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Technical Line

FASB — proposed guidance

Final standard on leases is taking shape

The new standard could affect companies' decisions about whether to lease or buy assets.

What you need to know

- The FASB and the IASB have substantially completed redeliberations on new leases standards that would require lessees to recognize assets and liabilities for most leases.
- Lessees and lessors applying US GAAP would classify most leases using a principle generally consistent with that of IAS 17, which is similar to current US GAAP but without the bright lines.
- The Boards have made different decisions about lease classification and the recognition, measurement and presentation of leases for lessees and lessors. In some cases, these differences would result in similar transactions being accounted for differently under US GAAP and IFRS.
- The Boards will set effective dates before issuing the new standards. We expect the Boards to issue the standards in the fourth quarter of 2015.

Overview

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards) have substantially completed redeliberations on new standards that would significantly change the accounting for leases and could have far-reaching implications for a company's finances and operations. This Technical Line is based on the FASB's decisions in redeliberations and supersedes the Technical Line with the same title that we issued on 25 March 2015.

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The standards the FASB and the IASB plan to issue would require lessees to recognize most leases on their balance sheets as lease liabilities with corresponding right-of-use assets. While many aspects of lessor accounting would remain the same, the standard that the FASB plans to issue (the new standard) would eliminate today's real estate-specific guidance and change today's additional lessor classification criteria.[1] It also would change what would be considered initial direct costs. The new standards would incorporate feedback the Boards received from constituents on their 2013 exposure draft[2] (2013 ED).

Like today's guidance in Accounting Standards Codification (ASC) 840, *Leases*, the new standard would require lessees to classify most leases. Leases would be classified as either Type A leases (generally today's capital leases) or Type B leases (generally today's operating leases). As discussed later in this publication, the IASB has decided that lessees would apply a single model for all recognized leases and would have the option not to recognize and measure leases of small assets.

The new standard would require lessors to classify all leases as either Type A leases or Type B leases (generally today's operating leases). There would be three categories of Type A leases for lessors: (1) those with selling profit that is recognized or deferred (generally today's sales-type leases), (2) those with no selling profit (generally today's direct financing leases), and (3) certain leases where collectibility of lease payments is not probable. Leases in the latter category would be recognized and measured in accordance with the new revenue recognition standard (i.e., ASC 606, *Revenue from Contracts with Customers)*. As discussed later in this publication, the IASB also has decided that lessors would apply a dual classification model for all leases.

Leases would be classified using a principle generally consistent with that of International Accounting Standards (IAS) 17, *Leases*, which is similar to US GAAP but without today's bright lines (i.e., the "75% of economic life" and "90% of fair value" tests in ASC 840). The new standard would eliminate today's real estate-specific guidance and would change today's additional lessor classification criteria. Lease classification would be important in determining how and when a lessee and a lessor would recognize lease expense and revenue, respectively, and what assets a lessor would record.

For lessees, the income statement recognition pattern for Type A leases would be similar to that of today's capital leases. The income statement recognition pattern for Type A leases for lessors would be similar to that of today's sales-type or direct financing leases. However, lessors would also evaluate whether a Type A lease, in effect, transfers control of the underlying asset to the lessee when determining whether to recognize or defer recognition of any profit. In addition, for some Type A leases, the recognition and measurement provisions of ASC 606 would apply.

Lessees' and lessors' income statement recognition patterns for Type B leases would be similar to today's patterns for operating leases.

For lessees, recognizing lease-related assets and liabilities could have significant financial reporting and business implications, such as:

- Key balance sheet metrics could change.
- Debt covenants and borrowing capacity might be affected.
- Decisions about whether to lease or buy significant assets might change.

As discussed in Appendix B to this publication, the new standard would eliminate the following lease and lease-related accounting guidance:

- Lessee involvement in asset construction ("build-to-suit" transactions)
- Separate requirements for leases involving real estate
- Leveraged leases that are not grandfathered upon transition

Before issuing a final standard, the FASB plans to revisit interpretive guidance in ASC 840 to determine whether to carry forward guidance it did not include in its 2013 ED. This could result in certain guidance being carried forward to the new standard, such as the following:

- Sale of assets subject to a lease or intended to be leased by the purchaser to a third party
- Lessee maintenance deposits
- The sale of tax benefits associated with a leased asset
- Accounting for a loss on a sublease

The FASB has not yet discussed an effective date but plans to address it before issuing a final standard. Given the current timeline, an effective date of 1 January 2018 or later is likely.

The new standard's transition provisions would be applied using a modified retrospective approach at the beginning of the earliest comparative period presented in the financial statements. For example, if the standard is effective for 2018 for calendar-year companies, a company that presents three years of financial statements would have an effective date of 1 January 2018 and would apply the transition provisions to periods beginning 1 January 2016. Full retrospective application would be prohibited.

This publication discusses how the FASB's standard would be applied and is intended to help companies consider the effects of adopting it. Please note that our publication is based on available information regarding the FASB's decisions in redeliberations. Until a final standard is issued, these decisions are tentative. The FASB may also clarify its decisions in the final standard. The discussions and illustrations in this publication represent our preliminary thoughts.

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Identifying a lease

Scope and scope exclusions (updated July 2015)

The scope of the new standard would be broader than the scope of ASC 840 and would not be limited to leases of property, plant and equipment. The new standard would apply to leases of all assets, except for the following:

- Leases of intangible assets
- Leases to explore for or use natural resources (e.g., minerals, oil, natural gas, similar non-regenerative resources)
- Leases of biological assets, including timber

How we see it

We believe that service concession arrangements[3] within the scope of ASC 853, *Service Concession Arrangements,* would be outside the scope of the new standard because they are currently excluded from the scope of today's guidance on leases. The FASB did not address them in the 2013 ED (and did not discuss them in redeliberations) because ASC 853 was codified after the FASB issued the ED.

A lease conveys the right to control the use of an identified asset.

Key differences between US GAAP and IFRS

Under the IASB's new standard, lessees of intangible assets could, as a policy election, apply the new lease standard, but they would not be required to. However, the IASB's new standard would specifically exclude lessors' leases of intangible assets from its scope.

Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

The requirement in ASC 350-40, *Intangibles — Goodwill and Other — Internal-Use Software,* that required licensees to analogize to ASC 840 for purposes of determining the accounting for a software licensing arrangement was eliminated by Accounting Standards Update (ASU) 2015-05.[4] Instead, customers will account for software licenses that are in the scope of ASC 350-40 in the same manner as licenses of other intangible assets.

Definition of a lease

A lease would be defined as a contract (i.e., an agreement between two or more parties that creates enforceable rights and obligations) that conveys the right to use an asset (i.e., the underlying asset) for a period of time in exchange for consideration. To be a lease, a contract would have to meet both of the following criteria:

- Fulfillment of the contract depends on the use of an identified asset.
- The contract conveys the right to control the use of the identified asset.

Identified asset

The FASB indicated that a contract's dependence on an identified asset is fundamental to the definition of a lease. This concept is generally consistent with the "specified asset" concept in ASC 840. Under the new standard, an identified asset could be either implicitly or explicitly specified in a contract and could be a physically distinct portion of a larger asset (e.g., a floor of a building). However, a capacity portion of an asset that is less than substantially all of that asset's capacity (e.g., 60% of a pipeline's capacity) would not be an identified asset because it is not physically distinct from the remaining capacity of the asset.

Illustration 1 — Identified asset

Scenario A

Assume that Customer X enters into a 12-year contract for the right to use a specified capacity of a supplier's data transmission within a fiber optic cable between New York and London. The contract identifies 3 of the cable's 20 fibers. The 3 fibers are dedicated solely to Customer X's data for the duration of the contract term.

Analysis: The 3 fibers would be identified assets because they are specified in the contract and are physically distinct from the other 17 fibers in the cable.

Scenario B

Assume the same facts as in Scenario A, except that the supplier is free to use any of the cable's 20 fibers, at any time during the contract term, to transmit any of its customers' data, including Customer X's data.

Analysis: The fibers are not identified assets because the contract allows the supplier to use any of the cable's 20 fibers to fulfill its obligations to Customer X, whose portion of the cable's capacity is not physically distinct from the cable's remaining capacity.

A contract would not involve the use of an identified asset if a supplier has the substantive right to substitute the asset used to fulfill the contract. A substitution right would be substantive if both of the following conditions are met:

- The supplier has the practical ability to substitute the asset.
- The supplier can benefit from exercising the right to substitute the asset.

A customer would presume that fulfillment of a contract depends on the use of an identified asset when it is impractical for the customer to evaluate either of these conditions. No presumption for suppliers is necessary because they generally have sufficient information to make such a determination.

Contract terms that allow or require a supplier to substitute other assets only when the underlying asset is not operating properly (e.g., a normal warranty provision) or when a technical upgrade becomes available would not create a substantive substitution right.

The FASB intends for the conditions above to mitigate the risk that customers and/or suppliers would structure arrangements with non-substantive substitution clauses to avoid applying lease accounting.

Illustration 2 — Substitution rights

Scenario A

Assume that an electronic data storage provider (supplier) provides services, through a centralized data center, that involve the use of a specified server (Server No. 9). The supplier maintains many identical servers in a single, accessible location and is permitted to and can easily substitute another server without the customer's consent. Further, the supplier would benefit from substituting an alternative asset, because it allows the supplier flexibility to optimize the performance of its network while incurring only nominal cost.

Analysis: Fulfillment of this contract would not depend on the use of an identified asset. Specifically, the supplier has the practical ability to substitute the asset and would benefit from such a substitution.

Scenario B

Assume the same facts as in Scenario A except that Server No. 9 is customized, and the supplier would not have the practical ability to substitute the customized asset. Additionally, the supplier would not obtain any benefits from sourcing a similar alternative asset. For example, the server may contain the customer's confidential information, requiring the destruction of the asset's primary components (e.g., hardware, software) adding significant costs to the supplier without benefiting the supplier, if substituted.

Analysis: Because it is not practical for the supplier to substitute the asset and the supplier would not benefit from substituting the asset, the substitution right would be non-substantive, and Server No. 9 would be an identified asset. In this scenario, neither of the conditions is met, but it is important to note that both conditions must be met for the supplier to have a substantive substitution right.

How we see it

The requirement that a substitution right must benefit the supplier in order to be substantive is a new concept that could disqualify substitution rights from being considered substantive.

Determining when a customer has the right to direct the use of the identified asset may require judgment.

Right to control the use of the identified asset

A contract would convey the right to control the use of an identified asset if, throughout the contract term, the customer has the right to both:

- Direct the use of the identified asset
- Obtain substantially all of the potential economic benefits from directing the use of the identified asset

Requiring a customer to have the right to direct the use of an identified asset would be a change from ASC 840. A contract may meet ASC 840's control criterion if, for example, the customer obtains substantially all of the output of an underlying asset. Under the new standard, these arrangements would no longer be considered leases unless the customer also has the right to direct the use of the identified asset.

Right to direct the use of the identified asset

A customer has the right to direct the use of an identified asset whenever it has the right to direct how and for what purpose the asset is used, including the right to change how and for what purpose the asset is used, throughout the period of use.

The determination of whether a customer has the right to direct how and for what purpose an asset is used should focus on whether the customer has the right to make the decisions that most significantly affect the economic benefits that can be derived from the use of the underlying asset. This right may include directing how, when, whether and where the asset is used and what it is used for throughout the contract term. Importantly, this right would permit the customer to change its decisions throughout the contract term without approval from the supplier. The customer would not necessarily need the right to operate the underlying asset to have the right to direct its use. That is, the customer may direct the use of an asset that is operated by the supplier's personnel.

If neither the customer nor the supplier directs how and for what purpose the asset is used throughout the period of use (e.g., when the contract specifies how and for what purpose the asset is used or when decisions are made jointly throughout the period of use), the customer would have the right to direct the use of the identified asset in either of the following circumstances:

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

A supplier's protective rights, in isolation, would not prevent the customer from having the right to direct the use of an identified asset. The FASB believes that protective rights typically define the scope of the customer's use of the asset without removing the customer's right to direct the use of the asset. Protective rights are intended to protect a supplier's interests (e.g., interests in the asset, its personnel, compliance with laws and regulations) and might take the form of a specified maximum amount of asset use or a requirement to follow specific operating instructions.

How we see it

- We understand that the FASB does not intend for the assessment of whether a customer has the right to direct "how" and "for what purpose" an asset is used to be two separate determinations. Instead, the assessment would be holistic, encompassing how, when, whether and where an asset is used and what it is used for (including the right to change these decisions) throughout the period of its use.
- We still have questions about how the definition would be applied to certain arrangements. For example, in contracts that include significant services, we believe that determining whether the contract conveys the right to direct the use of an identified asset may be challenging.

Illustration 3 — Right to direct the use of an asset

Customer enters into a contract with Supplier to use Automobile A for a three-year period. Automobile A is specified in the contract. Supplier cannot substitute another vehicle unless Automobile A is not operational (e.g., it breaks down).

Under the contract, Customer operates Automobile A (i.e., drives the vehicle) or directs others to operate Automobile A (e.g., hires a driver). Customer decides how to use the vehicle (within contractual limitations, discussed below). In addition, Customer decides where Automobile A goes as well as when or whether it is used, and what it is used for, throughout the period of use. Customer can also change its decisions throughout the period of use.

Under the contract, Supplier provides scheduled maintenance services and specifies that Customer can use Automobile A for a maximum of 12,000 miles per year without a substantive penalty. In addition, Supplier prohibits certain uses of Automobile A (e.g., moving it overseas) and modifications of Automobile A to protect its interest in the asset.

Analysis: Customer has the right to direct the use of Automobile A. Customer has the right to direct how the vehicle is used, when or whether the vehicle is used, where the vehicle goes and what the vehicle is used for. Customer also has the right to change the aforementioned decisions.

Supplier's limits on annual mileage and certain uses for the vehicle are considered protective rights that define the scope of Customer's use of the asset but do not affect the assessment of whether Customer directs the use of the asset.

Right to obtain substantially all of the potential economic benefits from directing the use of the identified asset

A customer's right to control the use of an identified asset also depends on its right to obtain substantially all of the potential economic benefits from directing the use of the asset during the contract term. The customer can obtain economic benefits either directly or indirectly through the asset's primary outputs (i.e., goods or services) and any byproducts (e.g., renewable energy credits). However, other tax benefits, such as those related to the ownership of the asset (e.g., excess tax depreciation benefits), would not be considered potential economic benefits of use.

How we see it

The term "substantially all" was not defined in the 2013 ED and was not addressed during redeliberations. However, entities might consider the term to mean more than 90%, based on how it is defined in ASC 840 in the context of sale and leaseback transactions. That definition states that "if the present value of a reasonable amount of rental for the leaseback represents 10 percent or less of the fair value of the asset sold, the seller-lessee would be presumed to have transferred to the purchaser-lessor the right to substantially all of the remaining use of the property sold."

The FASB decided against including an additional requirement that, for a contract to contain a lease, a customer must have the ability to derive benefits from directing the use of an identified asset on its own or together with other resources (e.g., goods or services) that are either sold separately (by the supplier or any other supplier) or can be sourced in a reasonable period of time. Some members of the FASB indicated that such a requirement would have made applying the definition more complex, and the costs would have outweighed the benefits. They also noted that the FASB's staff was unable to identify arrangements in which the conclusion would change as a result of the additional requirement.

Cancelable leases

The new standard would apply to contracts that are referred to as "cancelable," "month-to-month," "at will," "evergreen," "perpetual" or "rolling" if they create enforceable rights and obligations. Any noncancelable periods in contracts meeting the definition of a lease would be considered part of the lease term. See the lease term section below.

For example, consider an agreement with an initial noncancelable period of one year and an extension for an additional year if both parties agree. The initial one-year noncancelable period would meet the definition of a contract because it creates enforceable rights and obligations. However, the one-year extension period would not be a contract because either party could unilaterally elect to not extend the arrangement without incurring a substantive penalty.

Short-term leases

Lessees could make an accounting policy election (by class of underlying asset) to apply a method similar to current operating lease accounting to leases with a lease term of 12 months or less (short-term leases). To evaluate whether a lease qualifies for this accounting, the lease term would be determined in a manner consistent with the lease term of all other leases. For example, the lease term would only include periods covered by lease renewal options that a lessee is reasonably certain to exercise and would also include periods covered by lease termination options that a lessee is reasonably certain not to exercise. See the lease term section below.

Illustration 4 — Short-term lease

Scenario A

A lessee enters into a lease with a nine-month noncancelable term with an option to extend the lease for four months. At the lease commencement date, the lessee concludes that it is reasonably certain to exercise the extension option because the monthly lease payments during the extension period are significantly below market rates.

