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Leasing

IASB, FASB Lessor Accounting Debate Bogs Down Over Questions About Scope

LONDON—A July 23 consideration of lessor accounting issues by the International Accounting Standards Board and the U.S. Financial Accounting Standards Board saw the two accounting standard-setters hit a brick wall on the question of scope.

At issue was whether a lessor's receivable—the right to receive payments from a counterparty under a lease agreement—is a financial instrument, a question for the revenue recognition project, or alternatively a free-standing problem requiring its own accounting model.

In a nod toward the latter choice, in the case of the initial and subsequent remeasurement of the receivable, the boards agreed—albeit with hesitation and reservations—to following existing applicable literature under either international financial reporting standards or U.S. generally accepted accounting principles.

Highlighting the split thinking, the debate saw FASB member Thomas Linsmeier lean toward the revenue recognition notion of the lessor having to recognize a performance obligation, with some IASB members, including IASB Chairman David Tweedie, disagreeing.

Obligations, Unconditional Rights

"I don't think you've got a performance obligation," argued Tweedie. "I think your obligation has already been satisfied. You've actually handed the asset over. I don't think it ties up with the lessee side either."

Likewise, IASB member Warren McGregor said he had "exactly the same concern." This was because, McGregor said, "You already have an unconditional right to the cash being the receivable."

From the revenue perspective, however, Linsmeier argued there was a "delivery of a continuous asset letting someone use an asset that you still own."

Further complicating the question of scope is the issue of whether the lease receivable is in fact a financial instrument.

IASB member Jim Leisenring, himself a former FASB vice-chairman, noted that "you probably have no alternative but to take lease receivables out of the scope of financial instruments. They ain't in there now. This isn't the end of this world that these are different."

Under the board's current financial instruments literature, International Accounting Standard 39, Financial Instruments: Recognition and Measurement, lease receivables fall outside the scope of that standard other than for impairment and derecognition.

IASB and FASB issued their keenly awaited discussion paper setting out a new model to shake up lease accounting March 20 (5 APPR 303, 4/3/09).

Comments Closed

The public comment period on the document closed July 17. The discussion paper included a high-level discussion of lessor accounting issues, although the main focus of the document was fixed firmly on the lessor side of leasing transactions.

Meanwhile, in May, the boards tentatively decided to require a lessor to book both an asset for the right to receive rental payment and a performance obligation linked to its obligation to provide the lessee with the use of an item over the lease term.

Scope questions returned to haunt the boards later in the day when they returned to the lessor's receivable to consider its subsequent remeasurement.

Staff in September and October will look at whether the receivable is a financial instrument or what staff described as "some sort of right akin to the rights you receive under the revenue recognition project." Should their analysis lead them to conclude that the obligation is a financial asset, staff will consider whether they scope it in or out of the financial instruments literature.

But tentative decisions so far, explained IASB project manager Rachel Knubley, "would suggest that it was a financial liability."

From the perspective of the lessee, she added, the boards had concluded that they would "specify the accounting."

The issue is certainly significant when it comes to valuing a lease with a degree of optionality, such as an option to extend the lease term. IASB member John Smith told the meeting he did not "know how you do fair value on that. … It seems to me it's not a financial instrument anymore."

Scoping Out of Financial Instruments

Board colleague Robert Garnett told the meeting there are "fairly persuasive arguments for scoping these out of financial instruments and dealing with them separately."

To do otherwise, he argued, would produce "crazy answers on the lessee side compared with the lessor side. You're certainly not getting comparable accounting."

At issue for the board is to develop an accounting model that aligns like transactions with like, or rather, as Garnett pointed out, to avoid accounting for third-party financing in "two different ways because some are called leases and the others are called purchase financing."

As for where the July 23 debate leaves the revenue recognition model, FASB member Leslie Seidman noted the two boards "may learn something from the additional work the [revenue recognition] team is going to bring to us on how to distinguish goods and services."

In March, IASB director Alan Teixeira singled out lease accounting as one of three projects where the boards risk failing to meet their joint 2011 completion deadline.

By Stephen Bouvier

The notes accompanying the boards' joint July 23 discussions are on the web at http://www.iasb.org/Meetings/.

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