Lease Project Update: December 2013

Prepared by Bill Bosco

The next meeting on the project will be in January, where the Boards will begin re-deliberations.

The FASB and IASB met on the Leases Project on 11/20/2013 for the first time since the comment period ended for the second ED. The topics discussed were:

- The staff's summary of feedback from 638 comment letters (the majority of which were negative - I read 140 of the 638 comment letters and 76% were negative and the rest were split between fully positive letters and letters that agreed with the direction but pointed out serious issues), 8 roundtable meetings and outreach activities that included meeting 260 lessee analysts and 25 lessor analysts as well as 25 filed work meetings with lessee and lessor preparers
- The staff's recommended plan for re-deliberation

The general tone was the FASB board and FASB staff wanted to move quickly and leave lessor accounting and much of lessee accounting unchanged, while the IASB remained skeptical.

One should read the two documents that the staff presented to get the full picture of the feedback and the re-deliberation plan, as this is merely a summary of what was said.

Summary of Feedback

Overall

The presentation of feedback was much more balanced than previous presentations of feedback made by just the IASB staff. There was a lot of use of words like "many" and "most" when discussing specific items. Possibly the only thing that got general agreement was that the ED was overly complex and costly to implement and that that had to be a major priority so that the final cost-benefit analysis was clearly in favor of whatever the final solution is.

Lessee balance sheet

- Many support the need to capitalize operating lease obligations as they represent debt-like obligations (in my opinion only to a going concern)
- It is misleading not to report them on balance sheet as it under reports implied leverage
- Big concerns: cost, complexity, volume of small ticket items
- Many do not agree with the lessee model

Classification: TYPE A & B

- Varied views – creates complexity, new terminology, need to define what is property vs. equipment – many think the current GAAP criteria should be retained

Lessor

- Less support for changes to current GAAP
- Symmetry is nice to have – not necessary
- Recognize that long lived equipment is managed by some lessors like real estate = operating lease accounting best reflects economics

Definition of a lease

- Will be critical as it is the new off balance sheet line. The difference between a lease and a service must be clear.

Scope

- Concern about cost, complexity and materiality. Possibly revisiting the short-term exemption to lengthen it or only include renewals where there is a significant economic incentive to exercise. Concern about difficulty in separating non-lease components from payments.

Terminology

- There is a concern that there is new terminology, like insignificant, significant economic incentive, etc. We either need clear definitions/guidance or maybe use existing terms.

Re-assessment

- This is an area that adds complexity – thoughts are to add a higher threshold (like when a significant event occurs)

Variable payments

- Feedback was positive in general. The need for re-assessment adds complexity and should be looked at to possibly limit events that trigger re assessment

Discount rate

- They were surprised that the incremental borrowing rate was not readily available to lessees (my experience is that many SME & NIG companies do not borrow fixed rate short/medium term money so they do not have the rate needed to do the discounting – they have to figure it out by using comparables, swap rates, etc.)

Re-deliberation Plan

The staff suggested the 5 main issues for deliberation:

(a) Lessee accounting model
(b) Lessor accounting model
(c) Lease classification – integral to both lessee and lessor models
(d) Definition and scope including the short term exemption
(e) Measurement.

The suggested timeline presented:

1) Lessee model, lessor model, lease classification, scope simplifications (for example, short-term leases and unit of account (portfolio))
2) Measurement: lease term, reassessment of variable lease payments, in-substance fixed payments, residual value guarantees, and discount rate.
3) Scope: definition of a lease, separating lease and non-lease components, scope exclusions
4) Sale and leaseback, leveraged leases
5) Presentation and disclosure
6) Transition
7) Other topics: business combinations, FASB: nonpublic entities, related party leases, other consequential amendments, IASB: consequential amendments to IAS 40.
8) Effective date and cost/benefit

My opinion is that they should first acknowledge that the real objective is to capitalize operating leases, not to make wholesale changes where what is in place works well. Then they should work on lease classification as it impacts both lessee P&L and lessor accounting models. Then they should edit in their changes to definitions of lease payments, changes in variables payments and possibly sales type accounting. Finally, they should make sure that the lessee accounting is so simple that small ticket leases are not an issue (basically that means adopting our “display” executory contract accounting method and limiting reassessments).

My prediction is that the FASB will be very agreeable and flexible on the issues that dominate the comment letters (and that ELFA has been pressing for), while the IASB may resist. BUT, I hope Hans Hoogervorst will assert himself to force practicality and a quick resolution along the lines the FASB favors.