Analysis: The lease term is greater than 12 months (i.e., 13 months). Therefore, the lessee may not account for the lease similar to operating lease accounting under ASC 840 today.

Scenario B

A lessee enters into a lease with a nine-month noncancelable term with an option to extend the lease for four months. At the lease commencement date, the lessee concludes that it is not reasonably certain to exercise the extension option because the monthly lease payments during the optional extension period are at market rates and there are no other factors that would make exercise of the renewal option reasonably certain.

Analysis: The lease term is 12 months or less (i.e., nine months). Therefore, the lessee may (subject to its accounting policy, by class of underlying asset) account for the lease in a manner similar to an operating lease under ASC 840 today.

The short-term lease accounting policy election is intended to reduce the cost and complexity of applying the new standard. Lessees making the election would recognize lease expense on a straight-line basis over the lease term. Although such leases would not be recognized on the balance sheet, they would still meet the definition of a lease. As such, certain quantitative and qualitative disclosures would be required for short-term leases if a lessee makes such a policy election.

How we see it

- In its 2013 ED, the FASB proposed making the short-term lease accounting policy election available to lessees and lessors. However, given the FASB's decisions on lessor accounting, we believe the election will not be available to lessors in the final standard.
- The 2013 ED also said that any lease that contains a purchase option would not be considered a short-term lease. Because the FASB did not discuss this provision during redeliberations, it appears that such leases would not be short-term leases under the new standard.

Leases of small assets (IFRS-only)

Key differences between US GAAP and IFRS

The IASB's new standard would include an exemption from its recognition and measurement provisions for leases of small assets for lessees.

The IASB's new standard would specify that the exemption only applies to leases of assets that are not dependent on, or highly interrelated with, other leased assets. The Basis for Conclusions to the IASB's new standard would include a discussion of the quantitative threshold that the IASB considers appropriate in applying the exemption. In its redeliberations, the IASB discussed a threshold of $5,000. This was intended to help preparers determine what is meant by "small" and would be expressed in terms of the value of the underlying asset when new. Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

Identifying and separating lease and non-lease components and allocating contract consideration

Identifying and separating lease from non-lease components of contracts

Many contracts contain a lease coupled with an agreement to purchase or sell other goods or services (non-lease components). For these contracts, the non-lease components would be identified and accounted for separately from the lease component (except when a lessee applies the practical expedient as discussed below). The non-lease components may be accounted for as executory arrangements by lessees (customers) or as contracts subject to the new revenue recognition standard (i.e., ASC 606, *Revenue from Contracts with Customers*) by lessors (suppliers).

How we see it

Identifying non-lease components of contracts may change practice for some lessees. Today, entities may not focus on identifying lease and non-lease components because their accounting treatment (e.g., the accounting for an operating lease and a service contract) is often the same. However, because most leases would be recognized on the balance sheet under the new standard, lessees may need to put more robust processes in place to identify the lease and non-lease components of contracts.

Lessees could make a policy election to account for a lease and non-lease components as a single lease component.

Activities or lessor costs in a contract that do not provide the lessee with an additional good or service would not be considered lease or non-lease components, and lessees and lessors would not allocate contract consideration (discussed below) to these activities or costs. An example would be administrative costs a lessor charges a lessee. However, activities or lessor costs such as a lessor providing services (e.g., maintenance, supply of utilities) or operating the underlying asset (e.g., vessel charter, aircraft wet lease) would generally represent non-lease components.

Under current US GAAP, lease-related executory costs (e.g., insurance, maintenance, taxes) are considered part of lease components (or lease elements) for the purpose of separating lease and non-lease elements. However, under the new standard, certain lease-related executory costs, such as maintenance activities, would be non-lease components. Additionally, arrangements that include payments for other items such as taxes and insurance would have to be evaluated to determine whether an additional good or service is being provided to the lessee and whether those items should be considered lease or non-lease components.

Practical expedient — lessees

The new standard would provide a practical expedient that would permit lessees to make an accounting policy election (by class of underlying asset) to account for the lease and non-lease components of a contract as a single lease component. The FASB expects the practical expedient to most often be used when the non-lease components of a contract are not significant when compared with the lease components of a contract.

Lessees that make the policy election to account for the lease and non-lease components of contracts as a single lease component would allocate all of the contract consideration to the lease. Therefore, the initial and subsequent measurement of the lease liability and right-of-use asset would be higher than if the policy election were not applied. See the lessee accounting section below for a discussion of measurement of lease liabilities and right-of-use assets.

Identifying and separating lease components

For contracts that contain the rights to use multiple assets (e.g., a building and equipment), the right to use each asset would be considered a separate lease component if both of the following criteria are met:

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

If one or both of these criteria are not met, the right to use multiple assets would be considered a single lease component.

Illustration 5 — Identifying and separating lease components

Scenario A

Assume that a lessee enters into a lease of a warehouse and the surrounding parking lot that is used for deliveries and truck parking. The lessee is a local trucking company that intends to use the warehouse as the hub for its shipping operations.

Analysis: The contract contains one lease component. The lessee would be unable to benefit from the use of the warehouse without also using the parking lot. Therefore, the warehouse space is dependent upon the parking lot.

Scenario B

Assume the same facts as in Scenario A, except that the contract also conveys the right to use an additional plot of land that is adjacent to the parking lot. This plot of land could be developed by the lessee for other uses (e.g., to construct a truck maintenance facility).

Analysis: The contract contains two lease components: a lease of the warehouse (together with the parking lot) and a lease of the adjacent plot of land. Because the adjacent land could be developed for other uses independent of the warehouse and parking lot, the lessee can benefit from the adjacent plot of land on its own or together with other readily available resources. The lessee can also benefit from the use of the warehouse and parking lot on its own or together with other readily available resources.

Allocating contract consideration

Lessees that do not make an accounting policy election to use the practical expedient to account for a lease and non-lease components of a contract as a single lease component would allocate contract consideration to the lease and non-lease components on a relative standalone price basis. Lessees would use observable standalone prices (i.e., prices that the lessor or a similar supplier would charge separately for a similar lease, good or service component of a contract) when available. If observable standalone prices are not available, lessees would be permitted to estimate standalone prices. In doing so, lessees would be required to maximize the use of observable information and to apply estimation methods in a consistent manner. This would be similar to how lessees allocate contract consideration under current US GAAP.

Lessors would be required to apply the new revenue recognition standard (i.e., ASC 606) to allocate contract consideration between the lease and non-lease components of a contract.

Allocating contract consideration — reassessment

Lessees would be required to reallocate consideration upon either:

- A contract modification that is not accounted for as a separate, new lease
- A reassessment of the lease term or a lessee's purchase option (i.e., whether the lessee is reasonably certain to exercise the option)

How we see it

Although the FASB decided to require lessees to reallocate contract consideration upon the reassessment of the lease term or a lessee's purchase option, we believe the FASB intended for lessees to reallocate contract consideration only when a reassessment results in a change to either the lease term or to the lessee's conclusion about whether it is reasonably certain that the lessee will exercise a purchase option.

Lessors would be required to reallocate contract consideration upon a modification that is not accounted for as a separate, new lease.

Modifications resulting in a separate, new lease for lessors and lessees would require consideration to be allocated to the lease and non-lease components (as applicable), as with any new lease. See the lease modifications section below.

Refer to Appendix A for a summary of lessee and lessor reassessment requirements.

Lease modifications (updated July 2015)

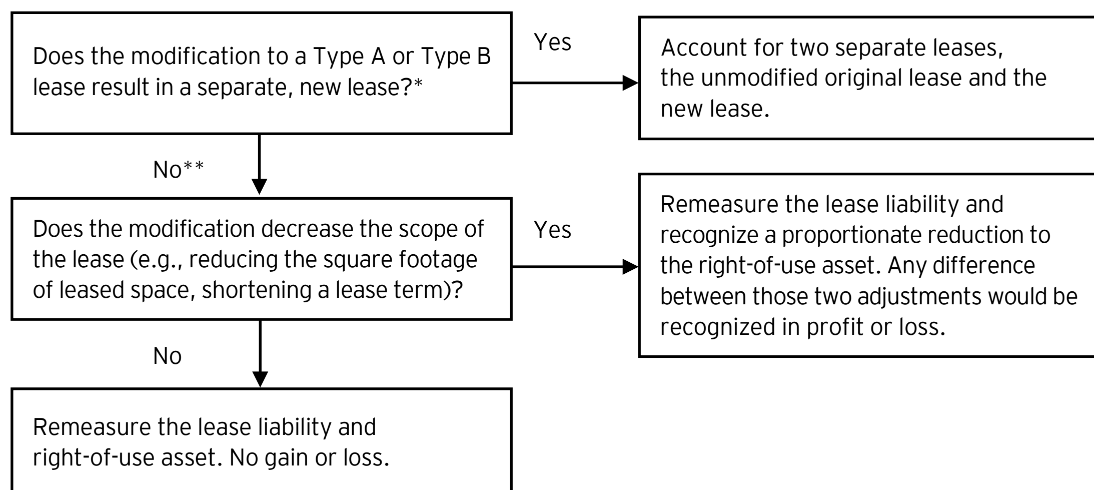
The new standard would define a lease modification as any change to the contractual terms and conditions of a lease that was not part of the original terms and conditions of the lease.

Lessees and lessors would account for a lease modification as a separate, new lease when both of the following conditions are met:

- The modification grants the lessee an additional right-of-use (e.g., an additional underlying asset, the same underlying asset for an additional period of time not contemplated by a renewal option) not included in the original lease.
- The additional right-of-use is priced commensurate with its standalone price.

This type of modification would result in a lessee and lessor accounting for two separate leases, the unmodified original lease and the new lease.

The following decision tree summarizes how lessees would evaluate and account for a lease modification under the new standard:



* Guidance for evaluating whether a modification results in a separate, new lease is discussed above.

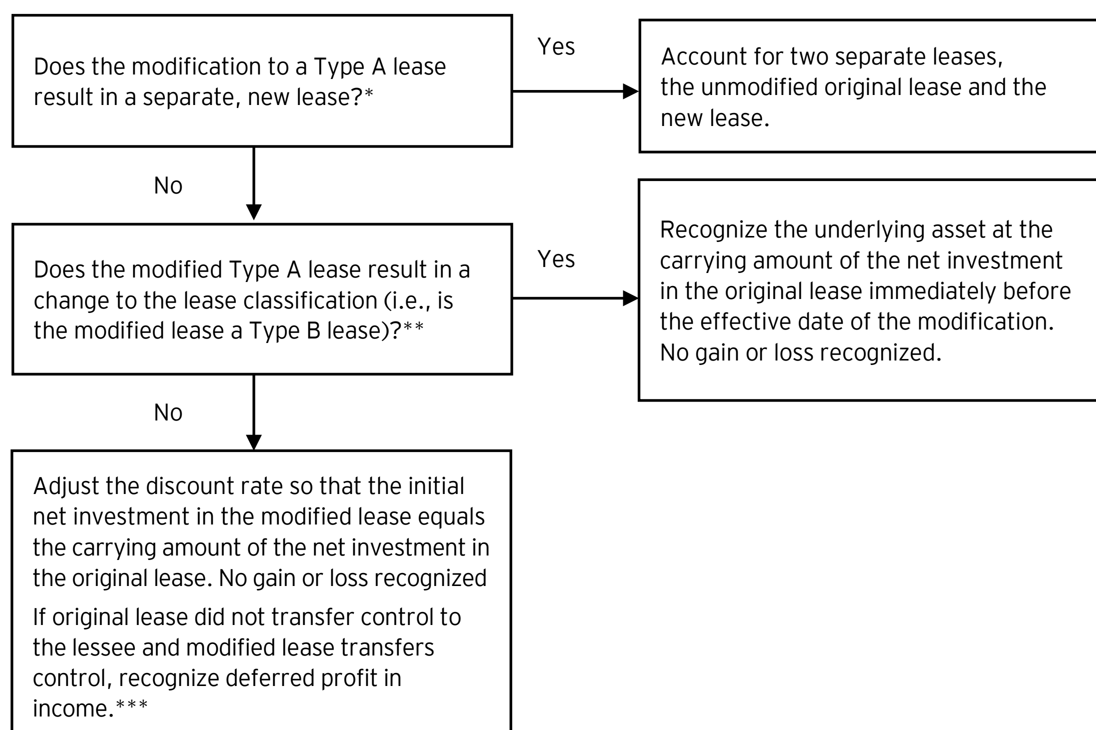
** It is unclear whether the final standard would require lessees to reassess lease classification upon a modification to a Type A or a Type B lease that does not result in a separate, new lease.

As indicated on the decision tree above, for a lease modification that does not result in a separate, new lease, lessees would generally remeasure the existing lease liability and right-of-use asset without affecting profit or loss. However, for a modification that decreases the scope of a lease (e.g., reducing the square footage of leased space, shortening a lease term), lessees would remeasure the lease liability and recognize a proportionate reduction (e.g., the proportion of the change in the lease liability to the pre-modification lease liability) to the right-of-use asset. Any difference between those adjustments would be recognized in profit or loss.

For lessors, a modification that does not result in a separate, new lease (as noted above) would be accounted for as follows:

- A modification to a Type B lease would be, in effect, a new Type B lease. The lease payments would be equal to the remaining lease payments of the modified lease, adjusted for any prepaid or accrued rent from the original lease.
- The accounting for a modification to a Type A lease would depend on whether lease classification changes. That is, lessors would reassess lease classification upon a modification to a Type A lease that does not result in a separate, new lease (as noted above).

The following decision tree summarizes how lessors would evaluate and account for a modification to a Type A lease under the new standard:



* Guidance for evaluating whether a modification results in a separate, new lease is discussed above.

** It is unclear how lessors would reassess classification. For example, the assessment could be made as of the original lease inception date (using modified terms) or at the effective date of the modification.

*** See lessor accounting – determining whether to defer or recognize selling profit section below.

Modification to a Type A lease that does not result in a separate, new lease — no change in lease classification

As indicated in the decision tree above, a lessor would adjust the discount rate used to measure the modified lease so that its initial net investment in the modified lease equals the carrying amount of its net investment in the original lease immediately before the effective date of the modification. No gain or loss would be recognized from such a modification, absent an impairment of the net investment in the lease (i.e., the lease receivable and any unguaranteed residual asset).

However, if the original Type A lease did not, in effect, transfer control of the underlying asset to the lessee (i.e., any initial selling profit was deferred, as discussed in the lessor accounting section), but the modified Type A lease would transfer control, a lessor would adjust the discount rate used to measure the modified lease so that its initial net investment in the modified lease would equal the carrying amount of its net investment in the original lease, exclusive of any deferred selling profit, immediately before the effective date of the modification. That is, lessors would recognize any previously deferred selling profit in income upon such a modification.

Modification of a Type A lease that does not result in a separate, new lease — change in lease classification to a Type B lease

As indicated in the decision tree above, a lessor would recognize the underlying asset at the carrying amount of its net investment in the original lease immediately before the effective date of the modification. No gain or loss would be recognized from such a modification, absent an impairment of the underlying asset.

Refer to Appendix A for a summary of lessee and lessor reassessment requirements.

How we see it

- It is unclear whether the FASB intends to require lessors to reassess lease classification upon a modification to a Type B lease that does not result in a separate, new lease.
- It is also unclear whether the final standard would require lessees to reassess lease classification upon a modification to a Type A or a Type B lease that does not result in a separate, new lease.

Key differences between US GAAP and IFRS

The IASB decided that lessors would account for a modification to a Type A lease that does not result in a separate, new lease in accordance with IFRS 9, *Financial Instruments*.

Refer to Appendix C for a summary of key differences.

Contract combinations

The new standard would require that two or more contracts entered into at or near the same time with the same counterparty (or related party) be considered a single transaction if either of the following is met:

- The contracts are negotiated as a package with a single commercial objective.
- The amount of consideration to be paid in one contract depends on the price or performance of the other contract.

These criteria are intended to address the FASB's concern that separately accounting for multiple contracts may not result in a faithful representation of the combined transaction.

Portfolio approach

Many constituents had expressed concerns that the cost of applying the 2013 ED would exceed the benefits for leases involving a large number of assets that have similar characteristics (e.g., leases of a fleet of similar cars). In response, the FASB acknowledged that lessees and lessors would be able to use a portfolio approach (rather than a lease-by-lease approach) when they reasonably expect that doing so would not result in a material difference from accounting for the leases on an individual basis. The new standard would not define "reasonably expect" and "material." Instead, the FASB decided to include a discussion of the portfolio approach in the Basis for Conclusions of the new standard rather than in the text that will appear in the Codification.

