## EQUIPMENT LEASING AND FINANCING ASSOCIATION: NEWS

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## LAST DECISION-MAKING MEETING OF THE LEASES PROJECT

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On Oct. 7, the FASB held its last decision-making meeting on the Leases project. The following is a brief summary of the issues discussed at the meeting:

**1)** Over 600 comments to the fatal flaws document issued by the FASB were listed in a memo not available to the public. This document was circulated privately to a limited number of interest groups and stakeholders requesting feedback on operational aspects of the proposed standard. The comments were divided into those the staff recommended that they could deal with and those where additional Board decisions were needed.

**2)** The Board discussed how to treat Initial Direct Costs (IDC) in a sales-type lease. Under the recently completed Revenue Recognition standard, any lease that has a PV of payments of 90% or more is a sale and thus a sales-type lease. It doesn't matter if there is no selling gross profit element. The Board decided that sales-type leases without a selling profit can treat IDC as an amortized item. This is good for the industry, but some Board members expressed displeasure that it was at variance with the Revenue Recognition standard. This is another illustration where the "control" concept in Revenue Recognition is reversing the risks-and-rewards-based decisions in the Leases project.

**3)** Lessor presentation was another interesting discussion. The Board decided that the lessor's net investment in a lease should be shown net on the balance sheet and that the lessor could either disclose the breakdown in the notes or show it broadly on the balance sheet. The staff had argued for it to be net only as they say a lease is a hybrid asset (financial and non-financial) so it should not be shown broadly. It would also beg the question: should one separate the current portion of the lease receivable?

**4)** The Board decided that lease extensions that are not renewal options should be treated the same as lease renewals and options that become reasonably assured due to a lessee action. In other words, any modification that has to be recognized as well as normal renewals mean the transaction is a new lease and must be tested for classification and rebooked. The implications are that an equipment lease can flip from an operating lease to a finance lease if including the renewal/extension rents in the PV test raise the PV to greater than 90% of the asset's fair value at commencement. In real estate leases, a significant leasehold expenditure can cause a renewal to be reasonably certain to be exercised. Since most real estate leases contain renewal options set at 95% of the then-market lease rate, the renewal rents will have to be estimated and booked and then rebooked when the actual renewal rent is set.

**5)** The Board decided not to give relief to private companies.

The Board seemed confident that the year-end 2105 target for adoption will be met. The transition date has not been decided and will be controversial. If 2018 is chosen it will mean transitioning to Revenue Recognition as well as Leases. For some companies that may not be possible.

For more information on this topic, visit ELFA's Lease Accounting Project page.


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