

report

Paper AASP 13-40

Committee	Accounting and Auditing Standards Panel
Date	August 2013
Author	Steven Cain
Subject	IASB ED on Leases

Purpose

To consider

- **IASB ED/2013/6 Leases**

Comments to be received by 13 September 2013

1 Introduction

- 1.1 The IASB has re-exposed its proposed approach for the recognition and measurement of leases. For lessees, the ED proposes the recognition of a liability and a right-of-use asset for all leases with a profit or loss impact dependent on the classification of a lease. The lessor model is similar to current lease accounting with some nuances for the recognition of revenue and discounting of the residual asset.
- 1.2 The proposals take forward a 2010 ED, to which CIPFA (and 800 or so other bodies) responded. A key element of CIPFA's response was concern about the potentially onerous cost attached to application of a complex approach to large numbers of relatively low value leases.

2 Analysis and comment

- 2.1 Key elements of the ED are as follows:
- recognition on lessee balance sheets of all leases of more than 12 months duration, based on the discounted value of committed rental payments .
 - 2 models for lessee expenses, Type A and Type B
 - Type A applies mainly to Equipment, and is similar to current finance lease reporting, with separate reporting of amortisation and interest
 - Type B applies mainly to Property, allowing simpler straight line reporting of lessee expenses
 - correspondingly different lessor accounting for Type A and Type B
- 2.2 The ED also includes proposals to exclude most truly variable costs from the calculation of lease liability, while requiring consideration of whether certain apparently variable or unlikely expenses are in fact probable. The ED also acknowledges the difference between service contracts and leases, in line with related work on revenue recognition.

- 2.3 The ED seeks to address the concerns of respondents to the 2010 ED that the reporting was too complicated, and also that expenses were inappropriately front-loaded for lease arrangements where there was little 'consumption' of the underlying asset. The ED also maintains the longstanding aim of the IASB to avoid reporting 'bright lines' and to reduce the motivation for 'gaming' by avoiding significant reporting discontinuity on the borderline.
- 2.4 Inevitably, this approach is a compromise, and there is a significant tension between simplifying the accounting and avoiding bright lines, albeit one that is eased by choosing reporting which avoids discontinuity by always putting significant leases on the lessee balance sheet.
- 2.5 I have reviewed some of the responses and draft responses which have been published online, including a draft response developed by EFRAG, who are also working with the FRC. The EFRAG response laments the lack of conceptual unity in the ED, particularly in respect of the simplified treatment for Type B leases. It criticises the ED further on a number of points, especially in respect of its approach to including variable items which might in practice be fixed or substantially predictable. In my view, the EFRAG response may be over-critical, but I agree with the factual analysis in many respects.
- 2.6 CIPFA is more inclined to support standards where measurement closely reflects with an economic model. The hybrid approach of the ED may be less close than normal, but the substance is arguably close enough. Given that CIPFA along with many others has called for a pragmatic approach, I am rather wary of asking for further conceptual development. The ED may well be the best offering yet, and I suggest that CIPFA supports it.
- 2.7 I would also suggest that CIPFA should be cautious about singling out individual aspects of the accounting for amendment – the ED proposals are very much a package.
- 2.8 Even despite the simplifications compared to the 2010 ED, the proposals will not be trivial to implement, and the challenges of retrospection for large lease populations should not be underestimated. This would however, be true for most non-trivial changes to lease accounting. I will be discussing the practical ramifications with the CIPFA/LASAAC secretariat.

Recommendation

Subject to any observations from AASP members or CIPFA/LASAAC, I suggest that CIPFA should send a short supportive response in line with the above.

