of a physical asset. Thus, he believes that the right-of-use asset is unique and represents the benefits accrued by the lessee from access granted by the lessor to use and temporarily control the underlying asset over the lease term as well as from any other rights conveyed by the lessor under the contract (including nonlease components) and, therefore, that subsequent accounting for the lease asset should not be defined by reference to other literature.

BC359. Mr. Linsmeier's preferred approach to accounting for lease contracts by both lessees and lessors addresses each of those issues. First, he believes the lease contract should be the unit of account for both lessees and lessors. Second, he believes the accounting for lessees and lessors should be asymmetric, reflecting the differences in the substance of the rights and/or obligations in the lease contact associated with the residual asset for lessors as compared to lessees. Finally, he does not take a position about the subsequent accounting for lessees based on references to other literature. Rather, he suggests that to maximize the decision usefulness of the information for users and to minimize reporting complexity, the Boards should prescribe a single (but asymmetric) lease model for both lessees and lessors and provide additional disclosures in one location that permit users to make the adjustments necessary to fit their decision models.

BC360. Mr. Linsmeier's preferred approach to lease accounting first would require that lease contracts that transfer substantially all of the benefits of the underlying asset from the lessor to the lessee be accounted for as constructive sales by the lessor and constructive purchases by the lessee of the underlying asset. He would require that the accounting for those contracts be consistent with point-in-time sales accounting by the lessor and purchase/acquisition accounting by the lessee. He would base the constructive sale and purchase decision on the principle in IAS 17, scope those contracts out of the leasing requirements, and scope them into the requirements on revenue recognition for lessors and property, plant, and equipment for lessees.

BC361. Based on that scoping decision and the views expressed above, Mr. Linsmeier believes the proposed leasing requirements for lessors should represent an application of the new revenue recognition requirements for contracts with customers with the unit of account being the lease contract and the underlying asset owned by the lessor being the focus of the analysis because under the lease contract the lessor retains substantive rights to the residual asset. Under the revenue recognition model, an entity would first decide whether there are one or more performance obligations under the contract. In that regard, the primary issue for lease contracts is whether performance obligations under the contract relating to any nonlease components are distinct from performance obligations relating to the lease of the underlying asset. If so, the nonlease components would be accounted for separately from the lease components in the contract.[2]

BC362. Regardless of that decision, Mr. Linsmeier believes that application of the new revenue recognition requirements to lease contracts would result in recognition of revenue over time for both types of performance obligations: lease and nonlease. Revenue would be recognized over time for leases with lease components only or with nondistinct lease and nonlease components for one or more of the following reasons:

[2]The only exception is that if the separate performance obligations relating to both the lease and nonlease components are recognized in revenue over time using the same input or output method, then the two sets of performance obligations can be combined for revenue recognition purposes.

a. The lease does not transfer substantially all of the underlying asset to the lessee and the revenue recognition model would require that substantially all of the underlying asset be transferred to the customer to recognize revenue at a point in time rather than over time.
b. The lease contract requires the lessee to return the underlying residual asset with an uncertain value to the lessor at the end of the lease term. The revenue recognition model would require revenue to be constrained from being recognized until the uncertainty in value of the residual asset is resolved, causing revenue not to be recognized at the inception of the lease but, instead, as the uncertainty is resolved over time.
c. If nondistinct, nonlease components exist in a contract and the performance obligations relating to those nonlease components are satisfied over time, the revenue recognition model would require all revenue in the contract to be recognized over time.

BC363. Under his preferred lessor model, Mr. Linsmeier would measure the contract assets and contract liabilities consistent with the measurements for lessees, as discussed below. In addition, he would require presentation of accounts receivables, net contract assets, and net contract liabilities consistent with the new revenue recognition requirements for contracts with customers.

BC364. In terms of his preferred lessee model, Mr. Linsmeier believes that the unit of account should be the lease contract and, therefore, that all present rights and obligations under the contract should be recognized and measured, including rights and obligations associated with fixed and variable payments that are required from use of the underlying asset during the lease term and rights and obligations associated with payments for nonlease components promised to be delivered under the contract. To simplify the reporting, Mr. Linsmeier would not include the rights relating to extension or termination options in the measurement of the rights and obligations under the lease contract until they are exercised, but he would require information on those options in the comprehensive disclosures relating to the lease contract. In addition, the obligation of the lessee to return the leased asset to the lessor at the end of the lease term would not affect the measurement of the rights or obligations of the lessee because the resource being transferred under the contract belongs to the lessor and not to the lessee. Finally, Mr. Linsmeier believes that recognized rights should be presented separately from the recognized obligations at contract inception as separate lease assets and lease liabilities. He supports that presentation because at contract inception the lessee obtains control of the underlying asset and has the unconditional right to its use during the lease term. The receipt of that right also creates a present obligation to make payments for the use of the underlying asset during the lease term as well as a present obligation for paying for bundled services committed to be provided by the lessor under the contract.

BC365. In terms of the subsequent income statement accounting for lessees, Mr. Linsmeier believes that conceptual arguments can be made supporting either the method used for Type A leases or the method used for Type B leases, as defined in the proposed requirements. The subsequent income statement accounting for Type A lease treatments can be supported by viewing the accounting as being consistent with current requirements on recognizing and subsequently measuring liabilities used to finance the purchase of tangible or intangible assets and is driven from a perspective that those rights and obligations should be accounted for separately throughout the financial statements. The subsequent income statement accounting for Type B lease treatments can be supported conceptually by viewing the contract as a whole that provides the lessee with equal access to the leased asset over the lease term with subsequent accounting reflecting equal payments for equal access over time. The latter approach may be most consistent with viewing the unit of account as the lease contract while still requiring the gross up of the lease asset and lease liability in the statement of financial position for the reasons discussed above.

