

## Lease Project Outreach News

### *The FASB/IASB Seek to Justify Straight Line Expense in Leases Project*

*Article by Bill Bosco, Leasing 101*

The latest FASB/IASB Lease Accounting Project meetings on February 28 and 29 had as the main objective changing the lessee cost pattern to straight line similar to current GAAP. The reason for the continued work on the lessee cost pattern is that most comment letters to the Lease Project Exposure Draft (ED) supported a straight line cost pattern for what we call operating leases under current GAAP to better reflect a lease's economic effects in lessee financial statements.

The Boards could not agree on any of the three lessee accounting approaches presented by the staff at the meetings and directed the staff to conduct outreach to get preparer and user feedback on the proposed approaches. The outreach meetings will run through the end of April 2012, further delaying the issuance of a new exposure draft.

**The important news here is that after the meeting the Boards added a fourth approach that the ELFA has been recommending from the start of the Leases project.** The four methods that are being discussed at the outreach meetings are:

- The right of use (ROU) approach as presented in the Leases Project Exposure Draft whereby the ROU asset is amortized straight line and interest is imputed versus the ROU liability using the "effective interest method". This ROU approach is the lessee accounting method in the project tentative decisions as of now but it has been highly criticized in the comment letters as it front loads lease costs.
- The interest based amortization (IBA) approach which amortizes the asset on a basis that factors in the timing and amount of rent payments as well as the assumed pattern of benefits realized from use of the leased asset. The resulting rate of amortization is similar to the debt amortization rate. This method only

creates a straight line pattern if the rents are level throughout the term and it is complex and involves estimates.

- The underlying asset approach (UA) which amortizes the ROU asset as the lessee estimates it consumes the value of the leased asset over the lease term (estimated decline in fair value of the underlying asset). This method only creates a straight line cost pattern if the asset's residual value at expiry is the same as the fair value at inception (this may be the case in real estate leases but not equipment leases). This method is complex and involves estimates that may not be feasible for the lessee to make.
- The whole contract (WC) method that accrues the average rent as the reported lease cost (much the same as current GAAP) and adjusts the ROU asset and lease liability on each balance sheet date to be the present value of the remaining lease payments. The outreach information provided by the FASB/IASB staff presents this new approach as follows: "The whole contract approach considers the ROU asset and the lease liability that arise from a lease contract to be one unit of account when initially and subsequently measuring those balances. This approach views the ROU asset as being different from other non-financial assets and different from the underlying asset itself. This is because the ROU asset is inextricably linked to the lease liability, not only at lease commencement, but also throughout the lease term. This approach also does not view a lease contract as a financing transaction. "

The ELFA believes that this method reflects the appropriate values of the ROU asset and lease liability on the balance sheet that arise from the lease contract. It also reflects the cost as a level rent expense which is what lessees perceive to be their lease cost benefit for each month. The lease payment would be reported as an operating cash outflow reflecting the true nature of the payment. Hopefully the presentation of this new method will be favorably received at the outreach meetings and lead to a

successful resolution of a major issue impeding the successful resolution of the Leases Project.

**This article was written by Bill Bosco, President, Leasing 101, Tel: 914 522 3233.  
Email: [wbleasing101@aol.com](mailto:wbleasing101@aol.com). Website: [www.leasing-101.com](http://www.leasing-101.com).**