



Discussion Paper (DP/2009/1)

Leases

Preliminary Views

Public Discussion

Frankfurt - June 12, 2009



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1. Vorbemerkungen

- **Presentation by chapters**
- **Presentation of the preliminary views of the Boards**
 - What are the issues?
 - Key features of the alternative views
 - ↳ no detailed explanation of the Pros and Cons
 - **prelim. View** – preliminary views of the Boards [IASB – FASB]
- **Questions to a Chapter**
 - Short form [detailed text is presented at the end of the document]
 - As a start all questions of a chapter will be presented
 - each with the preliminary views of the GASB
- **Discussion**



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2.01 Background

➤ Criticisms of IAS 17 + SFAS 13

- User's view
 - asset + liability should be recognised
 - comparability (like transactions ≠)
 - opportunities to structure
- Dividing line OL/FL => complex + subjective
- conceptually flawed

➤ History of the Project

- G4+1 – 1996 + 2000
- Project became active, jointly with FASB: July 2006
- DP – March 2009

➤ **3/09 - DP** ⇒ **HY1/2010 - ED** ⇒ **until mid 2011 - standard**

➤ **July 2008 – Lessor Accounting deferred**

		IAS 17 - Leasingverhältnisse	
Leasing Geber		Asset (PPE) no: receivable	No asset (PPE) but: <u>receivable</u>
Leasing Nehmer		No asset No liability !	Asset Liability
		Operating Lease	Finance Lease



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2.02 Scope of Lease Accounting Standard

➤ Proposal

① existing scope \leq **prelim. View**

(IAS 17 + IFRIC 4 + SIC 27)

IFRS vs. US-GAAP – Appendix B of the DP

no exclusion of so called „in-substance-purchases“

② fundamental reconsideration

➤ Scope exclusions?

Reference to the materiality principle, but

- ‘non-core asset leases’
- ‘short-term leases’



no prelim. View



2.02 Scope of Lease Accounting Standard

Q 01: **Scope** – do you agree with the approach as proposed by the boards?

prelim. GASB: yes; but alignment with US-GAAP on the basis of the scope of IAS 17;
possibly intangible assets to be scoped out;
possibly fundamental reconsideration.

Q 02: Scope exclusions for
- **short term leases** and
- **non-core asset leases**?

prelim GASB: scope exclusions are not necessary –
materiality principle will act as a corrective.



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2.03 Approach to Lease Accounting

➤ **Analysing of rights and obligations arising in a simple lease**

- Display of rights and obligations arising in a simple lease

Rights lessee

- Right to use the asset for the lease term

Obligations lessee

- Obligation to pay the rentals
- Obligation to return the asset at the end of the lease term

- Application of the asset and liability definitions
 ↪ please refer to next slide



2.03 Approach to Lease Accounting

- **Analysis of rights and obligations – simple lease**
=> **prelim. View:**

Description of Right	Control?	Past event?	Future economic benefits?	Asset?
Right to use machine during the lease term	Yes, lease contract	Yes, delivery following signing	Yes	Yes
Description of Obligation	Present obligation?	Past event?	Outflow of future economic benefits?	Liability?
Obligation to pay rentals	Yes, lease contract	Yes, delivery following signing	Yes	Yes
Obligation to return the machine	Yes, lease contract	Yes, delivery following signing	No	No



2.03 Approach to Lease Accounting

➤ A new approach

- **Rights-of-Use-approach (RoU)**

rejected (see appendix C of the DP):

- whole asset approach
- executory contract approach
- approach adopted in the existing standards

prelim. View: RoU-**asset** – right to use the leased item for the lease term
liability for the obligation to pay rentals

➤ Accounting for more complex leases

- no components approach **<= prelim view**

but:

- one asset
- one liability

because: practical considerations – components are often interrelated –
opportunities for structuring – problems to determine FV –
not necessarily the better information for users –



2.03 Approach to Lease Accounting

Q 03: **Analysis of the rights and obligations** with regard to the definitions of assets and liabilities (Framework) – do you agree?

prelim. GASB: yes.