BC366. Mr. Linsmeier believes that to reduce complexity in reporting, the Boards should select one of the two subsequent income statement accounting approaches described in the preceding paragraph and apply it to all leases. He also believes that the Boards should augment that approach by providing additional disclosures in one location that provide users with the information needed to make any adjustments they find necessary to fit their decision models. The outcome of that approach would reduce the number of line items reported for each lease in the income statement and in the statement of cash flows, would facilitate users' abilities to understand what is and what is not reported in the financial statements, and would allow users to make adjustments to reported numbers. Finally, to the extent that the Boards do not agree with aspects of this alternative view in redeliberations, Mr. Linsmeier believes it is paramount to facilitate users' decisions that the Boards require that comprehensive information is provided in a single lease disclosure footnote to facilitate adjustments to reported numbers for all rights and obligations in the lease contract that are not recognized in lease assets and lease liabilities.

BC367. Mr. Schroeder disagrees with the issuance of this Exposure Draft because he believes its requirments fail to adequately meet its primary objectives to improve financial reporting and to faithfully represent related rights and obligations. He also does not believe the proposed disclosures provide users with certain decision-useful information.

BC368. Mr. Schroeder agrees with the majority view that leases represent rights and obligations that meet the definitions of assets and liabilities in Concepts Statement 6. However, because the liability for all recognized leases is based on a present value of cash flows, he sees no conceptual basis for not separately recognizing related financing costs (that is, periodic reversal of the present value discount) for certain types of leases (that is, Type B leases) while recognizing it for other types (that is, Type A leases).

BC369. Mr. Schroeder's view is consistent with paragraph 93 of FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, which states that "an interest method . . . is generally considered more relevant than other methods" when applied to liabilities that exhibit one or more of several characteristics. One of those characteristics is that "measurement at initial recognition was based on present value." Clearly, all leases recognized as a liability under this Exposure Draft meet this characteristic (and likely others) identified in Concepts Statement 7.

BC370. In a separate but related issue, Mr. Schroeder sees no conceptual basis for the prescribed method of determining the periodic amortization of a Type B right-of-use asset. The financing cost issue, discussed in the preceding paragraphs, is related in that amortization of the right-of-use asset is affected by financing cost associated with the liability. In other words, a Type B right-of-use asset will decline each period by the difference between the straight-line single expense and the financing cost associated with the liability. As the liability declines over the lease term, financing cost also will decline. To maintain the straight-line expense pattern, the periodic amortization will by necessity increase over the lease term.

BC371. Mr. Schroeder sees no conceptual basis for a pattern of increasing amortization, because it is unrelated, except in extraordinary circumstances, to any allocation that would capture diminution of value. Furthermore, he is concerned that for leased assets that decline in value in a more straight-line pattern, entities may have to more frequently recognize an impairment of the right-of-use asset. That is because the proposed requirements will result in a higher Type B right-of-use asset value than a similar asset that is amortized using a straight-line (or more accelerated) method. Mr. Schroeder believes that any resulting impairment analysis will add further complexity to the proposed requirements.

BC372. For the reasons outlined, Mr. Schroeder believes that any resulting straight-line single expense for Type B leases is inconsistent with the time value of money and amortization of the right-of-use asset that would reasonably reflect diminution of value; therefore, it cannot faithfully represent the underlying economics.

BC373. A related concern results from permitting an accounting policy election to not apply the proposed requirements to short-term leases. In low-rate environments, financing costs could be immaterial and ignored. However, that may not be true when interest rates rise or the volume of leasing is substantive. Therefore, Mr. Schroeder believes that election could lead to an incomplete representation of some entities' rights and obligations, thereby reducing comparability.

BC374. Mr. Schroeder agrees with the majority view that the existing requirements on leases are complex, in part, because of the bright-line distinction between capital leases and operating leases. However, the proposed requirements maintain a two-model approach for both lessees and lessors, albeit by substituting a more opaque consumption-based classification approach for the current bright-line test.

BC375. The Boards heard clear feedback from stakeholders that a single method of accounting for leases would significantly reduce complexity, in part, by eliminating the need for a classification system. Mr. Schroeder believes that this Exposure Draft's introduction of a new classification system is not an improvement and, in fact, could add greater complexity for users, preparers, and auditors. Furthermore, he questions whether necessary classification assumptions will be operable and auditable.

BC376. The basis for a two-model approach is that the majority agrees that the economics of all leases are not the same. While there is merit to that view, Mr. Schroeder does not believe that consumption of an asset should affect accounting for financing costs of a related liability. He believes that any economic difference between types of leases is better reflected by lessees in the amount of recognized financing costs, which can vary on the basis of a number of key factors including volume and variety of leasing activities, contract duration, credit quality of the lessee, and the level of interest rates at lease inception.

BC377. Mr. Schroeder believes that the proposed disclosures do not meet the objective of providing decision-useful information about the timing and amount of lease cash flows or expenses by lease type. In his view, elevating the importance of disclosures is essential because there is a greater likelihood that more entities will have both Type A and Type B leases compared to current practice in which most are accounted for as operating leases.

BC378. While entities will be required to disclose right-of-use assets by type, there is no similar requirement for expense recognition. And, unlike the IASB's Exposure Draft, the FASB's Exposure Draft does not require a rollforward of the right-of-use asset, which could facilitate an assessment of the related expenses. Mr. Schroeder believes that not providing such a rollforward, and including a clear segregation of lease expense by type, is inconsistent with the majority view that Type A and Type B leases are economically distinct.

BC379. Mr. Schroeder also believes that disclosing as a single amount the sum of undiscounted cash flows (used in the liability measurement) beyond five years for longer-term leases will limit usefulness. The value of cash flow disclosures is further limited by not requiring disclosure of the actual discount rate (or range or weighted-average discount rates) used to determine lease assets and liabilities.

