



## Lease Accounting Project

### Executive Overview

January 15, 2010

- **Timeline**
  - Mid 2010 - Issue Exposure Draft of the rule for public comment
  - 4th Q 2010 – Deadline for comment letters
  - 1st Q 2011 – Make changes, if any, based on comment letters
  - Mid 2011 – Issue new rule
  - 2012 or 2013 – Lessees and lessors implement new rules
- **Recent Board Actions**
  - Board is currently re-deliberating issues
  - Officially added lessor accounting to the project
    - Rejected derecognition method for lessors (direct finance accounting) and favored performance obligation method instead, leaving leased asset on books of lessor and requires lessor to depreciate it
  - Decided that there are leases that are in fact financings
    - Important for lessor sales-type leases
    - May be limited to auto transfer of title and bargain purchase options only – criteria still to be determined
    - May result in significant decline in sales-type leases
- **Major Issues Decided**
  - Scope changed to include lessor accounting and to exclude leases that are financed purchases.
  - For lessee accounting for right to use leases (ROU)--as opposed to leases that are financed purchases--capitalize an asset and liability at the PV of the *estimated* lease payments (includes contingent rents, renewal options including FMV renewal options, purchase options including FMV purchase options and residual guarantees) for the longest possible *estimated* lease term that is more likely than not to occur (considers lessee behavior in prior leases). Use the lessee's incremental borrowing rate to PV payments. Estimates will be reviewed and adjusted if necessary on every reporting date.
  - Lessee expense recognition is depreciation/amortization of the asset and interest on the obligation for all leases, creating a front-ended lease expense pattern. Straight line rent expense would be eliminated.

- For lessor accounting, the Boards are in the early stages of discussions. They favor grossing up the lessor balance sheet by booking a rent receivable and “performance obligation” (a deferred credit) equal to the PV of the estimated payments over the longest possible lease term likely to occur. Boards contend the lessor has a performance obligation to allow the lessee to use the asset over the lease term. They may allow the performance obligation credit balance to be netted against the leased asset on the balance sheet for presentation purposes. They want symmetry so the lessor will include estimated contingent rents, renewal rents including FMV renewals, purchase options including FMV purchase options and residual guarantees in its estimated lease payments. Lessor’s revenue will be finance revenue and straight line amortization of the performance obligation. The lessor will continue to depreciate the full value of the leased asset. They have not discussed sales-type leases in detail but they will limit sales-type leases compared to current rules.
- They have not discussed leveraged lease accounting and likely will not include it in the new rules.
- Boards likely will allow exemption for short-term leases but did not agree on details.
- For transition, the favored view is for lessees to capitalize the remaining payments under all leases based on the new rules. They may allow a long transition due to the magnitude of the calculation for large companies. They have not discussed lessor transition.
- **Major issues outstanding**
  - Details of lessor accounting
  - Criteria for determining leases that are sales
  - Sale lease backs
  - Short-term lease exemption details
  - Transition
- **ELFA Objectives/Activities**
  - Our objectives are to:
    - Retain straight line P&L for lessees
    - Retain direct finance lease accounting for lessors for all leases
    - Avoid capitalization of estimated contingent rents and non-bargain renewal options for lessees
    - Avoid constant adjustments to estimates for lessees
  - The association continues to monitor all FASB/IASB meetings and send informal comments to FASB/IASB as necessary
  - The ELFA is soliciting analyst reaction to major issues addressed thus far in the project.
  - The ELFA has retained a professional to conduct a lessee education/outreach activity, in which major sector representatives in the retail, manufacturing, banking and transportation industries are being contacted for invitation to a conference call briefing on the project.

- ELFA representative participating in a webinar with the National Retail Tenants Association, to alert their members to the implications of the project and to get them to comment to the FASB/IASB.