Q 04: **Recognition** based on the RoU-approach of
- a **RoU-asset** and
- a **liability to pay rentals**?

prelim GASB: yes – subject to a later comprehensive evaluation of the approach and a commitment by the boards to implement this approach on a wider scale (?).

Q 05: **No components approach** for complex lease contracts?

prelim. GASB: no – specifically for options and residual value guarantees the components approach shall be required.



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2.04 Initial Measurement

➤ **Measuring the obligation to pay rentals**

meets definition of a financial liability in IAS 32

① Fair Value (FV) preferred –

but in most lease contracts it is not possible to observe it

② **DCF-techniques** – in this connection the interest rate:

① the interest rate implicit in the lease

② the lessee's incremental borrowing rate \leq **prelim. View**

↪ in most instances: 'reasonable approximation to FV' + simpler for lessees

➤ **Measuring the right-of-use asset**

Not a financial asset

① at FV

② at cost (AK) = obligation to pay rentals \leq **prelim. View**



2.04 Initial Measurement

Q 06: **Initial measurement of the obligation to pay rentals -**
at the present value of the lease payments discounted using
the lessee's incremental borrowing rate – do you agree?

prelim. GASB: yes – but the existing requirement in IAS 17.20
should be maintained (use of the two interest rates).

Q 07: **Initial Measurement of the RoU-asset at cost – do you**
agree?

prelim. GASB: yes.



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2.05 Subsequent Measurement

- **A linked approach to subsequent measurement**
 - In a lease there is a link between the obligation to pay rentals and the RoU-asset
 - 'linked approach' (example on page 39/40) => rejected

- **Subsequent measurement of the obligation to pay rentals**
 - ① FV – rejected
 - ② amortised cost-based approach <= **prelim. View**

- Reassessment of the incremental borrowing rate
 - => **prelim. View** IASB: **yes** (at each reporting date or only upon change in estimated CF?)
 - => **prelim. View** FASB: **no**



2.05 Subsequent Measurement

- Accounting for changes in estimated cash flows
(example page 45/46 DP)

Approach	Original carrying amount at the end of year 3	Original effective interest rate	Revised carrying amount at the end of year 3	Revised effective interest rate
Prospective	62,400	8%	62,400	42%
Catch-up	62,400	8%	115,900	8%
Retrospective	62,400	8%	97,900	16%

=> **prelim. View** IASB: catch-up with **updated** incr. borrow. rate

=> **prelim. View** FASB: catch-up with **original** incr. borrow. rate

- Subsequent Measurement – cross-referencing to existing guidance?



2.05 Subsequent Measurement

➤ Subsequent measurement of the RoU-asset

- ① FV – rejected
- ② amortised cost
 - **prelim. View** some of FASB: rental expense*
 - **prelim. View** others (incl. IASB): depreciation / amortisation*

* Comment possibly not systematic here => since referring to presentation

• Impairment

- necessary
- not yet **prelim. View**



2.05 Subsequent Measurement

Q 08: Subsequent measurement of the **obligation to pay rentals** and **RoU-asset** based on amortised cost-approach. Do you agree?

prelim. GASB: yes.

Q 09: Should a new lease accounting standard permit a lessee to elect to measure its obligation to pay rentals at **fair value**?

prelim. GASB : no.

Q 10: Should the lessee be **required to revise** its obligation to pay rentals to reflect **changes in its incremental borrowing rate**?

prelim. GASB : no.



2.05 Subsequent Measurement

Q 11: Should the boards require lessees to account for the obligation to pay rentals in accordance with **existing guidance** for financial liabilities?

prelim. GASB: no.

Q 12: Should for some leases the decrease in value of the RoU-asset be described as **rental expense** rather than amortisation or depreciation in the income statement?

prelim. GASB : Question is not clear since it relates to presentation issues.