BC380. Mr. Schroeder believes that to faithfully represent the underlying economics of leasing, as well as to reduce the substantial complexity introduced by this Exposure Draft, the Boards should require lessees to apply the Type A approach for all leases. Should the Boards not agree in redeliberations to apply this single-model approach, Mr. Schroeder believes enhanced disclosures will be needed to provide users with decision-useful information not available in this

Exposure Draft. While acknowledging this will add even further compliance costs, he believes a single comprehensive lease disclosure footnote will be necessary to facilitate adjustments to reported numbers for all rights and obligations in the lease contract that are not recognized in lease assets and lease liabilities. The single footnote also should provide a clear tabular segregation of expenses and cash flows for Type A and Type B leases that reconciles to the amounts recognized in the financial statements. Mr. Schroeder believes that the added compliance costs incurred by entities to provide those additional disclosures would, from a user perspective, be adequately offset by providing more decision-useful information related to the amount, timing, and uncertainty of lease-related cash flows.

BC381. While Mr. Schroeder has primarily addressed his concerns from the lessee perspective, he believes the same concerns apply to the proposed requirements for lessors. He also believes that, from a user perspective, the existing lessor accounting requirements work well in practice. Taken as a whole, Mr. Schroeder does not believe there is sufficient improvement to justify incurring costs to implement the proposed requirements as they relate to lessors. Therefore, he supports retaining current lessor accounting requirements.

BC382. Mr. Siegel disagrees with the issuance of the requirements in this Exposure Draft because he believes that the benefits of the new information will not justify the costs. He believes that the measurement of the lessee's liability required by the proposed requirements will provide insufficient decision-useful information for investors, such that significant adjustments will continue to be made by financial statement users. Specifically, Mr. Siegel disagrees with the proposed requirements on renewal options and variable lease payments. Mr. Siegel also believes that the presentation and disclosures required by the proposed requirements exacerbate the difficulty users will have in analyzing the lessee's financial position and performance. As such, Mr. Siegel asserts that the proposed requirements fail to meet the objective of reporting useful information to users of financial statements about the amount, timing, and uncertainty of cash flows arising from a lease that is set forth in this Exposure Draft.

BC383. Mr. Siegel agrees that leases create rights and obligations that meet the definitions of assets and liabilities that are set forth in Concepts Statement 6. However, he disagrees that the measurement of the obligation of the lessee should exclude amounts to be paid that are uncertain or variable. Paragraph QC7 of Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 1,* The Objective of General Purpose Financial Reporting, *and Chapter 3,* Qualitative Characteristics of Useful Financial Information, states that "financial information is capable of making a difference in decisions if it has predictive value, confirmatory value, or both." Paragraph QC8 elaborates, stating that "financial information has predictive value if it can be used as an input to processes employed by users to predict future outcomes." Mr. Siegel believes that the exclusion of all but some renewal options and variable payments will result in significantly increased efforts by users to make predictions using solely the measurements recorded in the financial statements. As such, he believes that the benefits of the measurements will not justify the costs to prepare and audit those measurements.

BC384. Furthermore, with respect to variable lease payments, Mr. Siegel finds it inconsistent that the requirements in this Exposure Draft would create a higher threshold for the measurement of those *contractual* liabilities than the measurement of *noncontractual* liabilities required by Subtopic 450-20, Contingencies—Loss Contingencies. Specifically, for *noncontractual* contingencies, paragraph 450-20-25-2 in part requires a liability be recognized when it is probable that a liability has been incurred. Conversely, the proposed requirements would prohibit the recognition of *contractual* variable lease payments that do not depend on an index or a rate when there is no uncertainty that a liability has been incurred. For example, he believes that the proposed requirements would result in no recognition of a liability for a lease of retail space if the lease payments were solely calculated as a percentage of sales. As such, Mr. Siegel believes the measurement will not meet the qualities of predictive value set forth in paragraphs QC7 and QC8 of Concepts Statement 8. Mr. Siegel asserts that the measurement of the lessee liability should include these uncertain amounts for the information to be decision useful.

BC385. Regarding lease payments to be made in optional periods, Mr. Siegel believes that excluding the measurement of the expected cash flows for those periods would impair the decision usefulness of the lease liability. He understands the operational challenges of measuring the renewal options as a separate component of the lease contract; therefore, he believes renewal options should be considered in the lease term, which was defined in the 2010 proposed FASB Accounting Standards Update, *Leases (Topic 840)*, as the longest possible term that is more likely than not to occur. He understands that the majority view is that the measurement of the renewal options should only take place when the lessee has a "significant economic incentive" to exercise the option, but he believes the resulting measurement will not meet the qualities of predictive value set forth in paragraphs QC7 and QC8. Mr. Siegel asserts that the measurement of the lessee liability should include those uncertain amounts for the information to be decision useful.

BC386. With respect to presentation, Mr. Siegel believes the proposed requirements could impede the ability of users to understand the economics of a reporting entity's lease transactions. Mr. Siegel is concerned that expenses associated with variable lease payments may be presented by a lessee within a line item other than lease expenses on the statement of comprehensive income. Because the presentation for those expenses was not prescribed in the proposed requirements, he believes that investors may have to make additional adjustments to understand the period costs associated with lease transactions. Furthermore, Mr. Siegel is concerned that the cash flow presentation of lessees' lease payments will be too complex for users to understand. Repayments of the principal portion of the lease liability arising from Type A leases will be presented within financing activities. Interest from the unwinding of the discount on the lease liability arising from Type A leases will be presented within operating activities in accordance with paragraph 230-10-45-17. Variable lease payments and short-term lease payments not included in the lease liability will be presented within operating activities, and payments arising from Type B leases will be presented within operating activities. Mr. Siegel believes that complexity will make it difficult for investors to aggregate cash outflows associated with lease transactions.