Key differences between US GAAP and IFRS
The IASB decided to state explicitly in the authoritative paragraphs of its new standard that lessees and lessors also would be permitted to use a portfolio approach (rather than a lease-by-lease approach) when they reasonably expect that doing so would not result in a material difference from accounting for the leases on an individual basis. Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

How we see it

The FASB's decision to discuss the portfolio approach in the Basis for Conclusions in its new standard (rather than in the text that will be codified) suggests that the approach would be applied as an accounting convention. That is, a decision to use the portfolio approach would be similar to a decision some entities make today to expense, rather than capitalize, certain assets when the accounting difference is and would continue to be immaterial to the financial statements.

Key concepts

Lessees and lessors would generally apply the same key concepts when they identify, classify, recognize and measure lease contracts, and both lessees and lessors would apply the concepts consistently.

Lease commencement and inception date

The lease commencement date would be the date on which the lessor makes an underlying asset available for use by the lessee. Lessees (except lessees applying the short-term lease exemption) and lessors (for most Type A leases) would initially recognize and measure lease-related assets and liabilities on the commencement date. Entities would consider other standards to determine how to account for and disclose the existence of other rights or obligations created between the lease inception date (i.e., the date on which the principal terms of the lease are agreed to) and the commencement date.

Lease term

Determining the lease term

The lease term would be determined at the lease commencement date based on the noncancelable term of the lease, together with both of the following:

- The periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option
- The periods after the exercise date of an option to terminate the lease if the lessee is reasonably certain **not** to exercise that option

The FASB decided that the phrase "reasonably certain," which is used in IAS 17 and is generally interpreted as a high threshold, has the same meaning as the phrase "reasonably assured" that is currently used in ASC 840. Therefore, the FASB does not anticipate a significant change in practice.

Purchase options would be assessed in the same way as options to extend the lease term or terminate the lease. The FASB reasoned that purchasing an underlying asset is economically similar to extending the lease term for the remaining economic life of the underlying asset. When a lease contains a purchase option and the lessee is reasonably certain to exercise that option, the lease would be classified as a Type A lease by a lessee. Lessors would be required to also evaluate an additional criterion related to the collectibility of lease payments to determine lease classification when a purchase option is present and it is reasonably certain the lessee will exercise it. See the lease classification section below.

Evaluating lease renewal, termination and purchase options

When initially evaluating the lease term and lease payments (discussed below), the new standard would require lessees and lessors to consider any factors associated with exercising lease renewal, termination and purchase options. The evaluation of whether it is reasonably certain that those options will be exercised would consider all contract-, asset-, entity- and market-based factors, including:

- The existence of a purchase option or lease renewal option and its pricing (e.g., fixed rates, discounted rates, "bargain" rates)
- The existence of a termination option and the amount of payments for termination or nonrenewal
- Contingent amounts due under residual value guarantees
- Costs of returning the asset in a contractually specified condition or to a contractually specified location
- Significant customization (e.g., leasehold improvements), installation costs or relocation costs
- The importance of the leased asset to the lessee's operations
- A sublease term that extends beyond the noncancelable period of the head lease (e.g., a head lease that has a noncancelable term of five years with a two-year renewal option, and the sublease term is for seven years)

Illustration 6 — Determining the lease term

Scenario A

Assume that Entity P enters into a lease for equipment that includes a noncancelable term of four years and a two-year market-priced renewal option. There are no termination penalties or other factors indicating that Entity P is reasonably certain to exercise the renewal option.

Analysis: At the lease commencement date, the lease term would be four years.

Scenario B

Assume that Entity Q enters into a lease for a building that includes a noncancelable term of four years and a two-year, market-priced renewal option. Before it takes possession of the building, Entity Q pays for leasehold improvements. The leasehold improvements are expected to have significant value at the end of four years, and that value can only be realized through continued occupancy of the leased property.

Analysis: At lease commencement, Entity Q determines that it is reasonably certain to exercise the renewal option because it would suffer a significant economic penalty if it abandoned the leasehold improvements at the end of the initial noncancelable period. At lease commencement, Entity Q would conclude that the lease term is six years.

Reassessment of the lease term

After lease commencement, lessees would monitor leases for significant changes that could trigger a change in the lease term. Lessees would be required to reassess the lease term upon the occurrence of significant events or significant changes in circumstances that are within the lessee's control (i.e., market-based events or changes wouldn't trigger a reassessment). The FASB expects that such events, and the related reassessment, would occur infrequently.

If the lease term changes, a lessee would remeasure the lease liability, using revised inputs (e.g., discount rate, allocation of contract consideration) at the reassessment date, and would adjust the right-of-use asset. However, if the right-of-use asset is reduced to zero, a lessee would recognize any remaining amount in profit or loss.

Lessors would not be required to reassess the lease term after lease commencement.

Refer to Appendix A for a summary of lessee and lessor reassessment requirements.

Lease payments

Lease payments would be payments, made by a lessee to a lessor, relating to the right to use an underlying asset during the lease term. The present value of the lease payments (excluding lease incentives received by the lessee) would be recognized as a lease liability by lessees or as part of the net investment in the lease by lessors in Type A leases.

Variable lease payments that depend on an index or a rate would be included in lease payments, but other variable lease payments would not be.

Lease payments would include:

- Fixed lease payments, less any lease incentives received or receivable from the lessor
- Variable lease payments that depend on an index or a rate
- In-substance fixed lease payments structured as variable payments
- The exercise price of a purchase option if the lessee is reasonably certain to exercise that purchase option
- Payments for penalties for terminating a lease, if the lease term reflects the lessee exercising an option to terminate the lease
- Amounts expected to be payable under residual value guarantees (lessee only)
- Fixed payments structured as residual value guarantees (lessor only)

Lease payments would not include payments allocated to the non-lease components of a contract, except when the lessee makes an accounting policy election to account for the lease and non-lease components as a single lease component (as described in the identifying and separating lease from non-lease components of contracts section above).

Variable lease payments that depend on an index or rate

Variable lease payments that depend on an index or a rate would be included in the lease payments using the prevailing index or rate at the measurement date (e.g., lease commencement date for initial measurement). The FASB reasoned that despite the measurement uncertainty associated with changes to index- or rate-based payments, the payments meet the definition of an asset (lessor) and a liability (lessee) because they are unavoidable. These types of variable lease payments are treated differently from other contingent lease payments that do not depend on an index or rate (e.g., lease payments based on usage) because contingent lease payments that do not depend on an index or rate are generally avoidable. See the section on variable lease payments that do not depend on an index or rate below.

Under the new standard, lessees would be required to reassess variable lease payments that depend on an index or rate only when the lease liability is remeasured for other reasons (e.g., due to a change in the lease term). Otherwise, lessees would recognize changes to index- and rate-based variable lease payments in profit or loss in the period of the change (i.e., similar to other variable lease payments).

If a reassessment results in a remeasurement of the lease liability, a lessee would use revised inputs at the reassessment date and would adjust the right-of-use asset, except that:

- The amount of the remeasurement arising from a change in an index or a rate that is attributable to the current period would be recognized in profit or loss.
- If the right-of-use asset is reduced to zero, a lessee would recognize any remaining amount in profit or loss.

Lessors would not be required to reassess variable lease payments that depend on an index or rate.

Refer to Appendix A for a summary of lessee and lessor reassessment requirements.

Key differences between US GAAP and IFRS

Under the IASB's new standard, lessees would reassess variable lease payments that depend on an index or rate when the lease liability is remeasured for other reasons (e.g., due to a change in the lease term) and upon a change in the cash flows resulting from a change in the reference index or rate (i.e., when an adjustment to the lease payments takes effect).

Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

In-substance fixed lease payments structured as variable payments

Some lease agreements include payments that are described as variable but are in-substance fixed payments because the contract terms ensure that the payment of a fixed amount is unavoidable. Such payments would be included in the lease payments at lease commencement and thus used to measure entities' lease assets and lease liabilities.

The exercise price of a purchase option

Entities would consider the exercise price of asset purchase options included in lease contracts consistently with the evaluation of lease renewal and termination options (discussed above). That is, if the lessee is reasonably certain to exercise a purchase option, the exercise price would be included as a lease payment.

Payments for penalties for terminating a lease

The determination of whether to include lease termination penalties as lease payments would be similar to the evaluation of lease renewal options. If it is reasonably certain that the lessee will not terminate a lease, the lease term would be determined assuming that the termination option would not be exercised, and any termination penalty would be excluded from the lease payments. Otherwise, the lease termination penalty would be included as a lease payment.

Amounts expected to be payable under residual value guarantees — lessees only

The new standard would require lessees to include the amounts they expect to pay to the lessor under residual value guarantees as lease payments.

A lessee may provide a guarantee to the lessor that the value of the underlying asset it returns to the lessor at the end of the lease will be at least a specified amount. Such guarantees represent enforceable obligations that the lessee has assumed by entering into the lease. Uncertainty related to a lessee's guarantee of a lessor's residual value affects the measurement of the obligation rather than the existence of an obligation.

Illustration 7 — Residual value guarantee included in lease payments

Entity R (lessee) enters into a lease and guarantees that the lessor will realize $15,000 from selling the asset to another party at the end of the lease. At lease commencement, Entity P estimates that the underlying asset will have a value of $9,000 at the end of the lease.

Analysis: Entity R expects to pay the lessor $6,000 under the residual value guarantee and would include that amount as a lease payment.

How we see it

We expect the FASB to include in the final standard a provision of the 2013 ED that would require the remeasurement of a lessee's lease liability and adjustment of the right-of-use asset if the amounts expected to be payable under residual value guarantees change during the lease term. If the right-of-use asset is reduced to zero, the provision would require the remaining adjustment to be recognized in profit or loss. The FASB did not discuss this provision in redeliberations.

The residual value guarantee reassessment provision would not apply to lessors.

Residual value guarantees — lessors only

Lessors' lease payments would generally exclude amounts receivable under residual value guarantees (from either the lessee or a third party). However, fixed lease payments structured as residual value guarantees (typically from the lessee but possibly from another party) would be included as lease payments.

For example, assume a lessor obtains a guarantee for the entire residual value of the underlying asset from the lessee, also the contract states that the lessor will pay to the lessee, or the lessee can retain, any difference between the selling price of the underlying asset and the residual value guarantee specified in the contract. In these cases, the lessee is exposed to all of the upside and downside risk of changes in the value of the asset, and the lessor would receive a fixed amount (i.e., the guarantee specified in the contract) at the end of the lease. The amount the lessor would receive is economically similar to a fixed balloon lease payment at the end of the lease. Consequently, such amounts would be included as lease payments.

Variable lease payments that do not depend on an index or rate

Variable payments that do not depend on an index or rate, such as those based on performance (e.g., a percentage of sales) or usage of the underlying asset (e.g., the number of hours flown, the number of units produced), would not be included as lease payments. These payments would be recognized in profit or loss when they are incurred (lessee) or earned (lessor), in a manner similar to today's accounting. For example, a variable payment based on the annual sales of a leased store would not be included in the lessee's right-of-use asset or lease liability. Instead, the variable payment would be recognized as an expense (by the lessee) and as income (by the lessor) as the sales at the store occur and an obligation for the lessee to make the contingent payment is created.

Discount rate

Discount rates would be used to determine the present value of the lease payments, which are used to determine lease classification (refer to the lease classification section below) and to measure a lessor's recognized net investment in the lease and the lessee's lease liability. Under the new standard, the rate the lessor charges the lessee would be defined as "the rate implicit in the lease." The rate implicit in the lease would reflect the nature and specific terms of the lease and would be similar to the current definition in US GAAP.

Lessors

Lessors would use the rate implicit in the lease that causes the sum of the following two items:

- The present value of lease payments made by the lessee for the right to use the underlying asset
- The present value of the amount the lessor expects to derive from the underlying asset at the end of the lease (excluding any amount included in lease payments)

To equal the sum of these two items:

- The fair value of the underlying asset
- The lessor's initial direct costs (in the case of Type A leases without recognized selling profit)

A lessor's initial direct costs for Type A leases with recognized selling profit would be expensed at lease commencement, and therefore, would be excluded from the calculation of the rate implicit in the lease for those leases. See the lessor accounting section below.

How we see it

The FASB's decision to define the discount rate as the "rate implicit in the lease" would result in two key changes in practice for lessors. The calculation of the rate implicit in the lease would include the lessor's initial direct costs for Type A leases without recognized selling profit and would exclude investment tax credits that the lessor retains and expects to realize.

Lessees

Lessees would also use the rate implicit in the lease as described above if that rate can be readily determined. When the lessee cannot determine that rate, the lessee would use its incremental borrowing rate. The lessee's incremental borrowing rate would be the rate of interest that the lessee would have to pay to borrow the funds necessary to obtain an asset of a similar value to the right-of-use asset, with similar payment terms (i.e., consistent with the lease term) and security (i.e., collateral) in a similar economic environment. This definition would be generally consistent with the definition in ASC 840.

Under the new standard, lessees that are not public business entities (PBEs)[5] would be permitted to make an accounting policy election to use the risk-free rate for the initial and subsequent measurement of lease liabilities. The risk-free rate would be determined using a period comparable with the lease term. The accounting policy election would be applied to all leases and disclosed in the notes to the financial statements.

Key differences between US GAAP and IFRS
The IASB's new standard would not provide an accounting policy election for lessees to use the risk-free rate for the initial and subsequent measurement of lease liabilities. Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

How we see it

- The rate implicit in the lease would not necessarily be the rate stated in the contract and could reflect the lessor's initial direct costs and estimates of residual value. Therefore, lessees may find it difficult to determine the rate implicit in the lease.
- While using a risk-free rate might reduce complexity for lessees applying the new standard, it would increase the likelihood that the present value of the lease payments and any residual value guaranteed by the lessee would amount to substantially all of the fair value of the leased asset, potentially resulting in a Type A lease. This might dissuade some non-PBE lessees from making a policy election to use a risk-free rate.

Reassessment of the discount rate (updated July 2015)

Lessees would reassess the discount rate only upon a lease modification, a change to the lease term or a change in whether the lessee is reasonably certain to exercise an option to purchase the underlying asset.

If a reassessment results in a change to the discount rate, lessees would remeasure the lease liability using a revised discount rate at the reassessment date and would adjust the right-of-use asset. However, if the right-of-use asset is reduced to zero, a lessee would recognize any remaining amount in profit or loss.

Lessors would be required to reassess the discount rate upon a contract modification to a Type A lease that does not result in a separate, new lease when the modified lease remains a Type A lease (i.e., when lease classification does not change).

Refer to Appendix A for a summary of lessee and lessor reassessment requirements.

Key differences between US GAAP and IFRS

Under the IASB's new standard, lessors would not be required to reassess the discount rate after lease commencement.

Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

Initial direct costs

Initial direct costs would be costs such as commissions that would not have been incurred if a lease had not been executed. Lessees and lessors would apply the same definition of initial direct costs. From the lessor's perspective, initial direct costs would be consistent with the concept of incremental costs in the new revenue recognition standard (i.e., ASC 606).

The new lease standard would require lessors to include initial direct costs in the initial measurement of their net investments in Type A leases. However, initial direct costs related to Type A leases that include recognized selling profit would be expensed at lease commencement. Lessors would recognize initial direct costs associated with Type B leases over the lease term on the same basis as lease income.

The new lease standard would require lessees to include their initial direct costs in their initial measurement of the right–of-use asset. Costs that a lessee incurs in a lease modification that meet the definition of initial direct costs would be included in the measurement of the new right-of-use asset (i.e., for a modification that results in a separate, new lease) or the adjustment to the right-of-use asset (i.e., for a modification that does not result in a separate, new lease).

How we see it

The FASB's clarification that only costs that wouldn't be incurred if a lease hadn't been executed would qualify as initial direct costs would result in two key changes in practice. Lessors' initial direct costs would exclude allocated costs (e.g., salaries) and costs incurred before the lease is executed (e.g., legal advice).

Economic life

The new standard would define the economic life of an asset as either:

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

This definition of economic life, while not the same as the definition in current US GAAP, is not expected to significantly change economic life estimates.

Fair value of the underlying asset

Under today's accounting, the fair value of leased property is defined as the price for which the property could be sold in an arm's length transaction between unrelated parties. ASC 820, *Fair Value Measurement*, which provides a framework for measuring fair value, defines fair value within that framework and establishes fair value measurement disclosure requirements. Importantly, the definition of fair value in ASC 820 does not apply to fair value measurements for the purposes of lease classification and measurement (with certain exceptions). That is, the fair value of leased property, which is used in classifying a lease and to determine the maximum amount at which a lessee can record an asset leased under a capital lease, is not a fair value measurement under the framework set out in the current US GAAP guidance.