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2.06 Leases with options

➤ Introduction

- Term options and purchase options (contractual options)
- No consideration of 'implicit options'

➤ Recognition of leases with term options

- **Basis:** no components approach (one asset + one liability)
- **two alternatives:** uncertainty about lease term is addressed through
 - ① measurement
 - ② recognition **<= prelim. View**
- **Determining** the lease term
 - ① Probability threshold ("bright-line-test")
 - ② qualitative assessment
 - ③ most-likely approach **<= prelim. View**



2.06 Leases with options

- **Factors to be considered in determining the lease term**
 - ① contractual, non-contractual financial, business => **yes**
 - ② Lessee specific, lessee's intentions and past practice => **no**
- **Reassessment of the lease term** (examples 6 - 8 of the DP)
 - is considered necessary
 - Accounting for a change in the obligation to pay rentals:
 - ① in profit and loss
 - ② to the carrying amount of the RoU-asset <= **prelim. View**
 - ③ recalculate based on reassessed term and adjust asset and liability (and P&L).
- **Leases with purchase options** – treat like term options
=> **prelim. View** (but: partly concerns due to poss. overstatement of RoU-asset))
- **Leases with both purchase and renewal options**
Outcome at start of the lease to be determined based on the most likely approach (+ reassessments necessary) <= **prelim. View**



2.06 Leases with options

Q 13: Lease contract over 10 years with an option to extend for 5 years – decision based on the **most-likely approach** whether liability is an obligation to pay 10 or 15 years rentals. Do you agree?

prelim. GASB: no – a components approach should be applied (① Option can be measured by the lessee – ② Option can not be measured).

Q 14: **Regular reassessments** with any changes in the obligation to pay rentals to be considered **against the RoU-asset**. Do you agree?

prelim. GASB : no – reassessment only for the option in case it can be reliably measured.

Q 15: **Purchase options** to be treated like term-options?

prelim. GASB : still open.



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2.07 Contingent rentals and residual value guarantees

➤ Contingent rentals

- **3 categories** - based on: ① indices or prices ② usage ③ performance
it remains unchanged: in embedded derivatives – to be separated
- **Recognition**
 - ① recognise expense as incurred
 - ② reflect in the measurement **<= prelim. View**
[but: also other view; 7.12]
- **Measurement**
 - ① probability-weighted estimate **<= prelim. View IASB**
 - ② most likely rental payment **<= prelim. View FASB**
- **Reassessment of contingent rentals** **<= prelim. View**
- **Accounting for a change in the obligation to pay rentals.**
 - ① against the RoU-asset **<= prelim. View IASB**
 - ② in profit or loss **<= prelim. View FASB**



2.07 Contingent rentals and residual value guarantees

➤ Residual value guarantees

- **Recognition** – as part of the liability **<= prelim. View**
- **Measurement**
 - ① probability-weighted estimate **<= prelim. View IASB**
 - ② most likely rental payment **<= prelim. View FASB**
 - ③ maximum amount payable (IAS 17)
- **Reassessment** **<= prelim. View**
- **Accounting for a change**
 - ① against the RoU-asset **<= prelim. View IASB**
 - ② in profit or loss **<= prelim. View FASB**
- **Applying the approach to a lease that includes an option**
 - option to extend the lease and
 - residual value guarantee
 - => prelim. View:** more-likely approach



2.07 Contingent rentals and residual value guarantees

Q 16: Lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements - do you agree?

prelim. GASB: still open.

Q 17: **IASB:** probability-weighted estimate,
FASB: most likely rental payments.
Which approach do you favour?

prelim. GASB: still open.

Q 18: **FASB:** if lease rentals are contingent on changes in an index or rate, the lessee should measure the obligation to pay rentals using the index or rate existing at the inception of the lease.
Do you agree?

prelim. GASB: yes.



2.07 Contingent rentals and residual value guarantees

Q 19: Reassessments are required – do you agree?

prelim. GASB: still open.

Q 20: How to recognise changes in the lessee's obligation to pay rentals arising from **changes in estimate** – in P&L or against the RoU-asset?

prelim. GASB : still open.

Q 21: Recognition and measurement requirements for contingent rentals and **residual value guarantees** should be the same. Do you agree?

prelim. GASB: still open.



