Lease Accounting Project Update
April 1, 2011

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have received an overwhelming response to their proposal to overhaul lease accounting. The Boards received nearly 800 comment letters on their Exposure Draft on Leases, and they held numerous outreach meetings where they heard from a cross section of users, preparers, lessees and lessors. The feedback caused IASB and FASB to re-deliberate issues. Generally, the tentative decisions have been favorable to the equipment finance industry. The following is a summary of those tentative decisions.

Issue	**Tentative decisions**
Issuance Date	2011
Effective Date	2015
Definition of a Lease (need to distinguish from service contract)	Regarding leases vs. installment purchases, the Boards decided to eliminate the scope exclusion but lease contracts should be accounted for in accordance with the leases standard and lease contracts that represent a purchase or sale of an underlying asset should be accounted for in accordance with other applicable standards (e.g. revenue recognition by lessors, property, plant and equipment by lessees). They are seeking feedback on the definition of a lease vs.an installment sale where the option is a bargain and how re-assessment of the likelihood of exercise should be handled. The Boards recommended that further outreach activities should include the issue of installment sales in the definition of a lease The Boards agreed to tentatively confirm the 'specific asset' notion versus a notion that assets could be substituted as long as they met specs, but they are looking for feedback by taking both approaches out for targeted outreach. They will also seek feedback through outreach to determine how to treat leases of non-physical assets like capacity in a fiber optic cable. They did not conclude on but are in favor of concepts like not including in lease accounting assets that are incidental to the provision of a service or insignificant to the services provided. They also could not conclude on whether to consider control based on the Revenue Recognition concepts or the EITF 01-08 concepts.
Lessor Accounting Model	They did not spend much time on lessor issues as they decided to wait for the Revenue Recognition project to progress to help determine direction of lessor accounting. They are also considering IAS 17-like lease classification criteria to determine which leases would get straight line P&L for lessees and they may use similar criteria to determine which leases get derecognition treatment for lessors. Leveraged lease accounting will not be included in the new rule.

Lease Term	The lease term is the contractual term plus renewals where the lessee has a “clear economic incentive” to exercise the options. The requirement to adjust estimates will be reduced to when an event occurs that causes the renewal option to become economically compelling.
Purchase Options	Subject to feedback from outreach, the Boards decided the exercise price of a purchase option should be included in the lessee's liability to make lease payments and the lessor's right to receive lease payments when there is a *significant* economic incentive to exercise the purchase option. If so, the ROU asset should be amortized over the useful life of the asset. Other purchase options are not considered lease payments to be capitalized. These conclusions are consistent with their conclusions on the lease term and renewals so it is good news except for the concerns re: reassessment. Further outreach is needed regarding when to reassess the purchase option and how reassessment affects lease classification now that the concept of finance leases and “other than finance leases” has been reintroduced into the project for both lessors and lessees.
Variable Payments	Variable lease payments will be included in the lessee lease capitalization and a lessor's lease receivable, but limited vs. what was proposed in the ED to include: - All variable lease payments that depend on an index (e.g. CPI) or a rate (e.g. LIBOR based floating rate leases); - Other variable lease payments based on usage (e.g. cost per mile) or lessee performance (e.g. rents based on sales) that are "reasonably assured/certain,"(to be defined). - Variable payments that are disguised minimum lease payments in leases where the fixed rents are off-market; - Disclosure within the notes of contingent rent leasing arrangements, (to be determined later). Estimates are reviewed and adjustments made if material.
Residual Guarantees	They reiterated their conclusions that: - a third party residual guarantee is not a minimum lease payment - lessees should only record the likely payment under a residual guarantee – not the full amount of the residual guarantee.
Lessee P&L Pattern	Former operating leases using IAS 17-like criteria (still being developed) will have straight line P&L cost pattern with details for calculation and presentation (will it be called rent expense) to be determined. Other leases will use capital lease-like accounting.

Short Term Leases	Lessees use current operating lease accounting for leases, elected as an accounting policy by asset class that, at the date of commencement of the lease has a maximum possible lease term, including any options to renew or extend, of 12 months or less.
Sale Leasebacks	If considered a sale by the revenue recognition standard (means when control has been transferred), account for as a sale leaseback, otherwise consider it a financing. When consideration is at fair value, gains or losses arising from the transaction should not be deferred. When consideration is not at fair value, the assets, liabilities, gains and losses should be adjusted to reflect current market rentals.
Lease Inception vs. Commencement	Lessees and lessors initially measure (calculate the amount capitalized) and recognize (book) the lease assets and liabilities at the date of lease commencement. Lessees use incremental borrowing rate at lease commencement to calculate the amount capitalized.
Pre-commencement Payment/Interim Rents	Recognized as a rent prepayment and at the date of commencement, the prepayments will be added to the right-of-use asset.
Lease Incentives	Cash payments received from the lessor reduce the lessee's ROU asset
Bundled Lease Payments	Payments must be bifurcated by lessees and lessors. Bifurcate using observable stand alone prices if know for all elements, consistent with the revenue recognition project; if only one element is observable assume the cost of the other is the residual cost. Where no observable market prices available, capitalize whole payment as a lease.
Initial Direct Costs	Costs that are directly attributable to negotiating and arranging a lease that would not have been incurred had the lease transaction not been made. Lessees and lessors should capitalize initial direct costs by adding them to the carrying amount of the right-of-use asset and the right to receive lease payments, respectively.
Rates for Lessee and Lessor Accounting	Lessees use the incremental borrowing rate unless the implicit rate is known. Lessors use the implicit rate