

FASB Lease Accounting

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The Lessor's Perspective on Lease Accounting

As we mentioned in our previous three articles¹, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have proposed major changes to lease accounting. The accounting by lessees has been described in a Discussion Paper titled *Leases: Preliminary Views*. Since that time, the Boards have decided that a final standard should also address lessor accounting issues. This article summarizes certain Board discussions and tentative decisions that have been made to date on lessor accounting. All decisions at Board meetings are tentative and may be changed at future meetings.

When is a lease not a lease?

Not all leases will fall within the scope of this standard; some leases will be accounted for as sales. To determine whether a lease is a sale or a lease, one must look at what happens when the lease term ends. If control of the underlying asset passes to the lessee at the end of the lease term, the lease is accounted for as a sale. The Boards have proposed four examples in which a lease will be considered a sale:

- Contracts in which title of the underlying asset transfers automatically
- Contracts that include a bargain purchase option if it is reasonably certain it will be exercised
- Contracts in which the return that the lessor receives is fixed
- Contracts in which it is reasonably certain that the contract will cover the expected useful life of the asset and where any risks or benefits retained by the lessor at the end of the contract are trivial

Those criteria are similar to, but not exactly the same as, the existing rules for determining whether a lease is a capital lease. A lease that is a sale will be within the scope of the new FASB/IASB joint project on revenue recognition.

If a lease is within the scope of the lease accounting proposal, it will be accounted for using the “performance obligation” approach. The lessor would recognize an asset (receivable) for its right to receive payment for use of the leased item. The other side of the journal entry is a performance obligation liability representing a promise to permit the lessee to use the underlying asset over the term of the lease. Revenue is recognized over the lease term as the performance obligation is satisfied.

Measurement

The lessor's receivable would be initially measured at the present value of the lease payments. Direct costs incurred in negotiating and arranging the lease would be added to the receivable. The liability would initially be recorded at the transaction price, that is, the same amount recorded for the leased asset. The amount recorded for the lease receivable and obligation would be based on the

longest possible lease term (including optional renewal periods) that is more likely than not to occur. The lease term would be reassessed each subsequent reporting period if there was a change in facts or circumstances. Changes in the lease term would be reflected in the amount recorded for the lease receivable and the lease obligation.

Presentation

The Boards discussed lease presentation based on the performance obligation approach. The Boards discussed various presentation approaches for the balance sheet, including the following:

- Present the leased asset, lease receivable asset and performance obligation separately.
- Present the lease receivable asset and performance obligation net, and present the underlying leased asset separately.
- Present the leased asset and performance obligation net, and present the lease receivable asset separately.
- Present the leased asset, lease receivable and performance obligation net, with the components presented separately on the face of the balance sheet (a new meaning for the term “triple net”).

The Boards tentatively decided on a triple net presentation, illustrated as follows:

Noncurrent Assets	
Leased assets, net of accumulated depreciation	\$ 1,400,000
Performance obligations	(900,000)
Lease receivables	900,000
	<u>\$1,400,000</u>

Income statement presentation would be similar to the balance sheet presentation. Depreciation expense on the leased asset, interest income on the lease receivable and lease revenue on derecognition of the lease obligation would be presented separately in the income statement, with a total for those items presented as net lease income (or expense). Amortization of the performance obligation would be recorded in a systematic and rational manner, based on the lessee’s pattern of use of the underlying asset. The pattern of use might be based, for example, on the passage of time or on the number of hours the asset is used.

Multiple components

Lease contracts may contain multiple components, including payments for services or goods such as supplies. Lessors would need to evaluate if and how lease payments should be allocated to the lease component and other components. The Boards have tentatively decided that a lessor would use the guidance being developed in the joint project revenue recognition model to identify and account for multiple components.

When evaluating service elements, the first step is to determine whether the element represents a distinct service. A service is distinct if the:

- Lessor or another entity separately sells a similar service,
- Contract separately identifies the service,
- Service has a distinct profit margin or function, or
- Service is transferred to the customer at a different time than the leased asset.

When the other elements in a lease are distinct services, total payments would be allocated between the lease components and service components. Payments allocated for services would not be included in the calculation of the lease receivable and performance obligation, although there would be a separate contract asset and performance obligation recorded net for the lease component. If the services are not distinct – or it is not feasible to allocate the payments between the lease and service elements – the total amount of the payments would be included in the calculation of the lease receivable and performance obligation. Changes in lease payments would be evaluated using a similar process.

What's next?

The Boards continue to deliberate on various lessor accounting issues, many of which have not been discussed above. An Exposure Draft is scheduled to be issued in the first half of 2010, and constituents will have an opportunity to comment on the proposal. The final standard is expected in 2011.

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¹ [“The Future of Leasing,”](#) [“Principles-based Accounting for Leases,”](#) and [“Operating Leases Moving to the Balance Sheet,”](#) are available at www.ugl-equis.com/media/white_papers.aspx and www.GrantThornton.com/Leasing.

Additional Resources:

www.fasb.org

www.iasb.org

[AICPA: FASB/IASB - Leases FAQs](#)

[Grant Thornton: New Developments Summary, “FASB and IASB express views on accounting by lessees”](#)