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2.08 Presentation

➤ **Obligation to pay rentals (SoFP)**

- ① no separate presentation necessary <= **prelim. View** IASB
- ② separate presentation necessary <= **prelim. View** FASB

➤ **RoU-Asset (SoFP)**

- ① acc. to the nature of the underlying leased item <= **prelim. View**
(but separate from own PP&E)
- ② as an intangible asset
- ③ on the basis von classification
 - „in-substance purchases“ => PP&E / Intangible assets
 - other lease contracts => RoU-assets (= intangibles)

=> **prelim. View** of some FASB-members:
specific treatment for „in-substance purchases“

so there would be **three categories** as follows:

- owned motor vehicles
- leased motor vehicles (in-substance purchases)
- leased motor vehicles (RoU – assets)



2.08 Presentation

➤ Implications of proposed changes to financial statement presentation

RoU-asset = business asset => either operating or investing asset
amort./depr. = business activity => either operating or investment expense

Obligation to pay rentals => either a business liability
(operating or investing)
or a financing liability

interest expense => consistent with classification of obligation

Cash rental payments => payments of interest and repayment
to be classified consistent with the above



2.08 Presentation

Q 22: **Separate presentation of the lessee's obligation to pay rentals?**

prelim. GASB: still open.

Q 23: Which of the following three approaches to **presentation of the RoU-asset** do you prefer?

- ① on the basis of the nature of the leased item
- ② as intangible asset
- ③ on the basis of the classification

Which **additional disclosures** do you consider necessary?

prelim. GASB: still open.



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2.09 Other lessee issues

- **Timing of initial recognition**
 - to deal with rights and obligations (and being assets and liabilities) which are transferred to the lessee before commencement date
- **Sale-and-Lease-back - transactions**
 - 3 approaches are discussed:
 - ① financing
 - ② sales
 - ③ hybrid model
- **Initial direct costs**
 - retaining the current approach or expense as incurred - approach
- **Leases that include service arrangements**
 - develop guidance on how to separate payments (services vs. lease)
- **Disclosure**
 - review current requirements and decide which to retain



2.09 Other lessee issues

Q 24: Are there any **lessee issues** not described in the DP that should be addressed in this project?

prelim. GASB: still open.



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2.10 Lessor Accounting

➤ Application of the right-of-use model to lessors

=> „High-Level Discussion“

1 Lease contract transfers a portion of the leased item

- asset: receivable lessor = right to receive lease payments
- asset: residual value asset
- derecognition of the leased item
(=> no performance obligation)

DR: Lease receivable	CR: Leased item
DR: Residual value	

2 Lease contract creates a new right and obligation

- lessor does not lose control of the leased property

DR: Lease receivable	CR: Performance obligation
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2.10 Lessor Accounting

➤ Subleases

- ① provide additional guidance on how to apply the existing lessor accounting standards to subleases;
- ② exclude the head lease from the scope of the new standard;
- ③ Develop a lessor right-of-use model for subleases only.

➤ Other lessor considerations

- if a lessor RoU-model is developed the following issue will also need to be resolved
 - initial and subsequent measurement
 - leases with options
 - contingent rentals and residual value guarantees
 - „leveraged leases“ (US-GAAP)
 - presentation
 - disclosure

➤ Investment properties – IAS 40



2.10 Lessor Accounting

Q 25: Do you think a lessor's **right to receive rentals** under a lease meets the definition of an **asset**?

prelim. GASB: yes.

Q 26: In the DP two possible approaches to lessor accounting under a RoU model are proposed:
① **derecognition** of the leased item by the lessor, and
② recognition of a **performance obligation** by the lessor.
Which of these two approaches do you support?

prelim. GASB: approach ①.

Q 27: Should the boards explore when it would be appropriate for a lessor to **recognise income** at the **inception of the lease**?

prelim. GASB: no.



2.10 Lessor Accounting

Q 28: Should accounting for **investment properties** be included within the scope of any proposed new standard on lessor accounting?

prelim. GASB: yes.

