MINUTES

Financial Accounting Standards Board

To:	Board Members		
From:	Leases Team—Hoyt (ext. 298)		
Subject:	Minutes of the March 21, 2007 Board Meeting: Leases—Identification of Assets and Liabilities and Analysis of Different Accounting Models	**Date:**	March 27, 2007
cc:	Leisenring, Bielstein, L. Smith, MacDonald, Lott, Zeyher, Roberge, Sledge, T. Johnson, C. Smith, Glotzer, Allen, Carney, Gabriele, Sutay, FASB Intranet, FASAC: Chookaszian, Polley, IASB: Upton, Hickey, Knubley, Peerless		

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Topic:	Leases: Identification of Assets and Liabilities and Analysis of Different Accounting Models
Basis for Discussion:	Board Memorandum Nos. 1, 2, 3, 4, and 5
Length of Discussion:	11:00 a.m. to 11:30 a.m.

Attendance:

Board members present:	FASB: Herz, Batavick, Crooch, Linsmeier, Seidman, Trott, and Young
Board members absent:	None
Staff in charge of topic:	Zeyher and Roberge
Other staff at Board table:	Bielstein, T. Johnson, Hoyt, and Sledge
Outside participants:	IASB staff: Knubley and Peerless (by phone)

Summary of Decisions Reached:

The Board discussed assets and liabilities arising from a simplified lease contract and a staff analysis of different possible models of accounting for those contracts. For the simple, non-cancelable lease example discussed, the Board tentatively decided that:

1. The lessee has an asset for the right to use the leased item over the lease term and a liability for the obligation to make payments over the lease term. The lessor has an asset for the right to receive payments over the lease term.

2. The staff should base future analyses on the existing conceptual framework; however, the staff should monitor developments in the conceptual framework project and consider whether those developments would change the staff's analyses and conclusions.

3. The staff should continue to develop the right-of-use model with the understanding that issues pertaining to measurement, presentation, derecognition, recognition, and scope have not yet been considered and could affect preliminary conclusions. The Board directed the staff to provide an expanded analysis of this simple lease transaction, for both the lessee and the lessor, in order to better understand the accounting and presentation of assets and liabilities under a right-of-use model.

Objective of the Meeting:

The objectives of the meeting were to (1) identify the assets and liabilities arising in a simple lease contract, (2) decide whether the staff should base future analysis on existing definitions of assets and liabilities found in the conceptual framework, proposed working definitions, or both, and (3) determine which of the four proposed lease accounting models the staff should continue to develop. The objectives of the meeting were met.

Matters Discussed and Decisions Reached:

IDENTIFICATION OF ASSETS AND LIABILITIES IN A SIMPLE LEASE

1. Ms. Zeyher began the meeting by directing the Board to Board Memorandum No. 2, which identifies the assets and liabilities that arise in a simple lease contract in which a piece of machinery with an expected life of 10 years is leased for a fixed term of 5 years with no complex clauses. She clarified that the staff has not addressed measurement, recognition, derecognition, revenue recognition, or presentation issues at this point.

2. Ms. Zeyher stated that the staff has identified the rights and obligations of the lessee and the lessor arising from this simple lease contract and has determined which of those rights and obligations meet the definition of assets and liabilities under both the current conceptual framework as well as the preliminary revised definitions under the current joint conceptual framework project. She stated that the staff's preliminary analysis has resulted in similar assets and liabilities being identified under both sets of definitions.

3. Ms. Zeyher stated that the staff's preliminary conclusions in identifying the lessee's assets and liabilities in this simple lease example are as follows:

    a. The lessee has an asset for the right to use the machinery for the lease term—the right to the economic benefits derivable from use of the machinery.
    b. The lessee has a liability for the obligation to make specified payments over the lease term.
    c. The lessee's obligation to return the machinery at the end of the lease term does not meet the definition of a liability because the lessee has no right to the economic benefit of the machinery at the end of the lease term and there is no outflow of economic benefit when the lessee returns the machinery.

