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Leasing

FASB-IASB Working Group on Leases Discusses Where to Go With Overall Project

LONDON—Critics of proposed lease accounting changes complained during a Sept. 3 meeting working group meeting that standard setters attach too much weight to views from members of the analyst community, who generally support proposed changes.

George Yungman, senior vice-president, financial standards, with the National Association of Real Estate Investment Trusts, said he thinks users' input has gotten too much weight, while "users get certain information anyway" from financial statement preparers, whether or not the information is mandated under accounting standards.

Yungman's comments came during a day-long meeting between members of the International Accounting Standards Board and the U.S. Financial Accounting Standards Board and their joint working group on lease account.

The meeting addressed a range of issues connected to the preliminary views document on lessee accounting being deliberated by IASB and FASB, including whether the proposal should be expanded to address lessor accounting, the need for field tests of proposals, and the approach to impairment.

FASB and IASB in March published a preliminary views document on lease accounting that sets out to replace existing guidance. The paper, which addressed only lessee accounting, would answer what many see as a serious shortcoming in existing accounting literature by requiring lessees to recognize the assets and liabilities arising from lease contracts on the statement of financial position (5 APPR 303, 4/3/09).(52 DTR I-1, 3/20/09)

Under the boards' proposed approach, entities would recognize:

- an asset representing its right to use the leased item for the lease term; and
- a liability for its obligation to pay for the right to use the leased item.

The two boards have since received just short of 300 comment letters from around the world. U.S. preparers and industry groups slammed the proposed approach, arguing that it will have an overwhelming impact on entities' balance sheets without providing any meaningful benefit to financial statements (5 APPR 801, 9/4/09).

Summary of Perspectives

During the Sept. 3 meeting, IASB project manager Rachel Knubley summarized responses to the plan. "We are generally disappointed by the level of user responses we get on our projects, and certainly only getting five responses on this project was disappointing, I have to say."

Knubley added that it was "very difficult to summarize what the responses of users actually were because they have different views." But overall, she said, "users generally had more support for the right-of-use approach, the overall approach that the board has taken, than perhaps the general population had."

Indeed, in a comment letter on the IASB and FASB proposals, the CFA Institute urged the standard setters to "be a little more bold when enacting improvement approaches to both initial and subsequent measurement and not to be constrained by the goal of being consistent with existing reporting standards that bear deficiencies in their measurement basis."

This view contrasts with a summary of wider constituent views in which project staff noted that a number of respondents called on the boards to field test any proposals "to determine that no unintended consequences could arise."

Further urging caution on the boards, citing the complexity of the subject matter and the interrelationships between this and some of the board's other ongoing projects, respondents suggested said "the board should take all necessary time to ensure that all issues are thoroughly examined."

While the preliminary views paper from FASB and IASB excludes lessor accounting, some respondents called for "a separate discussion paper on lessor accounting before issuing an exposure draft." These respondents argued that in the absence of this step "it would be questionable whether due process was appropriately followed"

Moving Forward by 2011

Speaking on his own account Sept. 3, IASB member Jan Engstrom said he felt "very strongly that 2011 is very important for us and I also think that we will not abandon" the leases project.

"Everyone knows that we have a little bit of a problem with some aspects of this," Engstrom said. "It won't be abandoned, so there will be an outcome. . . . I think the details are open to discussion."

Not for the first time, the IASB's packed agenda—stuffed largely with items slated for completion by mid-2011—emerged as a source of pressure on the board. IASB Chairman David Tweedie observed that the board has "a problem in 2011 in the sense that we have so many major economies switching to IFRS in that period and the one message that they have given us loud and clear is that we don't want to have to switch twice."

This, he continued, had led to pressure for the board to act on lessee accounting because "that is where it is deemed the worst excesses lie."

This compares, he added, with the fact that "we do have a model for lessor accounting; it's not great and, as we have heard this afternoon, there are others." Were the boards to press on and tackle lessor accounting at the same time, he said, "we're going to have to get our skates on."

One option open to the boards were that scenario to play out, Tweedie mused, might be to "do an exposure draft for lessees [and] follow it quite quickly with one for lessors."

"I think it's the case of if we are going for the rights of use by lessees, we've really got to start by saying 'what's there for the lessor?' " he added. The IASB chairman concluded by saying he would "really go for the right of use of the asset for lessors."

Looking to the longer term, Tweedie noted that, "As we move towards 2011 and these projects get completed, this time next year we will probably be asking, 'What do we do after 2011?' I think then we need to ask for priorities."

Impairment

During discussion on the plan, Yungmann was critical of the boards' approach to impairment, an issue that the discussion paper does not expressly address. He argued that "to measure and impair in different ways for the same asset is wrong."

But as for when the boards might embark on a convergence effort to address impairment, FASB member Leslie Seidman responded that "it's a capacity issue".

In their preliminary views paper, the boards proposed that the initial measurement of right of use assets should be at cost, with subsequent remeasurement on an amortized cost basis.

Treatment of impairment for leases is addressed differently in U.S. generally accepted accounting principles and international financial reporting standards.

Reflecting this complexity, the discussion paper proposed four possible alternatives approaches to address impairment: the IFRS model; the U.S. GAAP approach, a dedicated lease-accounting approach; and the option of preparers referring to their respective literature—IAS 36 under IFRS and FAS 144 under U.S. GAAP.

The board conceded that "each had its shortfalls." In particular, the fourth option has the potential to create divergence between U.S. GAAP and IFRS on lease accounting. Nonetheless, both boards have so far expressed a preference for this alternative.

Also absent from the due process document were any finalized thinking on lessor accounting issues. Staff conceded Sept. 3 that the boards have "more work to do" on that question.

In May, the boards tentatively decided to further develop the so-called performance obligation approach, but in July wanted more analysis of the derecognition approach.

Under the latter model, the lessor would recognize a receivable right to receive rental payments and would then derecognize a portion of the leased item. Any residual rights at the end of the lease term would remain on its books. The entity would recognize revenue at the start of the lease.

Under the performance obligation approach, however, an entity would also recognize a receivable for the right to receive rental payments, but the credit would not be a derecognition of the leased item. Instead the lessor would keep the item on its books and recognize a performance obligation to allow the lessee to use the leased item over the lease term, recognizing revenue over that term.

FASB's Seidman argued that users must articulate what they want to see from lessor accouning. " We want to look at the lessor issues from the [profit & loss statement] standpoint, but we want to look at the lessee issues primarily from the balance sheet standpoint."

Unable to square this circle, she said this was a question for users: " Do you think the balance sheet treatment needs to be symmetrical?"

By Stephen Bouvier

Text of the meeting papers to accompany the working group's discussions can be found at http://www.iasb.org/Meetings/Leases+Working+Group+Meeting.htm.

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