Q 29: Are there **any lessor accounting issues** not described in the DP that the boards should consider?

prelim. GASB:

- sales type leases – revenue recognition;
- presentation issues.



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3. Concluding Remarks

- **In addition to answering the single questions, the GASB presumably will comment in its **cover letter** as follows:**
 - refusal to defer **lessor accounting**;
 - general **support of the RoU model** –
but request to implement the approach on a wider scale (?);
 - identification of **conceptual inconsistencies**;
 - recommendation of a **components approach for options**;
 - consideration of **reassessments** of the obligation to pay rentals only if **substantiated evidence** is available.

- **Do you want to propose any **other main issues**?**



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Appendix: Questions in original text

Questions for respondents

Question 1

The boards tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards. Do you agree with this proposed approach?

If you disagree with the proposed approach, please describe how you would define the scope of the proposed new standard.

Question 2

Should the proposed new standard exclude non-core asset leases or short-term leases? Please explain why. Please explain how you would define those leases to be excluded from the scope of the proposed new standard.



Anhang: Fragen im Originaltext

Question 3

Do you agree with the boards' analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract? If you disagree, please explain why.

Question 4

The boards tentatively decided to adopt an approach to lessee accounting that would require the lessee to recognise:

- (a) an asset representing its right to use the leased item for the lease term (the right-of-use asset)
- (b) a liability for its obligation to pay rentals.

Appendix C describes some possible accounting approaches that were rejected by the boards.

Do you support the proposed approach?

If you support an alternative approach, please describe the approach and explain why you support it.



Anhang: Fragen im Originaltext

Question 5

The boards tentatively decided not to adopt a components approach to lease contracts. Instead, the boards tentatively decided to adopt an approach whereby the lessee recognises:

- (a) a single right-of-use asset that includes rights acquired under options
- (b) a single obligation to pay rentals that includes obligations arising under contingent rental arrangements and residual value guarantees. Do you support this proposed approach? If not, why?

Question 6

Do you agree with the boards' tentative decision to measure the lessee's obligation to pay rentals at the present value of the lease payments discounted using the lessee's incremental borrowing rate?

If you disagree, please explain why and describe how you would initially measure the lessee's obligation to pay rentals.



Anhang: Fragen im Originaltext

Question 7

Do you agree with the boards' tentative decision to initially measure the lessee's right-of-use asset at cost?

If you disagree, please explain why and describe how you would initially measure the lessee's right-of-use asset.

Question 8

The boards tentatively decided to adopt an amortised cost-based approach to subsequent measurement of both the obligation to pay rentals and the right-of-use asset. Do you agree with this proposed approach? If you disagree with the boards' proposed approach, please describe the approach to subsequent measurement you would favour and why.



Anhang: Fragen im Originaltext

Question 9

Should a new lease accounting standard permit a lessee to elect to measure its obligation to pay rentals at fair value? Please explain your reasons.

Question 10

Should the lessee be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate? Please explain your reasons.

If the boards decide to require the obligation to pay rentals to be revised for changes in the incremental borrowing rate, should revision be made at each reporting date or only when there is a change in the estimated cash flows? Please explain your reasons.



Anhang: Fragen im Originaltext

Question 11

In developing their preliminary views the boards decided to specify the required accounting for the obligation to pay rentals. An alternative approach would have been for the boards to require lessees to account for the obligation to pay rentals in accordance with existing guidance for financial liabilities.

Do you agree with the proposed approach taken by the boards?
If you disagree, please explain why.

Question 12

Some board members think that for some leases the decrease in value of the right-of-use asset should be described as rental expense rather than amortisation or depreciation in the income statement.
Would you support this approach? If so, for which leases?
Please explain your reasons.



Anhang: Fragen im Originaltext

Question 13

The boards tentatively decided that the lessee should recognise an obligation to pay rentals for a specified lease term, ie in a 10-year lease with an option to extend for five years, the lessee must decide whether its liability is an obligation to pay 10 or 15 years of rentals. The boards tentatively decided that the lease term should be the most likely lease term. Do you support the proposed approach?

