Most Recent IASB/FASB Meeting
Nets Favorable Decisions on the Leases Project

Overview of June 18, 2014 FASB/IASB Lease Project Board Meeting

By Bill Bosco

On June 18, 2014, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) held a board meeting on the Lease Project. The boards discussed three issues: subleases, lessee balance sheet presentation of the capitalized lease assets and liabilities, and cash flow statement presentation. The boards still seem to be on track for issuing new rules in the first half of 2015.

The meeting was easy for the FASB but much more difficult for the IASB, centering on the consequences of the IASB decision that all leases are the same for the lessee. The FASB made decisions quickly and easily, while the IASB struggled. When discussing the lessee balance sheet presentation, one IASB board member suggested that the IASB should re-open their one lease model decision.

The sublease decisions were easy for the FASB, as their lessee and lessor models are in line with each other, while the IASB models are not.

The lessee balance sheet discussions were easy for the FASB, as they are accounting for leases according to their substance as either an in-substance purchase (Type A) or a rental/executory lease (Type B) — meaning there are two types of assets (one physical and the other a new type of executory contract asset — not clearly intangible but surely different than an owned physical asset). The FASB discussed but did not conclude as to the nature of the Type B asset (meaning they did not put a label on the Type B asset). There are two types of liabilities: the Type A liability is debt, while the Type B liability is not debt — some were calling it an operating liability. The FASB decided that both the assets and liabilities are not to be lumped so that a user understands the nature of the assets and liabilities. They specifically stated that the difference in treatment of an in-substance purchase vs. a lease in a bankruptcy requires separate reporting so users have a clear understanding. A FASB member said they should change the names of the lease types, as Type A and Type B are not descriptive based on where the FASB model is. Rather they ***may*** be called in-substance purchases and leases — this is to be decided. This discussion went well for the FASB and the IASB consequently struggled, showing shortcomings of the IASB model.

The cash flow presentation discussion went well again for the FASB as they are not changing current practice. The IASB, on the other hand, discussed expanding disclosures to make up for the lack of clarity in reporting the nature of cash flows that result from a one lease lessee model.

Staff Questions and Boards' Answers

Subleases: Questions 1-4

Question 1: Do the Boards agree with the staff recommendation that an intermediate lessor should account for a head lease and a sublease as two separate contracts, unless those contracts meet the contract combination guidance adopted by the Boards at the April 2014 joint meeting? If not, what do the Boards prefer?

Vote: FASB and IASB voted yes. That is, that the head lease should follow lessee accounting and the sublease should follow lessee accounting. This is much more problematic for the IASB as their lessee and lessor models do not mesh for Type B leases. The IASB accounting will be confusing when the sub lease is a Type B lease as the revenue and cost patterns will not be in sync. They both decided to only allow netting if the right of offset rules are met.

Question 2: Do the Boards prefer for an intermediate lessor to classify a sublease with reference to the underlying asset or with reference to the ROU asset arising from the head lease?

Vote: The majority of the FASB voted to look to the underlying asset while the IASB voted to look to the ROU asset (they had to vote this way based on their choice of a one lease model for lessees).

Question 3: Do the Boards agree with the staff recommendation that an intermediate lessor should not offset lease assets and lease liabilities arising from a head lease and a sublease that do not meet the respective IFRS and U.S. GAAP financial instruments requirements for offsetting? If not, what do the Boards prefer?

Vote: Both Boards agreed

Question 4: Do the Boards agree with the staff recommendation that an intermediate lessor should not offset lease income and lease expense related to a head lease and a sublease, unless it recognizes sublease income as revenue and acts as an agent (assessed in accordance with the 'principal-agent' guidance in the recently-published revenue recognition standard)? If not, what do the Boards prefer?

Vote: Both Boards agreed

Presentation of the Type A ROU Asset: Question 1

Question 1: Do the Boards agree with the staff recommendation that a lessee should either present Type A ROU assets as a separate line item on the balance sheet or disclose in the notes Type A ROU assets? If a lessee does not present Type A ROU assets separately, a lessee should (a) present Type A ROU assets within the same line item as if the underlying assets were owned and (b) disclose in the notes which line items in the balance sheet include Type A ROU assets.

Vote: Both Boards agreed

Presentation of the Type B ROU Asset (FASB-only): Questions 2-3

Question 2: Does the FASB agree with the staff recommendations that Type A ROU assets and Type B ROU assets should either be presented as a separate line item on the balance sheet or disclosed separately in the notes?

Vote: The FASB voted yes.

Question 3: Does the FASB want to prohibit the presentation of Type B ROU assets in the same line on the balance sheet as Type A ROU assets?

Vote: The FASB voted yes. They specifically said they should not be reported combined on the balance sheet if the Type B amount is material. Neither should be combined with other assets if the amounts are material. *This is good news for bank lessees as their regulators may give them capital relief for Type B assets but they need to know the dollar amount of type B assets. Under current rules there is no capital required to support an operating lease. This may follow under the proposed rules as one could argue that the ROU asset does not survive a bankruptcy of the bank lessee whereas a Type A asset does survive bankruptcy and does need capital as it must be liquidated.*

Presentation of the Lease Liability: Questions 4-5

Question 4: Do the Boards agree with the staff recommendations to (a) either present as a separate line item on the balance sheet, or disclose in the notes, Type A lease liabilities; and (b) not specify the presentation of lease liabilities on the balance sheet?

Vote: The FASB agreed. The Type A liability could be combined with other debt. The Type A and B liabilities should not be combined on the balance sheet as their nature is very different. Type B is an operating liability. *This is good news as it should mean that debt limit covenants will not be impacted as the Type B liability is not considered debt.*

Question 5: Does the FASB agree with the staff recommendation that Type A lease liabilities should be either presented on the balance sheet or disclosed in the notes separately from Type B lease liabilities?

Vote: The FASB voted yes.

Lessor Cash Flow Presentation: Question 1

Question 1: Do the Boards agree with the staff recommendation to retain the proposals in the 2013 ED (which are the same as the existing requirements of IFRS and U.S. GAAP) for lessors to classify cash receipts from leases within operating activities in the statement of cash flows?

Vote: Both boards voted yes.

Lessee Cash Flow Presentation (FASB-only): Question 2

Question 2 – Does the FASB agree with the staff recommendation to retain the proposals in the 2013 ED regarding lessee presentation in the statement of cash flows for Type A and Type B leases?

Vote: The FASB voted yes.

Lessee Cash Flow Presentation (IASB-only): Questions 3-4

Question 3: Does the IASB agree with the staff recommendation that lessee cash flow presentation should classify all lessee cash outflows within cash flows from operating activities? If not, which approach does the IASB prefer?

Vote: The IASB voted to retain the presentation requirements in the statement of cash flows from the 2013 ED for Type A leases. Accordingly, a lessee would present cash payments that reduce the principal element of the lease liability within financing activities in the statement of cash flows for all leases. A lessee would classify interest payments within either operating activities or financing activities based on a lessee's accounting policy choice.

Question 4: Does the IASB agree with the staff recommendation to require the separate presentation of lease payments within cash flows from operating activities on the statement of cash flows?

Vote: The IASB voted yes. They had to in order to allow users to know the amount of rent paid.

Timing

The boards still seem to be on track for issuing new rules in the first half of 2015.