BC387. Mr. Siegel believes that some of the complexities with the presentation requirements could have been mitigated by disclosures that the Boards considered. Specifically, the Boards considered a disclosure that would have aggregated a reporting entity's lease activities into a single table that would have included the following lease expense items, followed by cash payments:

a. Amortization expense for Type A leases
b. Interest expense for Type A leases
c. Expenses relating to variable lease payments not included in the liability to make lease payments
d. Expenses for those leases in which the short-term practical expedient is applied
e. Lease expense for Type B leases
f. Principal and interest paid for Type A leases
g. Cash paid on the fixed portion of the leases for Type B leases.

BC388. Mr. Siegel disagrees with the Boards' decision to exclude that disclosure. While recognizing that a prescribed tabular disclosure potentially adds costs and complexity for preparers, Mr. Siegel believes that the table would mitigate the presentation issues discussed above and be responsive to the varied feedback from investors about the underlying economics of lease transactions. Mr. Siegel believes that because the views from investors ranged from those who noted that all leases should be reflected in the performance statement as financings to those who noted that all leases should be reflected as access to the underlying, the above-mentioned table would provide all investors with the information to adjust the statement of comprehensive income for their own purposes. Mr. Siegel also believes that the table would have provided a much easier means for investors to derive the aggregate cash outflows for lessees. He agrees that the proposed requirements do require the components of cash paid to be disclosed; however, he notes that the users would have to look to the rollforward of the lease liability, which will include cash paid relating to amounts included in the liability, and then will have to search for separate disclosures of amounts expensed for variable lease payments not included in the lease liability.

BC389. In conclusion, Mr. Siegel agrees with the objective of this Exposure Draft but feels that the benefits do not justify the cost. He is concerned that users who noted that all leases should be reflected as financings in the statement of comprehensive income and those who noted that all leases should be reflected as access to the underlying will be compelled to make considerable, albeit very different, adjustments to unwind the accounting in the proposed requirements to accommodate their analyses. He asserts that to meet the objective of the proposed requirements and the qualitative characteristics of decision-useful information outlined in the conceptual framework, variable lease payments and renewal options should be included in the measurement of the lessee's lease liability. Mr. Siegel believes that some of the above-mentioned presentation and disclosure concerns would be mitigated if the measurement includes these components of the lease obligation for lessees.

BC390. Mr. Siegel understands that the alternative view he suggests would, while significantly increasing the benefits, also increase the costs and complexities to prepare the financial statements. Should his alternative view not be supported, Mr. Siegel believes that a more cost-beneficial approach would be to make only targeted improvements to current U.S. GAAP by (a) replacing the current bright-line classification criteria with one similar to IAS 17 and (b) improving disclosures for lease transactions with specific, quantitative information about renewal options, variable lease arrangements, and cash payments for operating leases to facilitate users' ability to assess the nature, timing, and amount of future cash flows. More specifically, Mr. Siegel believes that there should be a requirement such that reporting entities do not aggregate lessee and lessor transactions. Additionally, he would include requirements for lessees to disclose the actual lease terms for the most significant leases and a weighted-average lease term for the total liability included in the statement of financial position. For renewal options on those most significant leases, Mr. Siegel would require a disclosure of the reporting entity's assessment of the likelihood of exercise into one of several categories such as "remote", "reasonably possible", or "more likely than not" and the impact on the maturity analysis of future committed cash flows currently required by U.S. GAAP for those with renewal options more likely than not to be exercised. Furthermore, Mr. Siegel would require explicit separate disclosures of any lease payments in excess of contractual payments and their nature, such as variable payments, payments on residual value guarantees, or penalty payments if material so that investors can understand cash flows made that might not be recurring. Mr. Siegel believes these targeted recognition, measurement, and disclosure changes would be more cost-beneficial than the proposed requirements and would still achieve the stated objective.

Note: The following alternative view was expressed jointly by 2 of the 16 IASB members. That view is not part of the FASB's Exposure Draft but has been included for informational purposes.

BC391. Two IASB members disagree with the issuance of this Exposure Draft.

BC392. Messrs Kalavacherla and Zhang support a right-of-use model, according to which a lessee would account for a lease as the acquisition of a right to use an underlying asset and the lessor would account for a lease as the transfer of that right-of-use in exchange for a commitment from the lessee to make lease payments. They also support an exception to that model for short-term leases.

BC393. However, Messrs Kalavacherla and Zhang voted against publication of this Exposure Draft for the following reasons:

BC394. First, Messrs Kalavacherla and Zhang disagree with the dual accounting model proposed for both lessees and lessors (as described in paragraphs BC397–BC401), which in their view undermines the principles underlying the proposed right-of-use model, is operationally complex and creates structuring opportunities.

BC395. Second, Mr Kalavacherla disagrees with the proposals regarding variable lease payments and payments to be made in optional periods (as described in paragraphs BC402 and BC403). Mr Kalavacherla believes that those proposals result in a failure to apply the definitions of assets and liabilities in the *Conceptual Framework* and create inconsistencies within the Exposure Draft.

BC396. Finally, Mr Kalavacherla disagrees with the proposal to require a lessee to separate lease components and non-lease components (as described in paragraph BC404).