How we see it

- The 2013 ED did not define fair value of the underlying asset or propose consequential amendments to ASC 820 to remove the scope exception for leases. Because the FASB did not address this topic in redeliberations, we do not anticipate the Board will change the meaning of fair value in the context of leased assets in the new standard.
- It is unclear whether the new standard will contain a "fair value constraint" that would set a maximum amount that could be used when recording a right-of-use asset.

Key differences between US GAAP and IFRS

As discussed above, the definition of fair value in ASC 820 would not apply to fair value measurements for the purposes of lease classification and measurement under the FASB's new standard. However, the measurement and disclosure requirements of IFRS 13, *Fair Value Measurement*, would apply to lease transactions within the scope of the IASB's new standard.

Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

Related party leasing transactions

The new standard would require lessees and lessors to account for related party leases on the basis of the legally enforceable terms and conditions of the lease. This would eliminate the current requirement under US GAAP for lessees and lessors to evaluate the economic substance of a lease to determine the appropriate accounting. Under the new standard, lessees and lessors would still be required to apply the disclosure requirements for related party transactions in accordance with ASC 850, *Related Party Disclosures*.

Key differences between US GAAP and IFRS
The IASB's new standard would not have guidance on the accounting for related party leasing transactions. Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

Lease classification (updated July 2015)

Under the new standard, lessees and lessors would classify all leases (with an optional exemption for short-term leases for lessees) using a principle similar to that of IAS 17. The principle in IAS 17 is similar to that of US GAAP but without today's bright lines. The new standard would eliminate ASC 840's real estate-specific guidance and would change its additional lessor classification criteria.

Lessees and lessors would classify leases using a principle similar to the one in IAS 17.

The new standard would require lessees to classify most leases as either Type A leases (generally today's capital leases) or Type B leases (generally today's operating leases). Lease classification would determine how and when a lessee would recognize lease expense.

Lessors would be required to classify all leases as either Type A leases or Type B leases (generally today's operating leases). There would be three categories of Type A leases: (1) those with selling profit that is recognized or deferred (generally today's sales-type leases), (2) those with no selling profit (generally today's direct financing leases), and (3) certain leases where collectibility of lease payments is not probable. Leases in the latter category would be recognized and measured in accordance with ASC 606 (i.e., a deferral of income similar to the new revenue standard). Refer to the lessor accounting section below for discussion of the recognition and measurement of lessors' leases.

Criteria for classification of leases (lessees and lessors)

At lease commencement, a lessee and a lessor would evaluate whether a lease meets any of the following criteria for purposes of lease classification: [6]

- The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
- The lessee is reasonably certain to exercise an option to purchase the underlying asset.
- The lease otherwise transfers substantially all the risks and rewards incidental to ownership of the underlying asset. Situations that individually or in combination would normally indicate this include:
  - The lease term is for a major part of the remaining economic life of the underlying asset.

- *For lessors* — The sum of the present value of the lease payments and any residual value guaranteed by any third party unrelated to the lessor (including the lessee) amounts to substantially all of the fair value of the underlying asset at lease commencement.
- *For lessees* — The sum of the present value of the lease payments and any residual value guaranteed by the lessee amounts to substantially all of the fair value of the underlying asset at lease commencement.
- The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term.

A lease would be classified as a Type A lease by lessees if it meets any one of the criteria above. At its May 2015 meeting, the FASB decided that for leases that meet any of the above criteria, a lessor would also consider whether the collectibility of lease payments is probable for purposes of lease classification.

If a lease does not meet any of the criteria above, it would be classified as a Type B lease by lessees and lessors.

Additional lessor classification criterion

Under the new standard, lessors would also be required to evaluate the collectibility of lease payments to determine lease classification. This assessment would also affect a lessor's recognition and measurement of its leases. Refer to the lessor accounting section below.

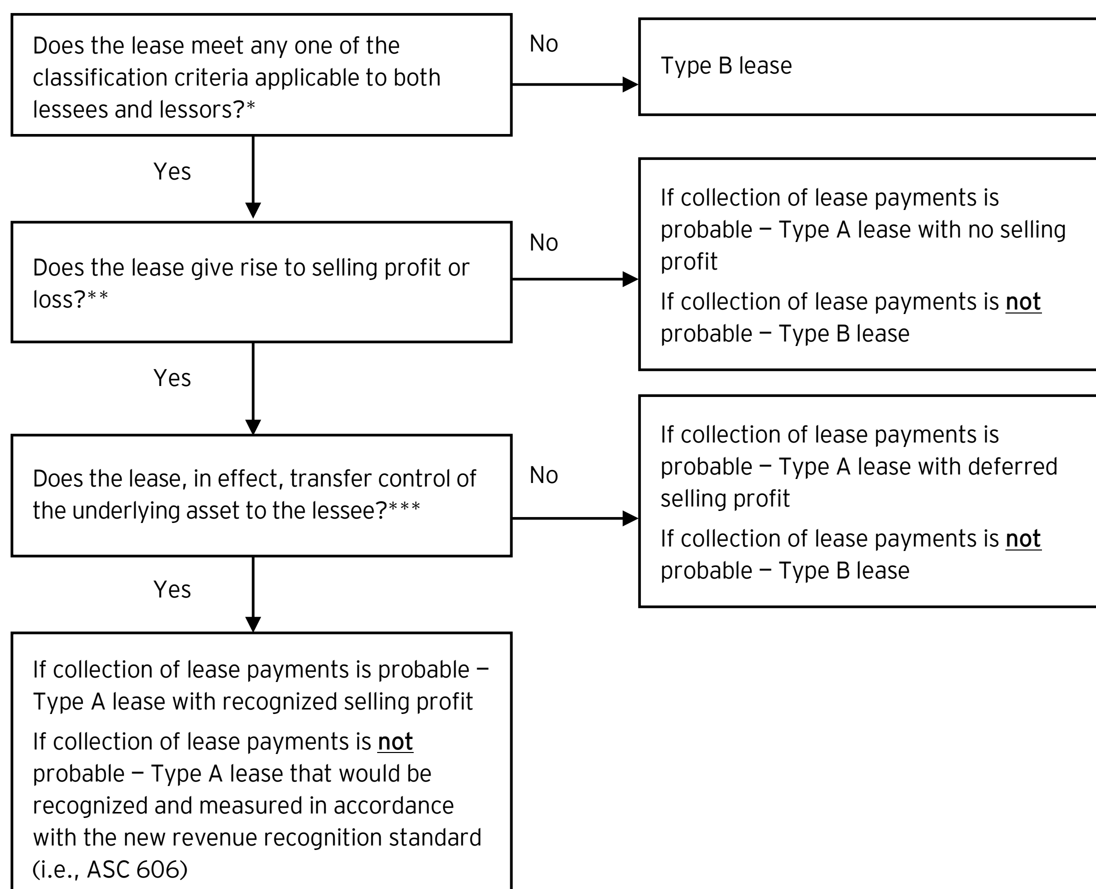
How we see it

Although the new standard's classification principle and criteria would be similar to that in IAS 17 today, there are three notable differences:

- The presence of any one of the IAS 17 classification indicators is not necessarily determinative of lease classification under IFRS today. However, it appears that the presence of any one of the new standard's classification criteria (described above) would result in a lease being classified as Type A for lessees and lessors (subject to the additional lessor collectibility criterion).
- Some of the classification indicators in IAS 17 today were not discussed in redeliberations or included in the new standard's criteria described above (e.g., a lessee's ability to continue the lease for a secondary period at a rent that is substantially lower than market rent, although this criterion may affect lease term and indirectly lease classification under the new standard).
- IAS 17 doesn't explicitly require lessors to assess the collectibility of lease payments for purposes of lease classification.

As a result, we believe the Board could further align the classification criteria with IAS 17 in the final standard.

The decision tree below summarizes the evaluation of lease classification for lessors, including the recognition and measurement alternatives for Type A leases, under the new standard. Note — the FASB could further clarify its decisions on lease classification, recognition and measurement for lessors in the final standard.



* See the criteria for classification of leases (lessees and lessors) section above.

** See the lessor accounting — selling profit or loss section below.

*** See the lessor accounting — determining whether to defer or recognize selling profit section below.

Other lease classification matters

Evaluating 'major part' and 'substantially all'

The terms "major part" and "substantially all" were not defined in the 2013 ED or during redeliberations. However, these terms are used to describe the indicators included today under IFRS to distinguish between finance and operating leases and were introduced into IFRS by borrowing from the bright-line tests used for lease classification in US GAAP.

Residual value guarantees included in the lease classification test

In evaluating the new standard's lease classification criteria, lessees would be required to include in the "substantially all" test the full amounts of residual value guarantees they provide. Lessors would be required to include in this test the full amounts of residual value guarantees provided by unrelated third parties, including the lessee.

Residual value guarantees would be treated differently when determining lease payments. Lessees would include amounts they expect to pay to lessors under residual value guarantees as lease payments. Lessors' lease payments receivable would generally exclude amounts under

residual value guarantees (from either the lessee or a third party) unless the residual value guarantee is in-substance a fixed lease payment. Refer to the lease payments section above.

Lease component with the right to use more than one interrelated asset

If a lease component contains the right to use more than one interrelated asset, the primary asset in the component would be used to determine lease classification. The primary asset would be the predominant asset for which the lessee has contracted the right to use. Any other assets in that lease component would facilitate the lessee's use of the primary asset. Entities would also refer to the economic life of the primary asset when making lease classification assessments.

Reassessment of lease classification

At its May 2015 meeting, the FASB decided that lessors would reassess lease classification upon a modification to a Type A lease that does not result in a separate, new lease. Refer to the lease modifications section above.

If a modification to a contract results in a separate, new lease, that new lease would be classified using the criteria described above.

Refer to Appendix A for a summary of lessee and lessor reassessment requirements.

The Boards reached different conclusions on lease classification for lessees and lessors.

How we see it

- It is unclear how lessors would reassess lease classification upon a modification to a Type A lease that does not result in a separate, new lease. For example, the assessment could be made as of the original lease inception date (using the modified terms) or at the effective date of the modification. It is also unclear whether the FASB intends to require lessors to reassess lease classification upon a modification to a Type B lease that does not result in a separate, new lease.
- In addition, it is unclear whether the final standard would require lessees to reassess lease classification upon a modification to a Type A or a Type B lease that does not result in a separate, new lease.

Key differences between US GAAP and IFRS

The Boards reached different decisions that would result is similar transactions being accounted for differently under US GAAP and IFRS.

Lessees

Lessees applying the FASB's new standard would use a dual model to recognize and measure leases with an option not to recognize and measure short-term leases. However, lessees applying the IASB's new standard would use a single recognition and measurement model for all leases (i.e., all leases would be Type A), with options not to recognize and measure both short-term leases and leases of small assets.

The FASB members who favored the dual model indicated that the FASB's new standard would be less costly for preparers to apply and for users to understand because it would use a lease classification principle similar to the one in ASC 840. The IASB members who favored the single model indicated that it is more conceptually sound because they believe that all leases contain a financing element. However, in lieu of the dual model, they did incorporate a small asset exemption. Some IASB members also indicated that the single model would be less costly to apply because preparers would not have to consider a classification test.

Lessors
Both new standards would use a dual model for all leases (i.e., all leases would be Type A or Type B). However, under the FASB's new standard, lessors would consider an additional criterion based on the collectibility of lease payments to classify leases.

Reassessment of lease classification
Lessors applying the FASB's new standard would reassess lease classification upon a modification to a Type A lease that does not result in a separate, new lease. Under the IASB's new standard, lease classification would not be reassessed after lease commencement for any lease.

Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

Lessee accounting

The new standard would require lessees to recognize all leases on the balance sheet, except for short-term leases if they choose to apply that exemption. At the commencement date of a lease, a lessee would recognize a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset).

The initial recognition of the right-of-use asset and the lease liability would be the same for Type A and Type B leases, as would the subsequent measurement of the lease liability. However, the subsequent measurement of the right-of-use asset for Type A and Type B leases would differ.

Initial recognition and measurement

The lease liability would be initially measured based on the present value of the lease payments to be made over the lease term. Lessees would apply the concepts described above to identify the lease components and to determine the lease term, lease payments and discount rate as of the commencement date of the lease. See the key concepts section above.

The right-of-use asset would initially be measured at cost and would consist of all of the following:

- The amount of the initial measurement of the lease liability
- Any lease payments made to the lessor at or before the commencement date, less any lease incentives received from the lessor (see the section on other lessee matters below)
- Any initial direct costs incurred by the lessee (see the section on initial direct costs above)

Subsequent measurement

Lease liabilities — Type A leases

The FASB believes that a lease liability for Type A leases should be accounted for in a manner similar to other financial liabilities (i.e., on an amortized cost basis). Consequently, the lease liability for Type A leases would be accreted using an amount that produces a constant periodic discount rate on the remaining balance of the liability (i.e., the discount rate determined at commencement, as long as a reassessment and a change in the discount rate have not been triggered). Lease payments would reduce the lease liability when paid.

Right-of-use assets — Type A leases

Amortization of the right-of-use asset would be recognized in a manner consistent with existing standards for nonfinancial assets that are measured at cost. Lessees would amortize the right-of-use asset on a straight-line basis, unless another systematic basis better represents the pattern in which the lessee expects to consume the right-of-use asset's future economic benefits. The right-of-use asset would generally be amortized over the shorter of the lease term or the useful life of the right-of-use asset. The amortization period would be the remaining useful life of the underlying asset if the lessee is reasonably certain to exercise a purchase option or if the lease transfers ownership of the underlying asset to the lessee by the end of the lease term.

Illustration 8 — Lessee accounting for a Type A lease

Entity H (lessee) enters into a three-year lease of equipment and concludes that the agreement is a Type A lease because the lease term is for a major part of the remaining economic life of the underlying asset (also three years). Entity H agrees to make the following annual payments at the end of each year: $10,000 in year one, $12,000 in year two and $14,000 in year three. For simplicity, there are no other elements to the lease payments (e.g., purchase options), payments to the lessor before the lease commencement date, lease incentives from the lessor or initial direct costs. The initial measurement of the right-of-use asset and lease liability is $33,000 (present value of lease payments using a discount rate of approximately 4.235%). Entity H uses its incremental borrowing rate because the rate implicit in the lease cannot be readily determined. Entity H determines the right-of-use asset should be amortized on a straight-line basis over the lease term.

Analysis: At lease commencement, Entity H would recognize the lease-related asset and liability:

Right-of-use asset	$ 33,000	
Lease liability		$ 33,000

To initially recognize the lease-related asset and liability

The following journal entries would be recorded in the first year:

Interest expense	$ 1,398	
Lease liability		$ 1,398

To record interest expense and accrete the lease liability using the interest method ($33,000 x 4.235%)

Amortization expense	$ 11,000	
Right-of-use asset		$ 11,000

To record amortization expense on the right-of-use asset ($33,000 ÷ 3 years)

Lease liability	$ 10,000	
Cash		$ 10,000

To record lease payment

A summary of the lease contract's accounting (assuming no changes due to reassessment) is as follows:

	Initial	Year 1	Year 2	Year 3
Cash lease payments		$ 10,000	$ 12,000	$ 14,000
Lease expense recognized				
Interest expense		$ 1,398	$ 1,033	$ 569
Amortization expense		11,000	11,000	11,000
Total periodic expense		$ 12,398	$ 12,033	$ 11,569
Balance sheet				
Right-of-use asset	$ 33,000	$ 22,000	$ 11,000	$ –
Lease liability	$ (33,000)	$ (24,398)	$ (13,431)	$ –

The total periodic expense (i.e., the sum of interest and amortization expense) of a Type A lease would generally be higher in the early periods and lower in the later periods. Because a consistent interest rate would be applied to the lease liability, which decreases as cash payments are made during the lease term, more interest expense would be incurred in the early periods and less would be incurred in the later periods. This trend in the interest expense, combined with the straight-line amortization of the right-of-use asset, would generally result in a front-loaded expense recognition pattern for Type A leases, which is consistent with the subsequent measurement of capital leases under ASC 840.

The separate recognition of interest and amortization expense for Type A leases is consistent with a view that such leases are effectively installment purchases. That is, the lessee is paying to finance the acquisition of the underlying asset that will be consumed during the lease term.

Lease liabilities — Type B leases

Lessees would calculate the lease liability for Type B leases at any point in time as the present value of the remaining lease payments using the discount rate determined at lease commencement, as long as a reassessment and a change in the discount rate hasn't been triggered.

How we see it

While we expect the new standard to describe the subsequent measurement of a Type B lease liability differently from that of a Type A lease liability, from a practical perspective, we expect the result of the subsequent measurement to be the same.

