Leases

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Singapore Accounting Standards Council

Introduction

- Project status
  - ED issued in Aug 2010
  - Re-exposure expected in 1H 2012

- Objective of today's session
  - To highlight the ***preliminary*** views of the AOSSG Leases WG on IASB's key tentative decisions as of 19 Oct 2011 to stimulate discussion so as to assist IASB in its drafting of the re-exposure document.

As IASB's discussions on leases are still ongoing, the views contained in these slides are broad preliminary views only. Individual WG member would need to conduct further assessment & outreach to fully analyse the impact of IASB's proposals.

Key Areas for Discussion

- Lessor Accounting
- Leases of Investment Properties
- Measurement of Lease Receivables/Liabilities

Lessor Accounting – Approaches

ED proposals	Tentative decisions
• ***Hybrid*** model: performance obligation (PO) approach if lessor retains exposure to significant risks or benefits associated with underlying asset (UA); partial derecognition (derecog) approach if otherwise. • PO approach: recognise lease receivable (LR) & corresponding PO at lease commencement. UA continues to be recognised by lessor.	• ***Single*** receivable & residual (R&R) model. • Initially measure RA as allocation of CA of UA [this comprises 2 amounts: (a) gross RA, measured at PV of estimated residual value (RV) at end of lease term, discounted at rate lessor charges lessee & (b) deferred profit, measured as difference between gross RA & allocation of CA of UA]. • Subsequently accrete gross RA to estimated RV*.

Lessor Accounting – Approaches

ED proposals	Tentative decisions
• Derecog approach: derecognise UA & recognise LR & residual asset (RA) at lease commencement. RA measured as allocation of carrying amount (CA) of UA & not subsequently remeasured unless impaired.	• Deferred profit recognised in P/L only when RA sold or re-leased. • Revaluation of RA prohibited. * *This is the only substantive difference between the proposed R&R model & the ED derecog approach*

- **Most WG members are supportive of the single R&R model (a variant of the ED partial derecog approach) but are concerned with various aspects of the model** – refer subsequent slides

- **The rest has mixed views**
  - There are support for: a single full derecog approach, a single PO approach, the ED hybrid approach, a single revenue standard for all income-generating activities including leases.

Lessor Accounting – Initial Measurement of RA

(a) Should RA be initially measured as allocation of CA of UA based on PV of LR relative to FV of UA?

➢ **Generally agree but have following concerns/suggestions:**

- Any loss on below-market leasing arrangements would be inappropriately recognised as impairment of RA as a result of proposed allocation method.

→ IASB could consider incorporating a requirement in the final standard to ensure any loss on below-market arrangements is recognised as such at lease inception.

- Consider if other allocation methods should be permitted, especially in situations where FV of UA cannot be determined reliably, e.g. allocation method based on lease term relative to useful life of UA.

Lessor Accounting – Subsequent Measurement of RA

(b) Should RA be accreted over lease term using rate charged by lessor?

➢ **Mixed views**

- Support:

- Accretion reflects how leasing arrangements are priced.
- However, is RA a financial asset, a non-financial asset or something else? Furthermore, CA of RA (gross RA net of deferred profit) is a hybrid measurement that is neither cost nor FV.

- Dissent:
  - RA is a non-financial asset, hence not appropriate to measure at "amortised cost using effective interest method".
  - Increases complexity of RA measurement.

→ Suggest that IASB clarify the nature of the RA & explain how this reconciles to the proposed measurement basis.

Lessor Accounting – Subsequent Measurement of RA

(c) Should revaluation of RA be prohibited?

- **Generally disagree and suggest that**

- Remeasurement to FV should be permitted if UA is permitted to be measured at FV.

Leases of Investment Properties (IPs)

ED proposals	Tentative decisions
• Leases of ***IPs measured at FV*** excluded from scope of lessor accounting. • Lessor continues to recognise UA & recognises lease income on straight-line basis over lease term.	• Leases of ***all IPs*** excluded from scope of lessor accounting. • Lessor continues to recognise UA & recognises lease income over lease term.