Dual Accounting Model

BC397. Messrs Kalavacherla and Zhang disagree with the dual accounting model proposed for lessees because they believe it contradicts an important objective of the project, which is to create a single lease accounting model. For Type B leases, the amortisation of the right-of-use asset in each period is, in effect, a balancing figure to achieve a straight-line expense in profit or loss, and combines a financing cost and amortisation of the right-of-use asset. Accordingly, a lessee would not measure right-of-use assets arising from Type B leases consistent with other non-financial assets measured on a cost basis. Messrs Kalavacherla and Zhang believe that, having recognised the right-of-use asset separately from the lease liability at the commencement date, a lessee should subsequently measure the right-of-use asset independently of the lease liability. They would propose that a lessee should account for all leases, except short-term leases, according to the proposals in this Exposure Draft for Type A leases. This would also remove the complexity and structuring opportunities described in paragraphs BC399 and BC400 for lessees.

BC398. Messrs Kalavacherla and Zhang believe that to apply the right-of-use model consistently, a lessor should recognise a receivable for all leases for which a lessee recognises a lease liability, unless the lessor measures the underlying asset at fair value. Accordingly, they disagree with the lessor accounting proposals for Type B leases when the underlying asset is not investment property measured at fair value. They believe that regardless of the type of lease and the business model of the lessor, the right to receive lease payments is a financial asset and accordingly should be reflected as such in the lessor's financial statements. This is because the nature of the risks associated with a financial asset are different from those of the underlying asset, and information about those different risks is critically important to users of a lessor's financial statements, including banks providing financing to lessors and investors in securitised vehicles that hold lease receivables. When the underlying asset is measured at fair value, the value of the lease receivable is embedded in the measurement of the underlying asset. Hence, Messrs Kalavacherla and Zhang do not view the lessor accounting proposals for leases of investment property measured at fair value as being inconsistent with the lease accounting proposals.

BC399. Messrs Kalavacherla and Zhang also have operational concerns about the application of the proposed dual accounting model and, in particular, the classification of leases. They question how an entity would assess what 'insignificant', 'substantially all' and 'major part' mean without additional guidance. They also believe that it is arbitrary and unnecessarily complex to have different criteria for assessing the lease term when classifying leases, namely relative to the remaining economic life of the underlying asset in the case of property but relative to the total economic life of the underlying asset in the case of assets other than property.

BC400. In addition, they believe that in a property lease incorporating land and a building, the land and the building should be evaluated separately when classifying the lease. Evaluating the land and the building separately would better reflect the consumption principle developed by the boards and the underlying economics of such transactions. For example, to correctly apply the consumption principle, Messrs Kalavacherla and Zhang believe that a lease of freehold land should always be classified as a Type B lease because the economic benefits embedded in that land would not be expected to be consumed by a lessee. However, under the proposals, when a lease incorporates both freehold land and a building, the entire lease could be classified as a Type A lease, even though the lessee does not consume the economic benefits embedded in the land. If land and buildings were evaluated separately, Messrs Kalavacherla and Zhang would then propose that the consumption principle be applied in the same way to all leases without the need for different classification criteria for different leases, which in their view would reduce the complexity of the proposals.

BC401. Finally, Messrs Kalavacherla and Zhang believe that the dual accounting model provides structuring opportunities and could lead to accounting that does not faithfully reflect the economics of a lease. For example, a lessee could enter into a lease that has a relatively short non-cancellable period but has a long optional extension period. Because payments to be made in optional periods would affect lease classification only if a lessee has a significant economic incentive to exercise an option, and a significant economic incentive is a high threshold, the lease is likely to be classified as a Type B lease. However, if the lessee subsequently exercises the extension option, the lease will continue to be classified as a Type B lease because the proposals prevent the reassessment of lease classification. This would be the case even though the lease might have been classified as a Type A lease if the lessee was required to reassess lease classification at the time of exercising the option. Messrs Kalavacherla and Zhang believe that lease classification should be reassessed when the lease term changes to ensure comparability with the classification of new leases and to avoid creating structuring opportunities.

Accounting for Variable Lease Payments and Options

BC402. Mr Kalavacherla believes that lease payments should not be treated differently solely because the amounts to be paid are uncertain or variable. Consequently, he disagrees with the proposal to exclude variable lease payments based on use or performance from the measurement of a lessee's lease liability and right-of-use asset, and a lessor's lease receivable. In his view, all variable lease payments give rise to an obligation for the lessee that meets the definition of a liability and are part of the cost of the right-of-use asset. Similarly, all variable lease payments give rise to a right for the lessor that meets the definition of an asset. Mr Kalavacherla believes that the proposals are inconsistent because an entity is required to estimate amounts expected to be payable under a residual value guarantee, which is a form of variable lease payment, but is not required to do so for other variable lease payments. Mr Kalavacherla would, therefore, propose to include in the measurement of the lessee's lease liability the amount of variable lease payments expected to be payable. He would also propose that a lessor include variable lease payments in the measurement of its lease receivable using criteria similar to those developed in the revenue recognition project. To reduce the costs of applying this approach, Mr Kalavacherla would propose that an entity not be required to reassess the amounts recognised unless a specified threshold is met.

BC403. Similarly, Mr Kalavacherla is of the view that lease payments to be made in optional periods give rise to a right (for the lessor) and an obligation (for the lessee) that meet the definition of an asset and a liability respectively in the *Conceptual Framework*. Consequently, he disagrees with the proposal to include lease payments to be made in optional periods when measuring lease assets and lease liabilities only if a lessee has a significant economic incentive to exercise the option. He believes that the 'significant economic incentive' threshold sets too high a hurdle for recognition and, thus, will result in accounting that does not reflect the economics of leases that include optional periods. Mr Kalavacherla would, therefore, propose to include lease payments expected to be made in optional periods in the measurement of the lessee's lease liability and the lessor's lease receivable. Mr Kalavacherla would propose that an entity not be required to reassess the amounts recognised unless a specified threshold is met to alleviate cost concerns.