Right-of-use assets — Type B leases

Lessees would subsequently measure the right-of-use asset (absent any impairment) for a Type B lease at the amount of the remeasured lease liability (i.e., the present value of the remaining lease payments), adjusted for any lease incentives received, any cumulative prepaid or accrued rent if the lease payments are uneven throughout the lease term and any lessee initial direct costs. The presence of uneven lease payments or lessee initial direct costs would cause the measurement of the right-of-use asset to differ from that of the lease liability at points throughout the lease term.

Lessees would recognize periodic lease expense for Type B leases on a straight-line basis, similar to today's accounting for operating leases. Throughout the lease term, the lessee would recognize periodic lease expense as ***the greater of*** the following:

(1) 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

(2) The periodic accretion on the lease liability (i.e., the difference between (a) the lease liability at the beginning of the period less payments made during the period and (b) the lease liability at the end of the period)

The remaining cost of the lease (item (1) above) would be calculated as:

- Lease payments (determined at the lease commencement date)
- Plus lessee initial direct costs (determined at the lease commencement date)
- Minus the periodic lease cost recognized in prior periods
- Minus any impairment of the right-of-use asset recognized in prior periods
- Plus or minus any adjustments to reflect changes that arise from the remeasurement of the lease liability not recognized in profit or loss at the date of remeasurement (e.g., the present value of the additional lease payments a lessee is obligated to pay if it exercises a renewal option that it originally was not reasonably certain to exercise)

The periodic accretion on the lease liability might be higher than the remaining cost of the lease allocated over the remaining lease term in the case of a significant impairment of the right-of-use asset.

Illustration 9 — Lessee accounting for a Type B lease

Entity L (lessee) enters into a three-year lease of office space and concludes that the agreement is a Type B lease. Entity L agrees to pay the following annual payments at the end of each year: $10,000 in year one, $12,000 in year two and $14,000 in year three. For simplicity, there are no other elements to the lease payments (e.g., purchase options), payments to the lessor before the lease commencement date, lease incentives from the lessor or initial direct costs. The initial measurement of the right-of-use asset and lease liability is $33,000 using a discount rate of approximately 4.235%. Entity L uses its incremental borrowing rate because the rate implicit in the lease cannot be readily determined. Entity L calculates that the annual straight-line lease expense is $12,000 per year [($10,000 + $12,000 + $14,000) ÷ 3].

Analysis: At lease commencement Entity L would recognize the lease-related asset and liability:

	Debit	Credit
Right-of-use asset	$ 33,000	
Lease liability		$ 33,000

To initially recognize the lease-related asset and liability

The following journal entries would be recorded in the first year:

	Debit	Credit
Lease expense	$ 12,000	
Right-of-use asset		$ 2,000
Cash		$ 10,000
Lease liability	$ 8,602	
Right-of-use asset		$ 8,602

To record lease expense and adjust the right-of-use asset for the difference between cash paid and straight-line lease expense (i.e., accrued rent). To adjust the lease liability to the present value of the remaining lease payments with an offset to the right-of-use asset. The adjustment of $8,602 is calculated as the initially recognized lease liability ($33,000) less the present value of remaining lease payments ($24,398) at the end of Year 1.

A summary of the lease contract's accounting (assuming no changes due to reassessment) is as follows:

	Initial	Year 1	Year 2	Year 3
Cash lease payments:		$ 10,000	$ 12,000	$ 14,000
Income statement:				
Periodic lease expense (straight-line)		12,000	12,000	12,000
Prepaid (accrued) rent for period		$ (2,000)	$ –	$ 2,000
Balance sheet:				
Lease liability	$ (33,000)	$ (24,398)	$ (13,431)	$ –
Right-of-use asset				
Lease liability	$ 33,000	$ 24,398	$ 13,431	$ –
Adjust: prepaid/(accrued) rent (cumulative)	–	(2,000)	(2,000)	–
Right-of-use asset	$ 33,000	$ 22,398	$ 11,431	$ –

Lease expense would be presented in a single line item in the income statement. This presentation is consistent with the concept of the lessee paying to use the asset during the lease term, rather than paying to finance the acquisition of the underlying asset in a Type A lease.

Illustration 10 — Comparing the two types of leases for lessees

This table illustrates the similarities and differences in accounting for the two types of leases discussed in Illustrations 8 and 9:

Type A lease:

Time	Lease liability	ROU asset	Interest expense	Amortization expense	Total expense
Initial	$ 33,000	$ 33,000			
Year 1	$ 24,398	$ 22,000	$ 1,398	$ 11,000	$ 12,398
Year 2	$ 13,431	$ 11,000	1,033	11,000	12,033
Year 3	$ –	$ –	569	11,000	11,569
			$ 3,000	$ 33,000	$ 36,000

Type B lease:

Time	Lease liability	Cumulative prepaid or (accrued) rent[1]	ROU asset	Lease expense
Initial	$ 33,000	$ –	$ 33,000	
Year 1	$ 24,398	$ (2,000)	$ 22,398	$ 12,000
Year 2	$ 13,431	$ (2,000)	$ 11,431	12,000
Year 3	$ –	$ –	$ –	12,000
				$ 36,000

[1] Prepaid and accrued rent amounts would not be presented separately on the balance sheet. Instead, the ROU asset would be presented on the balance sheet net of cumulative prepaid or accrued amounts (if any).

The initial measurement of the right-of-use asset and the lease liability would be the same for Type A and Type B leases. Also, the same total lease expense would be recognized over the life of the arrangement. However, a lessee would generally recognize higher periodic lease expense in the earlier periods of a Type A lease than it would for a Type B lease.

Type A leases would generally have a front-loaded expense recognition pattern.

Changes in foreign currency exchange rates

Lessees would apply ASC 830, *Foreign Currency Matters*, to leases denominated in a foreign currency. Lessees would remeasure the foreign currency-denominated lease liability using the exchange rate at each reporting date. Any changes to the lease liability due to exchange rate changes would be recognized in profit or loss. Because the right-of-use asset is a nonmonetary asset measured at historical cost, it would not be affected by changes in the exchange rate.

Other lessee matters

Impairment

Lessees' right-of-use assets, for both types of leases, would be subject to existing impairment guidance in ASC 360, *Property, Plant, and Equipment*.

ASC 360 requires an analysis of impairment indicators at each reporting period. If any indicators are present, a recoverability test using undiscounted cash flows is performed. If the recoverability test fails, the standard requires a fair value test. Under the new leases standard, if an impairment loss is recognized, the adjusted carrying amount of a right-of-use asset would

be its new accounting basis. Consistent with ASC 360, the impairment test for right-of-use assets often would be performed at an asset-group level. The subsequent reversal of an impairment loss for an asset held for use would be prohibited.

How we see it

While lessees would apply existing impairment guidance in the same manner they currently do for assets held under capital leases (generally would be Type A leases), the analysis would be new for current operating leases (generally would be Type B leases). For leases that are not currently on the balance sheet, the requirement to test right-of-use assets for impairment could accelerate expense recognition (i.e., if an impairment occurs).

Lease incentives received or receivable at lease commencement

Lessees often receive incentives (e.g., an up-front cash payment for leasehold improvements or relocation expenses) for entering into a new lease. Today's operating lease accounting requires lessees to recognize lease incentives over the lease term as a reduction of lease expense.

Under the new standard, lease incentives that are receivable from the lessor at the commencement date (i.e., amounts are paid by the lessor after the lease commencement date) would be deducted from lease payments and the corresponding lease liability and right-of-use asset. Separately, lease incentives that a lessee receives from the lessor at or before lease commencement would reduce the initial measurement of the right-of-use asset. Similar to the result under current operating lease accounting, lease incentives would reduce lease expense for both types of leases over the lease term.

Lease incentives not received or receivable at lease commencement

The 2013 ED did not address lease incentives that are contingently receivable by the lessee at the lease commencement date (i.e., lease incentives that are not received or receivable until the occurrence of an event subsequent to lease commencement) nor were such incentives discussed during redeliberations. Examples include reimbursements for moving costs or leasehold improvements that become receivable by the lessee when the lessee incurs these costs.

How we see it

It remains unclear whether and, if so, how incentives that are not received or receivable at lease commencement would be considered in the recognition and measurement of lessees' lease-related assets and liabilities.

Purchase of a leased asset by the lessee during the lease term (updated July 2015)

The new standard would include ASC 840's existing guidance for the purchase of a leased asset by a lessee during the term of a capital lease for both Type A and Type B leases. A lessee would account for the purchase of the leased asset and the related lease termination as a single transaction. The difference between the purchase price and the carrying amount of the lease liability would be recorded as an adjustment to the carrying amount of the asset. No gain or loss would be recognized.

Key differences between US GAAP and IFRS
The IASB did not discuss a lessee's accounting for the purchase of a leased asset during the lease term. Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

Income tax accounting

The new standard would also affect lessees' accounting for income taxes. For lessees, the new standard would change the measurements of lease-related assets and liabilities, including the recognition of amounts that are not on the balance sheet today (i.e., amounts related to leases that are operating leases today), and the expense recognition pattern. These changes would affect many aspects of accounting for income taxes such as the following:

- Recognition and measurement of deferred tax assets and liabilities
- Assessment of the recoverability of deferred tax assets (i.e., the need for and measurement of a valuation allowance)

Presentation

While the new standard would change balance sheet presentation for lessees, the income statement and statement of cash flows presentation requirements for Type A leases and Type B leases would be similar to the current requirements for capital and operating leases, respectively.

The following table summarizes how lease-related amounts and activities would be presented in lessees' financial statements.

Financial statement	Lessee presentation
Balance sheet	‣ **Type A leases:** ‣ Right-of-use assets presented either: ‣ Separately from other assets (e.g., owned assets) ‣ Together with the corresponding underlying assets as if they were owned, with disclosures of the balance sheet line items that include Type A right-of-use assets and their amounts ‣ Lease liabilities presented either: ‣ Separately from other liabilities ‣ Together with other liabilities with disclosure of the balance sheet line items that include Type A lease liabilities and their amounts ‣ **Type B leases:** ‣ Right-of-use assets presented separately from Type A right-of-use assets with disclosure of the related balance sheet line items that include the Type B assets ‣ Lease liabilities presented separately from Type A lease liabilities ‣ The FASB decided not to otherwise specify how lessees would separately present Type B right-of-use assets and lease liabilities except to say the presentation should be rational and consistent with similar leases and appropriate based on the facts and circumstances
Income statement	‣ **Type A leases:** Lease-related amortization and lease-related interest expense would be presented separately (i.e., lease-related amortization and interest expense could not be combined) ‣ **Type B leases:** Lease-related expenses would be presented as a single line of lease or rent expense

<table>
<tr><th>Financial statement</th><th>Lessee presentation</th></tr>
<tr><td>Statement of cash flows</td><td>Type A leases: Cash payments for the principal portion of the lease liability would be presented within financing activities and cash payments for the interest portion would be presented within operating activities in accordance with ASC 230, Statement of Cash Flows
Type B leases: Cash payments for lease payments would be presented within operating activities
Both types of leases:
Lease payments for short-term leases not recognized on the balance sheet and variable lease payments (not included in the lease liability) would be presented within operating activities
Noncash activity (e.g., the initial recognition of the lease at commencement) would be disclosed as a supplemental noncash item</td></tr>
</table>

Key differences between US GAAP and IFRS

Under the IASB's new standard, cash paid for interest on Type A leases would be presented within operating or financing activities consistent with the entity's policy election under IAS 7, *Statement of Cash Flows*.

Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

Disclosure

The objective of lessee disclosures would be to enable financial statement users to assess the amount, timing and uncertainty of cash flows arising from leases. Lessees would exercise judgment to determine the appropriate level at which to aggregate, or disaggregate, disclosures so that meaningful information will not be obscured by insignificant details or by groupings of items with different characteristics. The disclosure requirements would apply to both public and nonpublic business entities.

Qualitative disclosures

Lessees would be required to disclose the following qualitative information:

- The nature of their leases (and subleases, as applicable), including:
  - A general description of those leases
  - The basis, and terms and conditions, on which variable lease payments are determined
  - The existence, and terms and conditions, of options to extend or terminate the lease (including descriptions of the options that are recognized as part of the right-of-use assets and lease liabilities and those that are not)
  - The existence, and terms and conditions, of lessee residual value guarantees
  - The restrictions or covenants imposed by leases (e.g., those related to dividends or incurring additional financial obligations)
- Information about leases that have not yet commenced but that create significant rights and obligations for the lessee

- Information about the significant judgments and assumptions made in accounting for leases, which might include:
  - The determination of whether a contract contains a lease
  - The allocation of contract consideration between lease and non-lease components
  - The determination of the discount rate
- The main terms and conditions of any sale and leaseback transactions
- Whether an accounting policy election was made for the short-term lease exemption

Lessees would be required to provide these qualitative disclosures in sufficient detail such that the lessee disclosure objective is met.

The new standard would expand lessees' disclosures to include judgments made and assumptions used to account for leases.

Quantitative disclosures

Lessees would be required to disclose the following quantitative information:

- Type A lease expense (with amortization of right-of-use assets disclosed separately from interest on lease liabilities)
- Type B lease expense
- Short-term lease expense for such leases with a lease term greater than one month
- Variable lease expense
- Sublease income
- Cash paid for amounts included in the measurement of lease liabilities separately by lease type (i.e., Type A , Type B) and segregated between operating and financing cash flows
- Supplemental noncash information on lease liabilities arising from obtaining right-of-use assets (e.g., for new leases) separately by lease type
- Weighted-average remaining lease term, separately by lease type
- Weighted-average discount rate as of the reporting date, separately by lease type
- Gains and losses arising from sale and leaseback transactions

Expense items disclosed would also include any amounts capitalized as part of the cost of another asset.

The new standard would not require a specific format for lessees' quantitative disclosures, but would include an example presenting quantitative disclosures in a tabular format.

Lessees would also be required to disclose a maturity analysis of lease liabilities. The maturity analysis would include undiscounted cash flows, on an annual basis, for a minimum of each of the five years after the balance sheet date and a total of the amounts for the remaining years (i.e., the total undiscounted cash flows beyond the fifth year). The analysis would also include a reconciliation of the undiscounted cash flows to the lease liabilities presented on the balance sheet.

Key differences between US GAAP and IFRS
The IASB's new standard would not require specific qualitative disclosures. Instead, lessees would be required to disclose qualitative information necessary to satisfy the lessee disclosure objective. The FASB and the IASB differ on specific lessee quantitative disclosure requirements mainly because of differences in the lessee accounting models. For example, the FASB's new standard would require the disclosure of Type B lease expense, which is not applicable under the IASB's new standard (under which all lessee leases would be Type A). In addition, the FASB would not require a specific format for lessee quantitative disclosures. However, the IASB would require the disclosure to be made in a tabular format unless another format is more appropriate. Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

Lessor accounting (updated July 2015)

As discussed in the lease classification section, lessors would classify all leases as Type A or Type B. There would be three categories of Type A leases, which would affect how those leases are recognized and measured:

- Type A leases with selling profit that is recognized or deferred (similar to ASC 840's sales-type leases)
- Type A leases with no selling profit (similar to ASC 840's direct-financing leases)
- Type A leases that would be recognized and measured in accordance with ASC 606 (also refer to the lease classification section above)

Under the new standard, lessors would account for a Type B lease using an approach similar to ASC 840's operating leases.

Lessors would account for Type A leases with and without selling profit using approaches similar to ASC 840's guidance for sales-type and direct financing leases, respectively. However, there would be two key differences. First, the initial recognition of selling profit (if any) on a Type A lease would be deferred if the lease does not, in effect, transfer control of the underlying asset to the lessee. Second, a lessor would follow the guidance in ASC 606 if a lease would otherwise be a Type A lease with recognized selling profit except that the collection of lease payments is not probable. These differences are discussed further in the lessor accounting concepts section below.

Under the new standard, leveraged lease accounting would be eliminated for new leases after the effective date. That is, lessors would account for new leases, including those that would qualify as leveraged leases under ASC 840, using the classifications discussed above. However, leveraged leases that exist at transition would be grandfathered. Refer to Appendix B for further discussion on leveraged lease accounting.

Lessor accounting concepts

At lease commencement, lessors would apply the key concepts described earlier in this publication to determine the initial direct costs, lease term, lease payments and discount rate. Lessors would also apply the following concepts to recognize and measure their Type A leases.

Net investment in the lease

A lessor's net investment in a Type A lease would consist of the lease receivable and any unguaranteed residual asset.

