

## It's December 2014, Do You Know Where The FASB Is With Its Lease Accounting Proposal?

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It seems like it has been years since we first began anticipating the new lease accounting standard from the FASB, and it has been years. As you may recall, the first Exposure Draft on revisions to lease accounting, released back in 2010, raised such an array of concerns in the feedback and comments received by the FASB that a new Exposure Draft of the Proposed Accounting Standard Update, Leases (Topic 842) – A Revision of the 2010 Proposed FASB Accounting Standards Update, Leases (Topic 840), was released for comment in May 2013. A joint project of the FASB and the IASB, it has now become clear that the final pronouncements issued by the FASB and IASB on this topic are likely to be quite different despite the joint effort to issue the new guidance.

It is now the middle of the fourth quarter of 2014 and FASB and the IASB continue their re-deliberations of the 2013 Exposure Draft. Let's check in on where the FASB is headed with respect to lessees in its standard, keeping in mind that all decisions made by FASB so far are tentative, do not change current accounting and reporting requirements, and may change until extensive due process is complete and the final standard is released.

Most recently, at the October 22, 2014 FASB meeting, the definition of a lease was decided. After nearly four years of deliberation the FASB decided that a lease is "a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration." We will leave it at that for now due to the intricacies involved in assessing whether a contract contains a lease and the need for the Board's further consideration of certain related issues.

Lessee accounting will use a dual approach with both Type A and Type B leases recognizing a right-of-use (ROU) asset and a lease liability initially measured at the present value of lease payments. Nonpublic business entities may make an accounting policy election to use a risk-free discount rate to measure the lease liability under the revised proposal. A lessee will account for most existing capital/finance leases as Type A leases recognizing amortization of the ROU asset separately from interest on the lease liability and, most existing operating leases will be accounted for as Type B leases recognizing a single total lease expense. Lessees may apply the lease guidance at the portfolio level.

No specific requirements on materiality related to small-ticket leases will be included in the revised proposed lease guidance. In addition, short-term leases of twelve months or less retain the recognition and measurement exemption for the lessee as previously proposed.

With respect to lease terms and purchase options, "an entity should consider all relevant factors that create an economic incentive to exercise an option to extend, or not to terminate, a lease." and "should include such an option in the lease term only if it is reasonably certain that the lessee will exercise the option having considered the relevant economic factors.", with "reasonably certain" being substantially the same as "reasonably assured" as defined in existing U.S. GAAP. Reassessment of the lease term by the lessee should be performed only upon the occurrence of a significant event or significant change in circumstances that is within the control of the lessee. Purchase options should be accounted for in the same way as options to extend, or not to terminate, a lease.

Only variable lease payments that are dependent on an index or a rate should be included in the initial measurement of lease assets and lease liabilities using the index or rate at the lease commencement. Reassessment of included variable lease payments should be done by a lessee only when the lessee re-measures the lease liability for other reasons, i.e. reassessment of the lease term.

Lessees will reassess the discount rate only when there is a change to either the lease term or the assessment of whether the lessee is (or is not) reasonably certain to exercise an option to purchase the underlying asset.

Lease modifications should be accounted for by a lessee as a new, separate lease when the lessee is granted an additional right-of-use not included in the original lease and the additional right-of-use is priced commensurate with its standalone price. If a modification results in a change in scope or consideration of the lease, the lessee should re-measure the lease liability using a discount rate determined at the effective date of the modification. If lease scope or consideration paid increase, the ROU asset should be adjusted correspondingly. Modifications resulting in a decrease in the scope of the lease should decrease the carrying amount of the ROU asset to reflect partial or full termination of the lease and the lessee should recognize a gain or loss on a proportionate basis to the decrease in scope.

Decisions made related to initial direct costs require inclusion of only incremental costs that an entity would not have incurred if the lease had not been executed. Initial direct costs should be included by the lessee in the initial measurement of the ROU asset and the costs amortized over the lease term.

FASB has also made decisions in the revised proposal relating to guidance on identifying separate lease components, subleases, sale and leaseback transactions, related party leasing transactions and leveraged leases.

Lessees will have the option to present Type A ROU assets (liabilities) and Type B ROU assets (liabilities) as separate line items on the balance sheet or to disclose this information in the notes. If separate line items on the balance sheet are not presented, the lessee should disclose which line items in the balance sheet include Type A ROU assets (liabilities) and Type B ROU assets (liabilities). Presenting Type A and Type B ROU assets (liabilities) within the same line items will be prohibited for lessees.

Cash flow presentation for lessees will be as follows:

- Cash payments for the principal portion of the lease liability from Type A leases = financing activity;
- Cash payments for the interest portion of the lease liability from Type A leases = operating activity;
- Cash payments from Type B leases = operating activity.

Disclosure requirements are being re-deliberated as are transition and effective dates.