If you disagree with the proposed approach, please describe what alternative approach you would support and why.



Anhang: Fragen im Originaltext

Question 14

The boards tentatively decided to require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances. Changes in the obligation to pay rentals arising from a reassessment of the lease term should be recognised as an adjustment to the carrying amount of the right-of-use asset.

Do you support the proposed approach?

If you disagree with the proposed approach, please describe what alternative approach you would support and why.

Would requiring reassessment of the lease term provide users of financial statements with more relevant information?

Please explain why.



Anhang: Fragen im Originaltext

Question 15

The boards tentatively concluded that purchase options should be accounted for in the same way as options to extend or terminate the lease. Do you agree with the proposed approach?

If you disagree with the proposed approach, please describe what alternative approach you would support and why.

Question 16

The boards propose that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements.

Do you support the proposed approach?

If you disagree with the proposed approach, what alternative approach would you recommend and why?



Anhang: Fragen im Originaltext

Question 17

The IASB tentatively decided that the measurement of the lessee's obligation to pay rentals should include a probability-weighted estimate of contingent rentals payable. The FASB tentatively decided that a lessee should measure contingent rentals on the basis of the most likely rental payment. A lessee would determine the most likely amount by considering the range of possible outcomes. However, this measure would not necessarily equal the probability-weighted sum of the possible outcomes.

Which of these approaches to measuring the lessee's obligation to pay rentals do you support? Please explain your reasons.



Anhang: Fragen im Originaltext

Question 18

The FASB tentatively decided that if lease rentals are contingent on changes in an index or rate, such as the consumer price index or the prime interest rate, the lessee should measure the obligation to pay rentals using the index or rate existing at the inception of the lease. Do you support the proposed approach? Please explain your reasons.

Question 19

The boards tentatively decided to require remeasurement of the lessee's obligation to pay rentals for changes in estimated contingent rental payments. Do you support the proposed approach? If not, please explain why.



Anhang: Fragen im Originaltext

Question 20

The boards discussed two possible approaches to recognising all changes in the lessee's obligation to pay rentals arising from changes in estimated contingent rental payments:

- (a) recognise any change in the liability in profit or loss
- (b) recognise any change in the liability as an adjustment to the carrying amount of the right-of-use asset.

Which of these two approaches do you support? Please explain your reasons. If you support neither approach, please describe any alternative approach you would prefer and why.



Anhang: Fragen im Originaltext

Question 21

The boards tentatively decided that the recognition and measurement requirements for contingent rentals and residual value guarantees should be the same. In particular, the boards tentatively decided not to require residual value guarantees to be separated from the lease contract and accounted for as derivatives.

Do you agree with the proposed approach? If not, what alternative approach would you recommend and why?

Question 22

Should the lessee's obligation to pay rentals be presented separately in the statement of financial position?

Please explain your reasons.

What additional information would separate presentation provide?



Anhang: Fragen im Originaltext

Question 23

This chapter describes three approaches to presentation of the right-of-use asset in the statement of financial position.

How should the right-of-use asset be presented in the statement of financial position?

Please explain your reasons.

What additional disclosures (if any) do you think are necessary under each of the approaches?

Question 24

Are there any lessee issues not described in this discussion paper that should be addressed in this project? Please describe those issues.



Anhang: Fragen im Originaltext

Question 25

So you think that a lessor's right to receive rentals under a lease meets the definition of an asset? Please explain your reasons.

Question 26

This chapter describes two possible approaches to lessor accounting under a right-of-use model: (a) derecognition of the leased item by the lessor or (b) recognition of a performance obligation by the lessor. Which of these two approaches do you support? Please explain your reasons.

Question 27

Should the boards explore when it would be appropriate for a lessor to recognise income at the inception of the lease? Please explain your reasons.



Anhang: Fragen im Originaltext

Question 28

Should accounting for investment properties be included within the scope of any proposed new standard on lessor accounting? Please explain your reasons.

Question 29

Are there any lessor accounting issues not described in this discussion paper that the boards should consider? Please describe those issues.