- Lease receivable — The lease receivable would be the total lease payments (see the lease payments section above) discounted using the rate implicit in the lease and any guaranteed residual asset. Initial direct costs incurred as part of Type A leases without recognized selling profit would be included in the lease receivable. However, initial direct costs related to Type A leases with initially recognized selling profit would be expensed at lease commencement.
- Unguaranteed residual asset — The unguaranteed residual asset would be the lessor's right to the expected unguaranteed value of the leased asset at the end of the lease.
- Deferred selling profit — Selling profit would be deferred and would reduce the lessor's net investment in the lease when the lessor does not, in effect, transfer control of the underlying asset to the lessee.

Selling profit or loss

Selling profit would be the difference (if any) between the fair value of the underlying asset and its carrying amount. Leases that give rise to a manufacturer's or dealer's profit or loss to the lessor normally result when a company uses leasing as a means of marketing its products. A loss upon sale would be recognized immediately, but a loss may indicate that the underlying asset was impaired prior to the transaction.

Determining whether to defer or recognize selling profit – Type A leases with selling profit

For purposes of determining whether selling profit should be initially recognized or deferred, the new standard would require a lessor to determine whether the lease, in effect, transfers control of the underlying asset to the lessee. This evaluation considers the lease classification criteria applicable to lessees and lessors (discussed above), except that the control evaluation would exclude any risks and rewards transferred to parties other than the lessee. For example, a lessor would exclude residual value guarantees or asset buyback commitments from a third party unrelated to the lessee when evaluating whether selling profit can be recognized. Under this evaluation, control would be deemed to have transferred if any one of those lease classification criteria is met and selling profit would be recognized assuming that collectibility of the lease payments is probable.

The new standard would include this additional condition for the recognition of initial selling profit to better align the leases guidance with the principles in the new revenue recognition standard (i.e., ASC 606). That is, a lessor would evaluate the transfer of control of the underlying asset from the **lessee's** perspective and consider the risks and rewards transferred to only the lessee, just as the new revenue recognition standard requires control to be evaluated from the customer's perspective. However, if the lessee does not obtain control of the underlying asset, the lessor would defer any initial selling profit and amortize it over the lease term in a manner that, when combined with the interest income on the lease receivable and the unguaranteed residual asset, would produce a constant periodic rate of return on the lease.

How we see it

A lessor's recognition of initial selling profit for leases of part of a real estate asset (e.g., a floor of a building) under the new standard would be a significant change from current practice.

Key differences between US GAAP and IFRS
Under the IASB's new standard, lessors would be permitted to initially recognize profit (if any) on all Type A leases including those with significant third-party residual value guarantees. Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

Collectibility

The new standard would require lessors to evaluate the collectibility of lease payments to determine lease classification. Refer to the lease classification section above. This assessment would also affect the recognition and measurement of leases. A lessor would follow the guidance in ASC 606 if a lease would otherwise be a Type A lease with recognized selling profit except that the collection of lease payments is not probable. A lessor would apply the recognition and measurement provisions for a Type B lease to a lease that would otherwise be a Type A lease with deferred selling profit or no selling profit except that the collection of lease payments is not probable.

Type B leases

Lessors' Type B leases would be similar to today's operating leases.

Lessors would account for Type B leases in a manner similar to today's operating leases. That is, they would continue to recognize the underlying asset. At lease commencement for Type B leases, lessors would not recognize a net investment in the lease (i.e., a lease receivable and any unguaranteed residual asset) on the balance sheet or initial profit (if any) on the income statement. The underlying asset would continue to be accounted for in accordance with applicable accounting standards (e.g., ASC 360).

Lessors would recognize lease payments from Type B leases over the lease term on either a straight-line basis or another systematic basis if that basis better represents the pattern in which income is earned from the underlying asset. Lessors in a Type B lease would recognize initial direct costs as an expense over the lease term on the same basis as lease income.

In some cases, another systematic basis of accounting might better represent the pattern in which the lessor earns income. For example, variable lease payments that do not depend on an index or rate would be recognized as they are earned (i.e., when the variable payments become receivable). Likewise, "stepped" rent increases that are intended to compensate a lessor for expected increases in market rental rates would be recognized based on the contractual cash flows (i.e., as the stepped payments become receivable). In both examples, revenue would be recognized on a basis other than straight line because it better reflects the pattern in which the revenue is earned.

If lease payments are uneven for reasons other than to compensate the lessor for expected increases in market rentals or changes in market conditions, the lease revenue would be recognized on a straight-line basis. For example, lease payments might be front-loaded or back-loaded or a lease might include a rent-free period. The uneven pattern of these lease payments generally would not be related to the way in which the lessor earns revenue. Therefore, they would not support revenue recognition on a basis other than straight line.

How we see it

Determining that lease payments in a Type B lease should be recognized on a basis other than straight line would likely require judgment. There might not be a clear distinction between increases in scheduled lease payments that reflect the pattern in which lease income is earned (e.g., "stepped" increases intended to compensate the lessor for changes in the market rentals or market conditions) and other scheduled increases that do not.

Type A leases with selling profit — recognized or deferred

Initial recognition and measurement

Upon commencement of a Type A lease with selling profit, lessors would:

- Derecognize the carrying amount of the underlying asset
- Recognize the net investment in the lease
- Recognize, in net income, selling profit on leases in which the lessee, in effect, obtains control of the underlying asset
- Defer selling profit on leases in which the lessee, in effect, does not obtain control of the underlying asset

Subsequent measurement

After lease commencement, lessors would account for a Type A lease with selling profit as follows:

- Recognize interest income (in profit or loss) over the lease term using the rate implicit in the lease on the components of the net investment in the lease, including:
  - Interest on the lease receivable
  - Accretion of the unguaranteed residual asset to its expected undiscounted value at the end of the lease
- Amortize any deferred selling profit as interest income over the lease term in a manner that, when combined with the interest income on the lease receivable and the unguaranteed residual asset, would produce a constant periodic rate of return on the lease — only applicable for Type A leases with selling profit for which control has not transferred to the lessee
- Reduce the net investment in the lease for lease payments received (net of interest income and recognized profit calculated above)
- Separately recognize income from variable lease payments that are not included in the net investment in the lease (e.g., performance- or usage-based variable payments) in the period in which that income is earned

Type A leases with no selling profit

Initial recognition and measurement

Upon commencement of a Type A lease with no selling profit, lessors would:

- Derecognize the carrying amount of the underlying asset
- Recognize the net investment in the lease

Subsequent measurement

After lease commencement, lessors would account for a Type A lease with no selling profit as follows:

- Recognize interest income (in profit or loss) over the lease term using the rate implicit in the lease on the components of the net investment in the lease, including:
  - Interest on the lease receivable
  - Accretion of the unguaranteed residual asset to its expected undiscounted value at the end of the lease

- Reduce the net investment in the lease for lease payments received (net of interest income calculated above)
- Separately recognize income from variable lease payments that are not included in the net investment in the lease (e.g., performance- or usage-based variable payments) in the period in which that income is earned

Type A leases that would be recognized and measured under ASC 606

A lessor would recognize and measure a lease with selling profit that, in effect, transfers control of the underlying asset to the lessee for which collectibility of lease payments is not probable in accordance with the new revenue recognition standard.

If collection of the lease payments for those leases is not probable, the lessor would defer income recognition (i.e., a deferral of income similar to the new revenue standard).

How we see it

Lessors should monitor the discussions of the FASB for any potential amendments to the new revenue recognition standard.

Reassessment

Lessors would not be required to reassess the lease term or lease payments after lease commencement. Refer to Appendix A for a summary of lessee and lessor reassessment requirements. If a lease is modified, refer to the lease modifications section above.

Other lessor matters in Type A leases

Sale of lease receivables

The new standard would require lessors to measure all lease receivables, including those held for sale, at amortized cost.

How we see it

We expect the Basis for Conclusions to indicate that it would be appropriate for lessors to apply the existing financial asset derecognition guidance in ASC 860, *Transfers and Servicing*, when they sell lease receivables, including any guaranteed residual values.

Impairment of the net investment in the lease

The new standard would require lessors to evaluate their entire net investment in the lease (when applicable) for impairment using the guidance in ASC 310. This is a change from the 2013 ED that would have required lessors to apply the impairment guidance in ASC 310 to lease receivables and ASC 360 to the unguaranteed residual asset.

Classification of the underlying asset at the end of a lease

At the end of the lease term, lessors may receive the underlying asset back from the lessee. Under the new standard, lessors would reclassify the carrying amount of the unguaranteed residual asset to the applicable category of assets (e.g., property, plant and equipment). Thereafter, lessors would account for the underlying asset using other applicable accounting guidance (e.g., ASC 360).

Income tax accounting

The new standard could affect lessors' accounting for income taxes. Applying the new standard could change the recognition of lease-related assets (i.e., lease receivables and any unguaranteed residual assets), the measurement of lease-related assets and the derecognition of underlying assets for certain leases that are subject to operating leases today. The new standard also would change the timing of recognition of lease income for some leases. In addition, the special accounting for leveraged leases would be eliminated, except for leveraged leases that exist at the transition date, which would be grandfathered.

These changes could affect many aspects of accounting for income taxes, such as the following:

- Recognition and measurement of deferred tax assets and liabilities
- Assessment of the recoverability of deferred tax assets (i.e., the need for and measurement of valuation allowances)

Presentation

The table below summarizes how lease-related amounts and activities would be presented in lessors' financial statements. The FASB has not addressed presentation of Type A leases that would be recognized and measured in accordance with the new revenue recognition standard.

Financial statement	Lessor presentation
Balance sheet	‣ **Type A leases:** ‣ Lease assets (i.e., lease receivables and unguaranteed residual assets) would be presented separately from other assets ‣ Lease receivables and unguaranteed residual assets could be presented separately from each other or, if presented together (i.e., the net investment in the lease), they would be separately disclosed in the notes ‣ **Type B leases:** Underlying assets would be presented in accordance with applicable guidance
Income statement	‣ **Both types of leases:** Income arising from leases would be presented separately from other activity, or disclosed in the notes (along with the corresponding line item(s) in the income statement), although when leasing activity is material, public business entities would be required to present such activity separately ‣ **Type A leases:** ‣ Profit or loss recognized at the commencement date would be presented on either a gross or net basis, based on the lessor's business model ‣ Lessors that use leasing as an alternative means of realizing value from goods they would otherwise sell would present lease revenue and cost of goods sold on a gross basis (i.e., revenue and costs in separate line items) ‣ Lessors that use leases for the purpose of providing finance would present the gain or loss on a net basis (i.e., in a single line item) ‣ Interest on the net investment in the lease would be presented as interest income
Statement of cash flows	‣ **Both types of leases:** Cash lease payments received would be presented within operating activities

Disclosure

The disclosures that would be required for lessors are intended to help financial statement users understand the amount, timing and uncertainty of lease-related cash flows. These disclosures would include the amounts of recognized lease-related assets and liabilities, significant judgments and assumptions about lease terms, payments, the existence of residual value guarantees and options to extend or terminate a lease. Lessors would exercise judgment to determine the level at which to aggregate, or disaggregate, the disclosures. Disclosures would need to be disaggregated or aggregated at an appropriate level so that the information is meaningful to the financial statement users and is not obscured by insignificant details or by grouping items with different characteristics. The FASB has not addressed disclosures for Type A leases that would be recognized and measured in accordance with the new revenue recognition standard.

General disclosure requirements

Lessors would be required to disclose information about the nature of leases, such as:

- A general description of the leases
- The basis, and terms and conditions, on which variable lease payments are determined
- The existence, and terms and conditions, of options to extend or terminate the lease
- The existence, and terms and conditions, of options for a lessee to purchase the underlying asset

Lessors would be required to disclose more information about how they manage the risks related to residual values of assets under lease.

As noted above, the new standard would also require lessors to disclose information about the significant judgments and assumptions made in accounting for leases. For example, a lessor might disclose information about its judgments and assumptions associated with:

- The determination of whether a contract contains a lease
- The identification of the lease and non-lease components of a contract
- The allocation of the consideration in a contract between the lease and non-lease components
- The initial measurement of the residual asset included in the net investment in the lease
- Any other means by which the lessor reduces its residual asset risk (e.g., buyback agreements, variable lease payments for lessee use in excess of specified limits)

Lessors would also disclose lease income recognized in the reporting period, in a tabular format. The disclosure would include:

- For Type A leases:
    - Profit or loss recognized at the commencement date (presented gross or net, consistently with the lessor's business model)
    - The interest income on net investments in leases (i.e., lease receivables and unguaranteed residual assets), either individually for each component of the net investment or in the aggregate
- For Type B leases, lease income relating to lease payments
- Lease income relating to variable lease payments not included in the measurement of net investments in Type A leases

Other quantitative and qualitative disclosures — Type A leases

Under the new standard, lessors would be required to qualitatively and quantitatively explain significant changes in residual values of assets under Type A leases. However, disclosure of significant changes in the lease receivable portion of the net investment would follow other US GAAP.

Key differences between US GAAP and IFRS
Under the IASB's new standard, lessors would be required to explain significant changes in the net investment in both qualitative and quantitative terms. Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

To help financial statement users understand and evaluate liquidity risks of lease-related cash flows, lessors would be required to disclose a maturity analysis of undiscounted cash flows to be received, on an annual basis, for five years after the balance sheet date, and in total thereafter, that comprise Type A lease receivables and a reconciliation to lease receivables presented on the balance sheet (or in the notes).

Other quantitative disclosures — Type B leases

Lessors would be required to provide a separate maturity analysis of the undiscounted future lease payments to be received for Type B leases, as of the reporting date. The maturity analysis would include undiscounted cash flows to be received, on an annual basis, for five years after the balance sheet date, and in total thereafter.

For assets leased under Type B leases, lessors would be required to disclose the same information that is currently required under ASC 360 for property, plant and equipment (e.g., balances by major class, accumulated depreciation, a general description of method of computing depreciation).

Other considerations

Subleases

Lessees often enter into arrangements to sublease a leased asset to a third party while the original lease contract remains in effect. In these arrangements, one party acts as both the lessee and lessor of the same underlying asset. The original lease is often referred to as a head lease, the original lessee is often referred to as an intermediate lessor and the ultimate lessee is often referred to as the sub-lessee.

Intermediate lessor accounting

An intermediate lessor would assess sublease classification independently of the classification assessment that it makes as the lessee of the same asset. Under the new standard, an intermediate lessor would consider the lease classification criteria with reference to the underlying asset when classifying a sublease. See the lease classification section above.

Key differences between US GAAP and IFRS
Under the IASB's new standard, intermediate lessors would be required to consider the right-of-use asset when determining sublease classification. Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

An intermediate lessor generally would account for a head lease (as a lessee) and a sublease (as a lessor) as two separate lease contracts. However, when contracts are entered into at or near the same time, an intermediate lessor would be required to consider the criteria for combining contracts (i.e., whether the contracts are negotiated as a package with a single commercial objective or the consideration to be paid in one contract depends on the price or performance of the other contract. See the contract combinations section above for more information. If either criterion is met, the intermediate lessor would account for the head lease and sublease as a single combined transaction.

Today's guidance for subleases that are loss contracts would be eliminated. Therefore, intermediate lessors would assess right-of-use-assets that are subject to a sublease for impairment under the long-lived asset impairment provisions of ASC 360. Refer to Appendix B for a summary of current US GAAP lease and lease-related accounting guidance that would be eliminated under the new standard and guidance that may be eliminated pending further FASB discussions.

Sub-lessee accounting

The FASB concluded that a sub-lessee would classify the sublease by referring to the underlying asset rather than by referring to the right-of-use asset arising from the head lease.

Presentation

Intermediate lessors would generally present sublease revenues on a gross basis.

Intermediate lessors would not be permitted to offset lease liabilities and lease assets that arise from a head lease and a sublease, respectively, unless those liabilities and assets meet the requirement of ASC 210-20, *Balance Sheet — Offsetting*, for offsetting financial instruments. Intermediate lessors would apply the principal-agent guidance from the new revenue recognition standard (refer to ASC 606-10-55-36 through 55-40) to determine whether sublease revenue should be presented on a gross or net basis (i.e., reduced for head lease expenses). The FASB expects that intermediate lessors would generally present sublease revenue on a gross basis.

How we see it

Various aspects of the new standard (e.g., the principal-agent considerations for sublease revenue) would align with the new revenue recognition standard (i.e., ASC 606). Lessors should familiarize themselves with the new revenue standard because it could also influence their accounting for leases. In addition, lessors should monitor developments as the Board considers amending the new revenue standard.