➢ **Most WG members support tentative decisions**

- IP is different from many other assets that are leased [Jul 2011 IASB agenda paper 5G].
- The same leasing contracts would be accounted for consistently.
- Proposed R&R model would be onerous & costly for multi-tenant IPs with lease contracts that are of very short tenure (e.g. 2 to 3 years) & that span different time periods, without providing more decision-useful information.

➢ **A few members prefer to ring fence scope exception to IPs measured at FV**

Leases of Investment Properties (IPs)

➢ Implications of IASB's tentative decisions

- A lessor that currently accounts for leases of IPs as finance leases would be required to recognise the IPs in its FS & lease income over the lease terms. The WG is in the process of analysing the impact of this treatment.

Measurement of Lease Receivables/Liabilities – Contingent Rentals (CRs)

ED proposals	Tentative decisions
• All CRs would be included in the measurement of lease receivables (LR)/lease liabilities (LL).	• CRs that depend on an index or rate or are in substance fixed lease payments but are structured as variable lease payments in form would be included in the measurement of LR/LL. Other CRs would be expensed as incurred.

➢ **Mixed views on exclusion of certain types of CRs**

- Support:
  - Addresses concern over reliability of estimates of CRs that depend on future performance/usage and provides practical relief.

Measurement of Lease Receivables/Liabilities – Contingent Rentals (CRs)

➢ **Mixed views on exclusion of certain types of CRs**

- Dissent:

- Does not reflect economics of leasing arrangements & is inconsistent with treatment of contingent consideration in other standards/projects.

- Understates lessor's profit (& overstates RA) at lease inception as CRs that are not recognised as part of LR would be included in the measurement of RA under the proposed R&R model*.

- Appears disconnected with the tentative decision that lessor would adjust RA if rate lessor charges lessee reflects an expectation of unrecognised CRs*.

** Refer next 2 slides*

Unrecognised CRs & Measurement of RA

Tentative decisions

- If rate lessor charges lessee (rate) does not reflect an expectation of CRs, lessor would not make any adjustments to RA with respect to the CRs.

- If rate reflects an expectation of CRs:
  - Lessor would adjust RA on the basis of its expectation of CRs by recognising a portion of the cost of the RA as an expense when the CRs are recognised in P/L.
  - Any difference between actual & expected CRs would not result in any further adjustment to RA.

Unrecognised CRs & Measurement of RA

- **Mixed views from those who support non-recognition of certain CRs**

- Support:
  - Expected cash flows from CRs that are not recognised as part of LR would be included in the measurement of RA. When expected CRs are received, RA should be adjusted accordingly.

- Dissent:
  - Introduces significant complexity without enhancing decision-usefulness of resultant information substantially as unrecognised CRs are typically insignificant to total lease payments.
  - Complicates impairment assessment for RA.
  - Potential for abuse.
  - Issue of “auditability”.

Measurement of Lease Receivables/Liabilities – Residual Value Guarantees (RVGs)

ED proposals	Tentative decisions
• Lessors & lessees would recognise amounts expected to be received/paid under RVGs provided by lessees & related parties of lessess in LR/LL.	• Lessors would not recognise amounts expected to be received under RVGs until end of lease but would consider them when assessing if RA is impaired. • No change to ED proposal for lessees.

➢ **Mixed views on non-recognition of RVGs by lessors**

- Support: consistent with deferral of profit on RA under proposed R&R lessor model.
- Dissent: all RVGs are considered in the pricing of leasing arrangements. Also, inconsistent with proposed lessee accounting.

Next Steps

- AOSSG would like to request IASB to further evaluate the key concerns & suggestions highlighted in today's discussion & to carry out further outreach if necessary before finalising the re-exposure document.

- The WG will continue to monitor IASB's ongoing discussions & analyse the impact of its tentative proposals & provide regular feedback to IASB.

Questions?