Separating Lease Components and Nonlease Components

BC404. Mr Kalavacherla disagrees with the proposal to require a lessee to separate a contract and to account for the lease component separately from any non-lease components. He believes that, if a contract contains a lease, a lessee should include all payments to be made under the contract within the measurement of lease assets and liabilities. In many lease contracts, the lessee does not have the option to lease the asset alone. Default on the contract occurs for failing to make the entire payments due under the contract, not for failing to make only lease payments. Mr Kalavacherla believes that the right-of-use asset comprises the right to use the underlying asset for a period of time and any services that are provided by the lessor within the same contract if those services are not legally separable. For example, in a contract for the lease of a building and maintenance of that building for the term of the contract, Mr Kalavacherla believes that the lessee has a right to use a maintained building—it does not have a right to use a building and a separate contract for the maintenance of that building. In Mr Kalavacherla's view, the proposal to separate lease components and non-lease components of a contract understates the assets and liabilities of the lessee and results in unwarranted complexity within the proposals. The proposal would also require a user of financial statements to look to various places for information about an entity's cash flow commitments.

Appendix: Summary of Changes from the 2010 Exposure Draft

The following table summarizes the changes to the Boards' August 2010 proposals in response to feedback received:

Topic	Description of Changes to the Proposals
The lessee and lessor accounting models	Changed the proposals on the classification of leases as follows: The 2010 Exposure Draft proposed that when determining how to account for leases, a lessor would assess whether significant risks and benefits associated with the underlying asset are transferred to the lessee. This Exposure Draft proposes that a lessee and lessor would classify leases on the basis of whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset. That principle would be applied by presuming that: a. A lease of property is a Type B lease unless specified criteria are met. b. A lease of an asset that is not property is a Type A lease unless specified criteria are met.
	Changed the lessee accounting model as follows: The accounting for Type A leases is consistent with the lessee accounting approach proposed in the 2010 Exposure Draft. The accounting for Type B leases differs from the lessee accounting approach proposed in the 2010 Exposure Draft as follows: a. A lessee would amortize the right-of-use asset so that the remaining cost of the lease is allocated over the lease term on a straight-line basis. b. The lessee would present amortization of the right-of-use asset and the unwinding of the

Topic	Description of Changes to the Proposals
	discount on the lease liability together as a single lease cost. c. The lessee would classify cash flows arising from Type B leases within operating activities.
	Changed the lessor accounting model as follows: The 2010 Exposure Draft proposed that a lessor would apply either the derecognition approach or the performance obligation approach, depending on whether significant risks and benefits associated with the underlying asset are transferred to the lessee. This Exposure Draft proposes that a lessor would apply: a. An approach similar to the derecognition approach in the 2010 Exposure Draft to Type A leases. The accounting for Type A leases differs from the derecognition approach as follows: 1. The lessor would recognize the unwinding of the discount on the residual asset as interest income over the lease term. 2. The lessor would present the carrying amount of the lease receivable and the residual asset together as lease assets, with the lease receivable and the residual asset presented or disclosed separately. b. An approach similar to operating lease accounting in Topic 840 to Type B leases, recognizing lease income over the lease term on either a straight-line basis or another systematic basis if that basis is more representative of the pattern in which income is earned from the underlying asset. This Exposure Draft does not retain the performance obligation approach proposed in the 2010 Exposure Draft.
Other Topics	
Definition of a lease	Retained the definition of a *lease* but: a. Clarified that the underlying asset can be a physically distinct portion of a larger asset and cannot be a capacity portion of a larger asset that is not physically distinct.

Topic	Description of Changes to the Proposals
	b. Changed the guidance on the right to control the use of an asset to be more consistent with the concept of control applied in other requirements and projects (that is, the revenue recognition proposals and consolidation requirements).
Accounting for changes to a lease	Clarified that contract modifications resulting in substantive changes to a lease would result in the modified contract being treated as a new contract.
Cancellable leases	Clarified that a lease creates *enforceable* rights and obligations. Added requirements on cancellable leases, specifying that a lease is cancellable when both the lessee and the lessor each have the right to terminate the lease without permission from the other party, with no more than an insignificant penalty.
Separating lease and nonlease components	Modified the proposals to require both a lessee and a lessor to identify and account for each lease component separately from nonlease components of a contract, subject to some specified requirements for lessees.
Measurement of lease assets and lease liabilities	**Variable lease payments** Changed the proposals to include in the measurement of lease assets and lease liabilities only variable lease payments that either depend on an index or a rate or are in-substance fixed payments, rather than requiring the inclusion of an estimate of all variable lease payments. Variable lease payments that depend on an index or a rate would be measured using the index or rate at the commencement date and would be reassessed as at the end of each reporting period.
	Options to extend or terminate a lease or to purchase the underlying asset Changed the proposals to include in the measurement of lease assets and lease liabilities lease payments to be made in optional periods, or the exercise price of a purchase option, only when a lessee has a significant economic incentive to exercise an option, rather than including lease payments on the basis of an estimate of the lease term as the longest possible term that is more likely than not to occur.

<table>
<tr><th>Topic</th><th>Description of Changes to the Proposals</th></tr>
<tr><td rowspan="2"></td><td>Reassess the discount rate

Changed the proposals to require an entity to reassess the discount rate when there is a change in either of the following, unless the change was reflected in determining the discount rate at the commencement date:
a. Relevant factors, other than market-based factors, that result in a lessee having, or no longer having, a significant economic incentive either to exercise an option to extend the lease or purchase the underlying asset or not to exercise an option to terminate the lease.
b. Reference interest rates, if variable lease payments are determined using those reference rates.</td></tr>
<tr><td>Lessor—residual value guarantees

Changed the scope of application of the requirements on residual value guarantees for lessors so that they apply to all residual value guarantees rather than only residual value guarantees provided by a lessee.