Disclosure

In addition to the lessee and lessor disclosure requirements discussed previously, the new standard would require an intermediate lessor to disclose the following information relating to its subleases:

- A general description of the leases
- The basis, and terms and conditions, on which variable lease payments are determined
- The existence, and terms and conditions, of options to extend or terminate the lease
- The existence, and terms and conditions, of residual value guarantees provided by the sub-lessee
- The restrictions or covenants imposed by leases (e.g., those related to dividends or incurring additional financial obligations)

Business combinations

Classification of acquired leases

The new standard would require an acquirer to classify acquired leases using the contractual terms and conditions at the commencement date of the lease. If the contractual terms and conditions of a lease are modified as part of the business combination, the acquirer would classify the new lease based on the contractual terms and conditions of that new lease.

How we see it

- Under the new standard, no lease assets and liabilities would be recognized for acquired leases that have a remaining term of 12 months or less. We believe the acquirer would generally recognize lease payments on a straight-line basis over the remaining lease term following the business combination.
- It is unclear whether the acquirer's accounting for leases with a remaining term of 12 months or less would preclude the recognition of assets and liabilities for off-market contract terms or in-place leases. Precluding the recognition of these assets and liabilities would be inconsistent with the principles in ASC 805, *Business Combinations*, that typically result in the recognition of assets and liabilities for both the in-place leases and related off-market terms of contracts.

Acquiree in a business combination is a lessee

Initial measurement of a lease

The acquirer would measure the acquired lease liability as if the lease contract were a new lease at the acquisition date. That is, the acquirer would apply the new standard's initial measurement provisions, using the present value of the remaining lease payments at the acquisition date. The acquirer would follow the guidance for determining the lease term, lease payments and discount rate. The right-of-use asset would be measured at an amount equal to the recognized liability, adjusted to reflect both of the following:

- Favorable or unfavorable terms of the lease, relative to market terms
- Any other intangible asset associated with the lease, which may be evidenced by market participants' willingness to pay for the lease even if it is at market terms (e.g., a lease of gates at an airport, a lease of retail space in a prime shopping area that provides entry to the market or other future economic benefits that qualify as an intangible asset)

Because the off-market nature of the lease would be captured in the right-of-use asset, the acquirer would not separately recognize an intangible asset or liability for favorable or unfavorable lease terms relative to market. The classification of the lease would not affect the initial measurement of the lease liability or the right-of-use asset.

Subsequent measurement of a lease

The subsequent measurement of an acquired lease liability and right-of-use asset would be determined using the subsequent measurement guidance for pre-existing lease arrangements (refer to the lessee accounting section above).

Acquiree in a business combination is a lessor

Initial measurement of a lease when the acquiree is a Type A lessor

The acquirer would measure a lease receivable as if the lease contract were a new lease at the acquisition date (i.e., measured at the present value of the remaining lease payments). The acquirer would use the key concepts described previously to determine the lease term, lease payments and discount rate. An unguaranteed residual asset would be initially measured as

the difference between the acquisition date fair value of the underlying (acquired) asset and the initial measurement of the lease receivable portion of the net investment in the lease. The acquirer would take into consideration the terms and conditions of the lease (e.g., off-market terms) when calculating the acquisition date fair value of the underlying asset. An acquirer would not recognize a separate intangible asset or liability for favorable or unfavorable terms, relative to market.

Initial measurement of a lease when the acquiree is a Type B lessor

Underlying assets subject to Type B leases would remain on the lessor's balance sheet. Therefore, when an acquiree is a lessor, an underlying asset subject to a Type B lease would be recognized on the acquirer's balance sheet and initially measured at fair value. The acquirer would consider the terms and conditions of the lease (e.g., off-market terms) when measuring the fair value of the underlying asset (e.g., a building). No separate intangible asset or liability for favorable or unfavorable terms relative to market would be recognized.

Subsequent measurement of a lease

The subsequent measurement of the net investment in a Type A lease would be determined using the subsequent measurement guidance for pre-existing lease arrangements (see the lessor accounting section above). The subsequent measurement of the underlying asset subject to a Type B lease would be determined using other applicable accounting guidance (e.g., ASC 360).

To determine how to account for a sale and leaseback transaction, a seller-lessee would consider the control criteria in the new revenue standard.

How we see it

The FASB did not revisit its 2013 proposals on leases acquired in business combinations in redeliberations. The FASB may need to align the new guidance in the final standard to reflect its decisions on lease classification and lessee and lessor accounting.

Sale and leaseback transactions

Because lessees would recognize most leases on the balance sheet (i.e., all leases except for short-term leases depending on the lessee's accounting policy election), sale and leaseback transactions would no longer provide lessees with a source of off-balance sheet financing.

A seller-lessee would use the definition of a sale in the new revenue recognition standard (i.e., ASC 606), in conjunction with additional guidance described below, to determine whether a sale has occurred in a sale and leaseback transaction. The seller-lessee would assess whether the buyer-lessor has gained control of the underlying asset. Control of an underlying asset refers to the ability to direct the use of the asset and obtain substantially all of the remaining benefits from the asset.

If control of an underlying asset passes to the buyer-lessor, the transaction would be accounted for as a sale and a lease by the lessee. If not, the transaction would be accounted for as a financing.

The FASB decided to retain the guidance in the 2013 ED that a buyer-lessor would account for the purchase of the underlying asset consistent with the guidance that would apply to any other purchase of a nonfinancial asset (i.e., without the presence of the leaseback).

How we see it

We generally expect more transactions to be accounted for as sales and leasebacks under the new standard than under today's standard.

Ability to direct the use of an underlying asset

While the concepts of "control" in the new leases standard and the new revenue recognition standard (i.e., ASC 606) are similar, a key difference exists. Under the new leases standard, the right to control the use of an underlying asset would involve the right to direct how and for what purpose the asset is used throughout the period of its use. Under ASC 606, control will be based on a broader consideration of rights with respect to the asset over its entire useful life.

The presence of a leaseback, in and of itself, would not preclude a sale. However, the FASB decided that a sale and a purchase would not occur when a leaseback involves a Type A lease from the seller-lessee's perspective. The FASB believes that a lessee's Type A lease is effectively a financed purchase of the underlying asset. Therefore, it would be inappropriate for a seller-lessee to account for the sale of an underlying asset that it concurrently repurchases. Instead, these transactions would be accounted for as financings.

While a seller's repurchase option would generally preclude sale accounting under ASC 606, the new leases standard would specify that repurchase options would not preclude sale accounting when **all** of the following conditions are met:

- The option is exercisable only at the then-prevailing fair market value (i.e., at the time of exercise) of the underlying asset.
- The underlying asset is a non-specialized asset.
- The underlying asset is readily available in the marketplace.

The FASB believes that such a repurchase option is effectively non-substantive in the context of a sale and leaseback transaction and therefore should not preclude sale accounting in such a transaction. The FASB staff indicated that it believes real estate would not meet the non-specialized asset condition above.

How we see it

- During redeliberations, the FASB discussed an example of a leased automobile and appeared to agree that such an asset would generally be non-specialized and would be readily available in the marketplace. However, determining when an underlying asset is non-specialized and readily available in the marketplace could require judgment.
- In a sale and leaseback transaction, it is unclear whether options to extend a lease for the remaining economic life of the underlying asset would be evaluated in the same manner as purchase options under the new revenue standard (i.e., ASC 606).

Key differences between US GAAP and IFRS

Under the IASB's new standard, no sale would occur when the seller-lessee has a substantive repurchase option. The IASB does not plan to provide further guidance about when repurchase options would be considered substantive. Additionally, sale accounting is not prohibited for Type A leasebacks because all leases are Type A leases for lessees under the IASB's new standard.

Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

Transactions in which the buyer-lessor obtains control of the underlying asset

Accounting for the sale

When the seller-lessee transfers control of the underlying asset to the buyer-lessor in a sale and leaseback transaction, the seller-lessee would do each of the following:

- Derecognize the underlying asset
- Recognize a lease liability and right-of-use asset for the leaseback (subject to the optional exemption for short-term leases)
- Recognize the gain or loss, if any, immediately (adjusted for off-market terms)

Key differences between US GAAP and IFRS

Under the IASB's new standard, gain recognition would be limited to the portion related to the buyer-lessor's residual asset. The remaining gain would be recognized as a reduction to the initial measurement of the seller-lessee's right-of-use asset and thus reflected as a reduction in amortization of the right-of-use asset over the term of the leaseback.

Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

Accounting for the leaseback

When a sale occurs, both the seller-lessee and the buyer-lessor would account for the leaseback in the same manner as any other lease (i.e., in accordance with the lessee and lessor guidance, respectively, with adjustments for any off-market terms).

Adjustment for off-market terms

The sale transaction and the ensuing lease are generally interdependent and negotiated as a package. Consequently, in some cases the transaction could be structured with a negotiated sales price above fair value and with lease payments for the ensuing lease above the then-current market rates, or vice-versa. Under either scenario, the off-market terms could distort the gain on sale (or disposition) and the recognition of lease expense for the ensuing lease. To ensure that the gain or loss on disposition and the lease-related assets and liabilities associated with such transactions are not understated or overstated, the FASB decided to require adjustments for any off-market elements of sale and leaseback transactions.

The off-market adjustments would be determined using the fair value of the underlying asset or the market lease payments, whichever provides the more readily determinable evidence. Entities would be expected to maximize the use of observable prices and information when determining which measure is the most appropriate to use.

When the sale price is (or the total lease payments are) less than the underlying asset's fair value (or the total market lease payments), a seller-lessee would increase the initial measurement of the right-of-use asset. This treatment would be similar to the accounting for lease prepayments under the new standard. When the sale price is (or the total lease payments are) greater than the underlying asset's fair value (or the total market lease payments), a seller-lessee would recognize an additional financial liability (i.e., additional financing received from the buyer-lessor) separately from the lease liability.

Buyer-lessors would also be required to adjust the purchase price of the underlying asset for any off-market terms. Such adjustments would be recognized as lease prepayments made by the seller-lessee or as additional financing provided to the seller-lessee.

Adjustments would not be made to reflect either the fair value of the purchase and sale or the current market rates for the lease in sale and leaseback transactions among related parties. Refer to the related party leasing transactions section above.

Disclosure

A seller-lessee in a sale and leaseback transaction would be required to disclose:

- The main terms and conditions of the transaction
- Any gains or losses arising from the transaction separately from gains or losses on disposal of other assets

Effective date and transition

Effective date

The FASB has not yet discussed an effective date but plans to address it in the fourth quarter of 2015.

How we see it

Given the current timeline, we believe an effective date of 1 January 2018 or later is likely.

A final standard is not likely to be effective before 1 January 2018.

Transition

The new standard's transition provisions would be applied as of the beginning of the earliest comparative period presented in the financial statements (date of initial application). For example, assuming an effective date of 1 January 2018, a calendar-year company that presents three-year comparative financial statements would apply the transition provisions on 1 January 2016 (i.e., the beginning of the earliest comparative period presented).

Lessees and lessors would be required to apply the new standard using a modified retrospective approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief (discussed below).

Lessees and lessors would be prohibited from using a full retrospective transition approach.

Lessee transition — capital leases

For capital leases existing at, or entered into after, the date of initial application, a lessee would:

- Initially recognize a Type A right-of-use asset and lease liability at the later of (1) the date of initial application and (2) the date of initial recognition under ASC 840, measured at the carrying amount of the capital lease asset and capital lease obligation under ASC 840
- Recognize as part of the Type A right-of-use asset any unamortized initial direct costs not included in the capital lease asset under ASC 840 that would have qualified for capitalization under the new standard and write-off costs that would not have qualified for capitalization under the new standard as an adjustment to equity
- Subsequently measure the Type A right-of-use asset and lease liability in accordance with the subsequent measurement guidance in ASC 840 in the periods prior to the effective date

Beginning on the effective date, lessees would subsequently measure the Type A right-of-use asset and lease liability in accordance with the subsequent measurement guidance in the new standard, except that a lessee would not remeasure the Type A right-of-use asset or lease liability for changes in the amount the lessee expects to pay under residual value guarantees unless it remeasures the asset or liability for other reasons (e.g., because of a change in the

lease term resulting from a reassessment). If a lease is modified after the effective date or the lease liability is remeasured for any reason, lessees would account for the lease under the new standard. For lease modifications, this would be the case, regardless of whether the modification results in a separate lease.

Lessee transition — operating leases

For operating leases existing at, or entered into after, the date of initial application, a lessee would:

- Initially recognize a Type B right-of-use asset and lease liability at the later of (1) the date of initial application and (2) lease commencement
- Initially and subsequently measure the lease liability at the present value of the sum of the following items unless the lease is modified or the lease liability is required to be remeasured on or after the effective date:
  - The remaining minimum rental payments (as described under ASC 840)
  - Any amounts the lessee expects to pay to satisfy a residual value guarantee
- Use a discount rate established in accordance with the new leases standard as of the later of (1) the date of initial application and (2) lease commencement
- Measure the Type B right-of-use asset throughout the lease at an amount equal to the lease liability, adjusted for any prepaid or accrued rent, lease incentives or unamortized initial direct costs that would have qualified for capitalization under the new leases standard
- Write off, as an adjustment to equity, any unamortized initial direct costs that would not have qualified for capitalization under the new leases standard

Beginning on the effective date, lessees would account for a lease modification or remeasurement of the lease liability under the new standard. For lease modifications, this would be the case, regardless of whether the modification results in a separate lease.

Lessor transition — sales-type and direct financing leases

For sales-type and direct financing leases existing at, or entered into after, the date of initial application, a lessor would:

- Not reassess whether a sales-type lease would have qualified for up-front selling profit recognition in accordance with the new leases standard
- Initially recognize a net investment in the lease at the later of (1) the date of initial application and (2) lease commencement, measured at the carrying amount of the net investment in the lease under ASC 840
- Include in the net investment in a direct financing lease any unamortized initial direct costs that were capitalized in accordance with ASC 840
- Subsequently measure the net investment in the lease in accordance with the subsequent measurement guidance in ASC 840 in the periods prior to the effective date

Beginning on the effective date, the lessor would subsequently measure the net investment in the lease in accordance with the subsequent measurement guidance in the new standard. If the lease is modified after the effective date, lessors would account for the lease under the new standard, regardless of whether the modification results in a separate lease.

Lessor transition — operating leases

For operating leases existing at, or entered into after, the date of initial application, the carrying amount of the underlying asset and any lease assets or liabilities (for example, prepaid or deferred rent) would be the same as that recognized under ASC 840 at the later of (1) the date of initial application and (2) lease commencement.

A lessor would recognize any initial direct costs that would have qualified for capitalization under the new leases standard as an expense over the lease term on the same basis as lease income. Those costs that would not have qualified for capitalization under the new standard would be written off as an adjustment to equity.

If a lessor had previously securitized receivables arising from leases that were classified as operating leases in accordance with ASC 840, the lessor would account for those transactions as secured borrowings in accordance with other GAAP.

Other considerations — transition relief (policy election)

Lessees and lessors would be permitted to make an accounting policy election to apply the following relief which must be elected as a package and must be consistently applied to all leases (i.e., an entity cannot choose which provisions to apply or which leases to apply them to). In addition, an entity that is both a lessee and a lessor must make the election regarding relief for all leases.

Lessees and lessors could elect not to reassess all of the following:

- Whether any expired or existing contracts are or contain leases
- Lease classification for any expired or existing leases
- Initial direct costs for any expired or existing leases (i.e., whether those costs would have qualified for capitalization under the new leases standard)

Lessees and lessors would also be permitted to make an accounting policy election to use hindsight with respect to lease renewals and purchase options when accounting for existing leases. This relief may be elected separately or in conjunction with the package of relief described above. An entity would have to make an accounting policy election (i.e., it could not elect this relief on a lease-by-lease basis).

How we see it

Because the current accounting for operating leases and service contracts is similar, determining whether an arrangement is a lease or service contract might not have been a focus for many entities. Given the consequences of the new standard, the effects of treating an arrangement as a service instead of a lease may be material when it may not have been material in the past. This may require some entities to revisit the assessment made under ASC 840.

Disclosures

Lessees and lessors would be required to provide transition disclosures in accordance with ASC 250, *Accounting Changes and Error Corrections*, without the disclosure of the effect of the change on income from continuing operations, net income, any other affected financial statement line item and any affected per-share amounts for the current period and any prior periods that are adjusted.

Sale and leaseback transition

A seller-lessee would reassess whether there was a sale in a sale and leaseback transaction only when the transaction is still being accounted for as a "failed sale" (i.e., a financing) under ASC 840, at the effective date of the new standard. Transactions previously determined to be sales by a seller-lessee would not be reassessed.