4. Ms. Zeyher continued by stating that the staff's preliminary conclusions with respect to the lessor's assets and liabilities under this simple lease example are as follows:

a. The lessor's obligation to permit use of the machinery during the lease term does not meet the definition of a liability because the obligation does not result in a future outflow of economic benefits since that outflow had already taken place when the machinery was delivered.
b. The lessor has an asset for the right to receive payments during the lease term.
c. The lessor's right to return of machinery at the end of the lease term does not meet the definition of an asset because it does not result in an inflow of economic benefits.
d. The lessor has an asset for the right to the economic benefits derivable from the use of the machinery in the period after the lease term (residual rights). This asset arises from the lessor's legal right to the machinery as opposed to rights that arise from the lease contract.

5. Mr. Herz stated that he supports the staff's conclusions with respect to the lessee. However, the staff's preliminary analysis with respect to the lessee's obligation to return the machinery assumes an instantaneous redelivery at no cost to the lessee and does not consider transportation expenses relating to redelivery as well as the obligation to return the machinery in a certain condition.

6. Mr. Linsmeier stated that he supports the staff's conclusions, but would like to see the staff's preliminary journal entries with respect to this example to better understand the accounting and presentation. He stated that the staff's analysis is consistent as long as the machinery no longer resides on the lessor's balance sheet. However, other alternatives for accounting for this simple lease may include keeping the machinery on the lessor's balance sheet. If the asset were to remain on the lessor's books, even though it resided with the lessee, the lessor may have an obligation to permit the use of the machinery and, therefore, the accounting would be different.

7. All Board members supported the staff's preliminary conclusions. However, the Board noted that it has not explored issues with regard to measurement, recognition, derecognition, and presentation and how these issues may change the staff's preliminary conclusions.

CONCEPTUAL BASIS FOR DEFINITIONS OF ASSETS AND LIABILITIES

8. Ms. Zeyher asked the Board if the staff should base future analysis on the existing definitions of assets and liabilities within the conceptual framework, on proposed working definitions, or both. She stated that the staff recommends focusing their analyses on existing definitions in reaching preliminary conclusions for reasons of efficiency and the fact that the leases project may influence the direction of the conceptual framework.

9. Mr. Linsmeier stated that perhaps the question being asked is whether the staff should be writing about both definitions in their documentation going forward. He stated that he supports reading documentation based on existing definitions provided the staff continues to monitor proposed revisions to the working definitions that could potentially change the staff's conclusions.

10. The Board agreed with the staff's recommendations to base future analysis on existing definitions of assets and liabilities bearing in mind the implications of revisions to working definitions and how the staff's conclusions might change.

PROPOSED LEASE ACCOUNTING MODELS AND FURTHER DEVELOPMENT

11. Ms. Zeyher presented the four proposed lease accounting models to the Board—the right-of-use model, the whole asset model, the executory contract model, and the current lease accounting model. She asked which of these models the Board would like the staff to continue to develop.

12. All Board members supported the staff's recommendations to further develop the right-of-use model. However, Board members raised concerns with how the model will account for both non-core, high volume leases over relatively short terms as well as leases whose terms extend for practically the entire useful life of the leased item and which, in substance, appear to belong on the balance sheet of the lessee. The consensus among Board members was that accounting for these leases at the extreme

ends of the continuum, particularly for the lessor, is going to be difficult and raises questions with respect to recognition, derecognition, classification, presentation, and measurement, all of which remain unresolved at this point.

13. Mr. Young stated that he is concerned with the fact that there is no accounting for the forgoing of economic benefits derivable from the leased item (a credit) when the lessor enters into a lease, even though under this model, the lessee would recognize as an asset those same benefits in the form of a right of use. He stated that investors would like to see the same accounting for the asset regardless of the financing. However, he is concerned, at this early stage, that the staff is proposing a right-of-use model that changes the accounting for the asset such that it looks very different if it is leased as opposed to purchased. He stated that the example proposed under this model for the lessor is a derecognition of the machinery and then a return to the balance sheet as a residual. He stated that investors would be better served with the asset being retained on the balance sheet with a credit accumulating against it.

Follow-up Items:

14. The staff will provide the Board with preliminary journal entries reflecting the accounting of the simple lease example presented in Board Memorandum No. 2 under the right-of-use model.

General Announcements:

None.