Modified the proposals on the accounting for residual value guarantees to be consistent with the changes to the lessor accounting model to require a lessor to consider guarantees relating to Type A leases when determining whether the residual asset is impaired, but not include the expected amounts to be received under residual value guarantees in the measurement of the lease receivable.

Added requirements on lease payments structured as residual value guarantees.</td></tr>
<tr><td>Costs relating to the construction or design of an underlying asset</td><td>Added application guidance on costs incurred by a lessee relating to the construction or design of an underlying asset.</td></tr>
<tr><td>Disclosure</td><td>Modified to reflect changes to the lessee and lessor accounting models.</td></tr>
</table>

Topic	Description of Changes to the Proposals
Sale and leaseback transactions	Retained the proposal to account for a sale and leaseback transaction as a sale and leaseback when the transferred asset has been sold. However, revised the proposals to require an entity to assess whether the transferred asset has been sold using the control principle in the 2011 Revenue Recognition Exposure Draft rather than on the basis of a list of conditions that would apply only when assessing sale and leaseback transactions.
Short-term leases	Revised the proposals to permit both a lessee and a lessor to apply an approach similar to operating lease accounting in Topic 840 as an accounting policy election.
Transition	Revised the transition proposals to permit an entity to apply the proposed requirements using a full retrospective approach or, alternatively, using a modified retrospective approach reflecting changes to the lessee and lessor accounting models. According to the modified retrospective approach: a. For leases classified as capital or sales type/direct finance leases in accordance with Topic 840, an entity would carry forward amounts previously recognized for lease assets and lease liabilities, subject to some reclassifications. b. For leases classified as operating leases in accordance with Topic 840, an entity would apply a retrospective approach but would use information available at the date of transition when measuring lease assets and lease liabilities. c. The Exposure Draft includes some specified reliefs for transitioning to the proposed requirements on a retrospective basis. Added transition requirements relating to sale and leaseback transactions and amounts previously recognized in respect of business combinations.
Business combinations	Added requirements relating to the measurement of lease assets and lease liabilities acquired in a business combination.

Topic	Description of Changes to the Proposals
FASB—Related party leases	The FASB decided that the recognition and measurement requirements for all leases should be applied by lessees and lessors that are related parties on the basis of legally enforceable terms and conditions of the lease, acknowledging that some related party transactions are not documented and/or the terms and conditions are not at arm's length. In addition, a lessee and a lessor would be required to apply the disclosure requirements for related party transactions in Topic 850. Under existing U.S. GAAP, entities are required to account for leases with related parties on the basis of their economic substance, which may be different from the legally enforceable terms and conditions of the arrangement.
FASB—Application by nonpublic entities	Added FASB-only specific requirements for nonpublic entities as follows: **Discount rate** Added a specified relief for nonpublic entity lessees permitting the use of a risk-free discount rate, determined using a period comparable to that of the lease term as an accounting policy election for all leases. **Lessee disclosures** Added an exemption for nonpublic entity lessees from the requirement to provide a reconciliation of the opening and closing balances of the lease liability.

Table of Concordance

This table shows how the contents of the FASB's revised Exposure Draft correspond with the IASB's revised Exposure Draft.

FASB Paragraph	IASB Paragraph
842-10-05-1	FASB only
842-10-05-2	FASB only
842-10-05-3	FASB only
842-10-10-1	1
842-10-10-2	2
842-10-10-3	3
842-10-15-1	4
IASB only	5
842-10-15-2	6
842-10-15-3	7
842-10-15-4	FASB only
842-10-15-5	8
842-10-15-6	9
842-10-15-7	10
842-10-15-8	11
842-10-15-9	12
842-10-15-10	13
842-10-15-11	14
842-10-15-12	15
842-10-15-13	16
842-10-15-14	17
842-10-15-15	18
842-10-15-16	19
842-10-15-17	20

FASB Paragraph	IASB Paragraph
842-10-15-18	21
842-10-15-19	FASB only
842-10-15-20	23
842-10-15-21	24
842-10-15-22	22
Glossary	Appendix A
842-10-25-1	25
842-10-25-2	26
842-10-25-3	27
842-10-25-4	FASB only
842-10-25-5	28
842-10-25-6	29
842-10-25-7	30
842-10-25-8	31
842-10-25-9	32
842-10-25-10	33
842-10-25-11	34
842-10-25-12	FASB only
IASB only	35
842-10-25-13	36
842-10-25-14	118
842-10-25-15	119
842-10-25-16	FASB only
842-10-50-1	120
IASB only	B1
842-10-55-1	B2
842-10-55-2	B3
842-10-55-3	B4
842-10-55-4	B5

FASB Paragraph	IASB Paragraph
842-10-55-5	B6
IASB only	IE1
IASB only	IE2
842-10-55-6	IE3
842-10-55-7–55-19	Example 1
842-10-55-20–55-22	Example 2
842-10-55-23–55-26	Example 3
842-10-55-27–55-34	Example 4
842-10-55-35–55-41	Example 5
842-10-55-42	IE4
842-10-55-43–55-47	Example 6
842-10-55-48	IE5
842-10-55-49–55-51	Example 7
842-10-55-52–55-54	Example 8
842-10-55-55–55-57	Example 9
842-10-55-58–55-60	Example 10
842-10-55-61	IE7
842-10-55-62–55-63	Example 12
842-10-55-64–55-65	Example 13
842-10-55-66	IE6
842-10-55-67–55-69	Example 11
842-10-55-70	IE16
842-10-55-71–55-78	Example 24
842-10-55-79	IE17
842-10-55-80–55-85	Example 25
842-10-55-86	IE18
842-10-55-87–55-92	Example 26
842-10-65-1	FASB only
842-10-65-1(a)	C1