However, a seller-lessee would account for any deferred gain or loss on a transaction previously accounted for as a sale and leaseback as follows:

- For leasebacks classified as capital leases, the entity would continue amortizing the gain or loss in the same manner as under ASC 840.
- For leasebacks classified as operating leases, the entity would recognize any deferred gain or loss not resulting from off-market terms as an adjustment to equity. Any deferred amount that is the result of off-market terms would be recognized as an adjustment to the right-of-use asset if the amount is a loss or as a financial liability if it is a gain.

Seller-lessees would account for the leaseback in accordance with the lessee transition requirements.

Build-to-suit arrangement transition

As discussed in Appendix B, build-to-suit accounting would be eliminated under the new standard. As part of transition, lessees would be required to apply a modified retrospective transition approach for build-to-suit lease arrangements existing at, or entered into after, the date of initial application.

An entity that has recognized assets and liabilities as a result of the build-to-suit guidance in ASC 840 would derecognize those assets and liabilities at the later of (1) the date of initial application and (2) the date that the lessee is determined to be the accounting owner of the asset under existing build-to-suit guidance. Any difference between the amounts of the assets and the liabilities derecognized would be recorded as an adjustment to equity at that date. The lessee would then follow the general lessee transition guidance for the lease.

Key differences between US GAAP and IFRS

While the FASB's new standard would prohibit the use of a full-retrospective transition approach, the IASB's new standard would permit such an approach.

The FASB would require adoption of its new standard using a modified retrospective transition approach. The IASB would permit such a transition approach. However, the FASB and the IASB would require the modified retrospective approach to be applied differently and would provide different types of transition relief.

Refer to Appendix C for a summary of key differences between US GAAP and IFRS.

Endnotes:

[1] ASC 840-10-25-42 requires lessors to consider all four lease classification criteria in paragraph 840-10-25-1 and both of the following criteria: (a) collectibility of the minimum lease payments is reasonably predictable, and (b) no important uncertainties surround the amount of unreimbursable costs yet to be incurred by the lessor under the lease.

[2] See Proposed Accounting Standards Update (Revised), *Leases (Topic 842),* on the FASB's website.

[3] A service concession arrangement is an arrangement between a public-sector entity grantor and an operating entity under which the operating entity generally operates the grantor's infrastructure (e.g., an airport, road, bridge, tunnel) for a specified period of time. Refer to our Financial reporting developments publication, *Lease accounting*, for further information.

[4] ASU 2015-05, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*.

[5] See ASC Master Glossary for definition of public business entity.

[6] For lessees, see the Lessee Accounting Model March 2014 staff paper 3A paragraph 36. For lessors, see the Lessor Accounting Model March 2014 staff paper 3C paragraph 19.

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Appendix A: Summary of lessee and lessor reassessment requirements (updated July 2015)

<table>
<tr><th></th><th>Lessees</th><th>Lessors</th></tr>
<tr><td>Allocating contract consideration</td><td>Reallocate contract consideration upon either of the following events:
▸ A contract modification that is not accounted for as a separate, new lease.
▸ A reassessment of the lease term or whether the lessee is reasonably certain to exercise an option to purchase the underlying asset.</td><td>Reallocate contract consideration upon a contract modification that is not accounted for as a separate, new lease.</td></tr>
<tr><td>Lease term</td><td>Reassess upon the occurrence of significant events or changes in circumstances that are within the lessee's control (i.e., market-based events or changes would not trigger a reassessment).</td><td>No requirement to reassess after lease commencement.</td></tr>
<tr><td>Variable lease payments that depend on an index or rate</td><td>Reassess when the lease liability is remeasured for other reasons (e.g., due to a change in the lease term).</td><td>No requirement to reassess after lease commencement.</td></tr>
<tr><td>Amounts expected to be payable under residual value guarantees — lessees only</td><td>Remeasure the lease liability and adjust the right-of-use asset if the amounts expected to be payable under residual value guarantees change during the lease term.
Recognize the remaining adjustment in profit or loss if the right-of-use asset is reduced to zero.</td><td>Not applicable for lessors because lease payments would generally exclude amounts receivable under residual value guarantees (from the lessee or a third party).</td></tr>
<tr><td>Discount rate</td><td>Reassess upon a lease modification, a change to the lease term or a change to the assessment of whether a lessee is reasonably certain to exercise an option to purchase the underlying asset.</td><td>Reassess upon a modification to a Type A lease that does not result in a separate, new lease when the modified lease remains a Type A lease (i.e., when lease classification does not change).</td></tr>
<tr><td>Lease classification</td><td>It is unclear whether lessees would reassess lease classification upon a modification to a Type A or Type B lease that does not result in a separate, new lease.</td><td>Reassess upon a modification to a Type A lease that does not result in a separate, new lease.
It is unclear whether lessors would reassess lease classification upon a modification to a Type B lease that does not result in a separate, new lease.</td></tr>
</table>

Appendix B: US GAAP guidance that would be eliminated and guidance the FASB may eliminate (updated July 2015)

This appendix discusses accounting guidance that the FASB would eliminate under the new standard. This appendix also discusses interpretive guidance in ASC 840 that the FASB did not include in its 2013 ED. At its May 2015 meeting, the FASB indicated that its staff plans to revisit this guidance to determine whether to would be carried forward to the new standard.

Guidance that would be eliminated under the new standard

Lessee involvement in asset construction ('build-to-suit' transactions)

Build-to-suit lease transactions involve various forms of lessee involvement in the construction of an asset for the lessee's own use. Under ASC 840, a lessee is considered the owner of an asset during the construction period if it takes on substantially all of the construction-period risks. If the lessee is considered the owner of the asset during the construction period, a deemed sale and leaseback of the asset would occur when construction of the asset is completed and the lease term begins. The 2013 ED proposed eliminating this guidance. In the Basis for Conclusions in the 2013 ED, the FASB said entities would apply other existing guidance (e.g., ASC 360) when costs are incurred to construct or design an asset before that asset is ready for use. If the lessee controls the underlying asset before the lease commencement date, the lessee would apply the sale and leaseback provisions of the new standard.

How we see it

Absent additional guidance, it is not clear how lessees and lessors would determine what, if any, assets to record in certain arrangements (e.g., when leasehold improvements are constructed by or on behalf of the lessee). In many instances, judgment would be required to determine whether the lessee is constructing leasehold improvements or leasing fully built-out space.

Separate requirements for leases involving real estate

ASC 840 requires both lessees and lessors to account for leases involving real estate according to their classification as capital, sales-type, direct financing or operating using their respective criteria. However, certain additional tests are necessary, and the land, building and equipment components of a lease are accounted for separately in some instances. The unique treatment of real estate in lease transactions is consistent with the accounting recognition that real estate is different from equipment by its nature. Just as there are distinct rules for real estate sales transactions (until the effective date of ASC 606 and ASC 610), there are also distinct rules for leases involving real estate and sale and leaseback transactions involving real estate.

How we see it

The elimination of today's real estate-specific guidance, including the restrictions for sale and leaseback transactions, would be a major change. We would generally expect more sale and leaseback transactions involving real estate to be accounted for as sales and subsequent leasebacks under the new standard than under today's guidance. In addition, we would expect more leases of real estate to result in up-front selling profit recognition (i.e., for Type A leases).

Leveraged leases that are not grandfathered upon transition

Leveraged lease arrangements existing at transition would be grandfathered. Thus, we expect the new standard to retain the subsequent measurement guidance for leveraged leases currently in ASC 840.

After transition, entities would apply the new standard to all newly recognized leases, including those that would have been classified as leveraged leases under ASC 840 today. For such leases, entities would apply other relevant US GAAP (e.g., ASC 740, *Income taxes*, ASC 470, *Debt*) to account for the non-lease components of such transactions.

How we see it

It is unclear how modifications or extensions of leveraged leases that are grandfathered would be accounted for under the new standard.

Guidance that may be eliminated pending further FASB discussions

Sale of assets subject to a lease or intended to be leased by the purchaser to a third party

ASC 840 provides guidance for the sale of property subject to an operating lease, or property that is leased or intended to be leased by a third-party purchaser. Such transactions should not be treated as sales when the seller retains substantial risks of ownership, unless the seller is able to determine that the buyer will lease the asset to a third party under a sales-type or direct financing lease.

How we see it

If the FASB eliminates this guidance, we would generally expect lessors to look to the new revenue recognition standard (i.e., ASC 606) or ASC 610-20, *Other Income — Gains and Losses from the Derecognition of Nonfinancial Assets*, to determine whether a sale has occurred.

Lessee maintenance deposits

Under certain lease arrangements, a lessee may be contractually or legally responsible for repair and maintenance of the leased asset during the term of the lease arrangement. In addition, the lease arrangement may require the lessee to make deposits (also commonly referred to as maintenance reserves or supplemental rent) with the lessor to protect the lessor if the lessee does not properly maintain the leased asset (i.e., the lessor would use the funds to restore the leased asset to proper working order).

Under a typical maintenance deposit lease arrangement, the lessor is contractually required to reimburse the lessee a portion of the deposit as qualifying maintenance activities are performed and paid for by the lessee. If the deposits paid to the lessor exceed the costs incurred for maintenance activities, certain lease arrangements state that the lessor is entitled to retain such excess amounts at the expiration of the lease arrangements, whereas other lease arrangements require the lessor to refund such excess amounts to the lessee.

Today, ASC 840 provides guidance for maintenance deposits that are paid by the lessee and refunded only if the lessee performs specified maintenance activities. Such arrangements should be considered deposit assets (by the lessee) if it is probable that the deposits will be refunded. The cost of maintenance activities should be expensed or capitalized by the lessee, as appropriate, when the underlying maintenance is performed. If the likelihood of a maintenance deposit being refunded to the lessee is less than probable, the deposit should be recognized as additional rent expense. If it is probable at inception of the lease that a portion of the deposits will not be refunded, the lessee should recognize a pro-rata portion of the deposits as expense as they are paid.

The sale of tax benefits associated with a leased asset

Periodically, companies enter into transactions that are, in substance, sales of tax benefits through tax leases. These transactions are commonly referred to as "double-dip" transactions as their objective is to provide to more than one entity a deduction in separate tax jurisdictions (e.g., Switzerland, US). The transaction generally involves the sale of a depreciable asset or an interest in an asset (or through a sales-type lease — commonly referred to as a "head lease") to an investor in a foreign jurisdiction in consideration for cash proceeds and an obligation by the seller to lease back the asset under a capital or operating lease. ASC 840 provides guidance on identifying and accounting for sales of tax benefits.

Accounting for a loss on a sublease

An entity may enter into a sublease that will result in a loss. ASC 840 provides guidance on determining when and how a loss is recorded based the type of sublease (i.e., operating, direct financing or sale-type sublease).

If the FASB does not retain the existing guidance, under the new standard intermediate lessors would assess right-of-use-assets that are subject to a sublease for impairment under the long-lived asset impairment provisions of ASC 360.

Appendix C: Key differences between US GAAP and IFRS (updated July 2015)

	US GAAP (FASB)	IFRS (IASB)
Scope and scope exclusions	The scope of the new standard would not apply to leases of intangible assets.	The scope of the new standard would not apply to lessors' leases of intangible assets. However, lessees of intangible assets could apply the new standard but would not be required to.
Leases of small assets (IFRS-only)	No exemption for leases of small assets.	*For lessees only* — Recognition and measurement exemption for leases of certain low-value assets (i.e., small assets).
Lease modifications (updated July 2015)	The accounting for a modification to a Type A lease that does not result in a separate, new lease, would depend on whether lease classification changes. Refer to the lease modifications section.	The accounting for a modification to a Type A lease that does not result in a separate, new lease, would be in accordance with IFRS 9, *Financial Instruments*.
Portfolio approach	Guidance would be included in the non-authoritative Basis for Conclusions.	Guidance would be included in the authoritative paragraphs of the new standard.
Variable lease payments that depend on an index or rate — lessee reassessment	Reassess only when lease liability is remeasured for other reasons (e.g., due to a change in lease term).	Reassess upon remeasurement of lease liability for other reasons and upon a change in the cash flows resulting from a change in the reference index or rate (i.e., when an adjustment to the lease payments takes effect).
Discount rate — lessees	Accounting policy election for lessees that are not public business entities to use the risk-free rate to determine the present value of lease payments (for all leases).	No accounting policy election for lessees to use the risk-free rate for the initial and subsequent measurement of lease liabilities.
Reassessment of the discount rate (updated July 2015)	Reassess upon a modification to a Type A lease that does not result in a separate, new lease when the modified lease remains a Type A lease (i.e., when lease classification does not change).	No reassessment after lease commencement.
Fair value of the underlying asset	Definition of fair value in ASC 820 would not apply to fair value measurements for the purposes of lease classification and measurement (with certain exceptions).	The measurement and disclosure requirements of IFRS 13, would apply to lease transactions within the scope of the new standard.
Related party leasing transactions	Entities would be required to account for related party leasing transactions on the basis of the legally enforceable terms and conditions of the lease.	No guidance for related party leasing transactions.

	US GAAP (FASB)	IFRS (IASB)
Lease classification — lessees	Leases (with an optional exemption for short-term leases) would be classified as Type A or Type B, and there would be no initial measurement difference between them. Differences would result in the recognition, measurement and presentation of leases for lessees.	Leases (with optional exemptions for short-term leases and leases of small assets) would be Type A leases.
Lease classification — lessors	Leases would be classified as Type A or Type B. However, lessors would consider an additional criterion based on collectibility of lease payments.	Leases would be classified as Type A or Type B.
Determining whether to defer or recognize selling profit — Type A leases with selling profit	Recognize initial selling profit in a Type A lease only if lessee obtains control of the underlying asset, as that would be defined in the new standard, and collection of lease payments is probable.	Recognize initial selling profit for all Type A leases with selling profit.
Reassessment of lease classification — lessors	Reassess upon a modification to a Type A lease that does not result in a separate, new lease.	No reassessment after lease commencement.
Purchase of a leased asset by the lessee during the lease term (updated July 2015)	No gain or loss recognized. The difference between the purchase price and the carrying amount of the lease liability would be recorded as an adjustment to the carrying amount of the asset.	No guidance for the purchase a leased asset by the lessee during the lease term
Presentation — statement of cash flows — lessees	Cash paid for interest on Type A leases would be presented within operating activities.	Cash paid for interest on Type A leases would be presented within operating or financing activities consistent with the entity's policy election under IAS 7, *Statement of Cash Flow*s.
Disclosure — qualitative disclosures — lessees	Would include a specific list of qualitative disclosure requirements.	Would not include specific qualitative disclosure requirement.
Disclosure — quantitative disclosures — lessees	▸ The FASB and IASB differ on specific lessee quantitative disclosure requirements mainly because of differences in the lessee accounting models. For example, the FASB's new standard would require disclosure of Type B lease expense, which is not applicable under the IASB's new standard (under which all leases would be Type A leases). ▸ The FASB would not require a specific format for lessee quantitative disclosures. However, the IASB would require the disclosures to be made in a tabular format, unless another format is more appropriate, and presented in a single note or separate section of the notes to the financial statements.	
Other quantitative and qualitative disclosures — Type A leases — lessors	Qualitative and quantitative disclosure of significant changes in the residual value component of the net investment.	Qualitative and quantitative disclosure of significant changes in the net investment.

	US GAAP (FASB)	IFRS (IASB)
Intermediate lessor accounting — classification of a sublease	For purposes of lease classification, the intermediate lessor would consider the underlying asset the leased asset.	For purposes of lease classification, the intermediate lessor would consider its right-of-use asset as the leased asset.
Sale and leaseback transactions — determining whether a sale has occurred	No sale occurs when either: ▸ Leaseback is a Type A lease. ▸ Seller-lessee has a substantive repurchase option. ▸ Fair value (date of exercise) repurchase options for non-specialized assets that are readily available in the marketplace would **not** preclude a sale (i.e., option would be non-substantive).	No sale occurs when the seller-lessee has a substantive repurchase option with no further guidance for non-specialized assets that are readily available in the marketplace. Sale accounting is not prohibited for Type A leasebacks because all leases are classified as Type A leases by lessees.
Sale and leaseback transactions — accounting for gains	Recognize gain in full.	Recognition of gain would be limited to the portion related to the residual asset. The remaining gain would be recognized as a reduction to the initial measurement of right-of-use asset, thus reflected as a reduction in amortization of the right-of-use asset over term of the leaseback.
Transition	▸ While the FASB's new standard would prohibit the use of a full retrospective transition approach, the IASB's new standard would permit such an approach. ▸ The FASB would require adoption of its new standard using a modified retrospective transition approach. The IASB would permit such a transition approach. However, the FASB and the IASB would require the modified retrospective approach to be applied differently and would provide different types of transition relief.	