FASB Paragraph	IASB Paragraph
IASB only	C2
842-10-65-1(b)	C3
842-10-65-1(c)	C4
842-10-65-1(d)	C5
842-10-65-1(e)	C6
842-10-65-1(f)	FASB only
842-10-65-1(g)	C7
842-10-65-1(h)	C22
842-10-65-1(i)	C23
842-10-65-1(j)	C24
842-10-65-1(k)	C8
842-10-65-1(l)	C9
842-10-65-1(m)	C10
842-10-65-1(n)	C11
842-10-65-1(o)	C12
842-10-65-1(p)	C13
842-10-65-1(q)	C14
842-10-65-1(r)	C15
842-10-65-1(s)	C16
842-10-65-1(t)	C17
842-10-65-1(u)	C18
842-10-65-1(v)	FASB only
842-10-65-1(w)	C19
842-10-65-1(x)	C20
842-10-65-1(y)	C21
IASB only	C25
842-20-05-1	FASB only
842-20-05-2	FASB only
842-20-05-3	FASB only

FASB Paragraph	IASB Paragraph
842-20-15-1	FASB only
842-20-25-1	37
842-20-30-1	38
842-20-30-2	FASB only
842-20-30-3	39
842-20-30-4	40
842-20-30-5	FASB only
842-20-35-1	41
842-20-35-2	42
842-20-35-3	FASB only
842-20-35-4	43
842-20-35-5	44
842-20-35-6	45
842-20-35-7	46
842-20-35-8	47
842-20-35-9	48
IASB only	49
842-20-35-10	50
842-20-35-11	51
IASB only	52
IASB only	53
842-20-45-1	54
842-20-45-2	55
842-20-45-3	56
842-20-45-4	57
842-20-50-1	58
842-20-50-2	59
842-20-50-3	60
IASB only	61

FASB Paragraph	IASB Paragraph
842-20-50-4	64
842-20-50-5	FASB only
IASB only	62
IASB only	63
842-20-50-6	65
842-20-50-7	66
842-20-50-8	67
842-20-50-9	FASB only
842-20-50-10	FASB only
842-20-55-1	B7
842-20-55-2	B8
842-20-55-3	B9
842-20-55-4	FASB only
842-20-55-5	B10
842-20-55-6	B11
842-20-55-7	B15
842-20-55-8	B16
842-20-55-9	IE8
842-20-55-10–55-31	Example 14
842-20-55-32–55-34	Example 15
842-20-55-35	IE9
842-20-55-36–55-44	Example 16
842-20-55-45	IE10
842-20-55-46–55-52	Example 17
842-20-55-53	IE11
842-20-55-54–55-66	Example 18
842-30-05-1	FASB only
842-30-05-2	FASB only
842-30-05-3	FASB only

FASB Paragraph	IASB Paragraph
842-30-15-1	FASB only
842-30-25-1	68
842-30-25-2	93
842-30-25-3	94
842-30-25-4	95
842-30-30-1	69
842-30-30-2	70
842-30-30-3	FASB only
842-30-30-4	71
842-30-30-5	72
842-30-30-6	73
842-30-30-7	74
842-30-30-8	75
842-30-30-9	96
842-30-35-1	76
842-30-35-2	77
842-30-35-3	78
842-30-35-4	79
842-30-35-5	80
842-30-35-6	81
842-30-35-7	82
842-30-35-8	83
842-30-35-9	FASB only
842-30-35-10	84
842-30-35-11	85
842-30-35-12	86
842-30-35-13	87
842-30-35-14	96
842-30-40-1	68(a)

FASB Paragraph	IASB Paragraph
842-30-45-1	88
842-30-45-2	89
842-30-45-3	90
842-30-45-4	91
842-30-45-5	92
842-30-45-6	96
842-30-45-7	97
842-30-50-1	98
842-30-50-2	99
842-30-50-3	100
842-30-50-4	FASB only
842-30-50-5	101
842-30-50-6	102
842-30-50-7	103
842-30-50-8	104
IASB only	105
842-30-50-9	106
842-30-50-10	107
842-30-50-11	108
842-30-50-12	109
842-30-55-1	B17
842-30-55-2	B18
842-30-55-3	B19
842-30-55-4	B20
842-30-55-5	B21
842-30-55-6	IE12
842-30-55-7–55-20	Example 19
842-30-55-21–55-29	Example 20
842-30-55-30	IE13

FASB Paragraph	IASB Paragraph
842-30-55-31–55-35	Example 21
842-30-55-36	IE14
842-30-55-37–55-47	Example 22
842-40-05-1	FASB only
842-40-15-1	FASB only
842-40-15-2	110
842-40-25-1	111
842-40-25-2	112
842-40-25-3	113
842-40-25-4	115
842-40-30-1	114
842-40-30-2	FASB only
842-40-30-3	FASB only
842-40-50-1	116
842-40-50-2	117
842-40-55-1	B12
842-40-55-2	B13
842-40-55-3	B14
842-40-55-4	IE15
842-40-55-5–55-9	Example 23
BC1–BC317	BC1–BC317
BC318–BC322	Nonpublic (FASB only)
BC323–BC341	Cost-Benefit (FASB only)
BC342–BC352	BC318–BC328
Effects Analysis (IASB only)	BC329–BC466
BC353	FASB only
BC354–BC390	AV11–AV47
BC391	FASB only
BC392–BC404	AV1–AV10

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require changes to the U.S. GAAP Financial Reporting Taxonomy (UGT). We welcome comments on these proposed changes to the UGT at ASU Taxonomy Changes provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, proposed amendments to the UGT will be made available for public comment at www.fasb.org and finalized as part of the annual release process.