MINUTES

Financial Accounting Standards Board

To: Board Members

From: Leases Team (Martin, ext. 354)

Subject: Minutes of the May 18, 2009, Board Meeting: Lessor Accounting-Right-of-Use Model **Date:** May 29, 2009

cc: FASB: Bielstein, Golden, Lott, Stoklosa, Proestakes, Zeyher, Nickell, Homant, Helmus, C. Smith, Brickman, Hood, Sutay, Glotzer, Mechanick, Gabriele, McGarity, Klimek, Willis, FASB Intranet; FASAC: Chookaszian, Posta; IASB: Leisenring, Francis, Knubley, Kim, Vatrenjak

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement, Interpretation, or FASB Staff Position.

Topic:	Lessor Accounting—Right-of-Use Model
Basis for Discussion:	Memorandum #29 (IASB Agenda Paper 11)
	Memorandum #30 (IASB Agenda Paper 11A)
Length of Discussion:	9:00 a.m. to 9:50 a.m.
Attendance:	
Board members present:	Herz, Linsmeier, Seidman, Siegel, and Smith
Board members absent:	None
Staff in charge of topic:	Zeyher
Other staff at Board table:	Golden, Stoklosa, Homant, and Martin
Outside participants:	Knubley (IASB)

Summary of Decisions Reached

The Board discussed how a lessor would apply a right-of-use model, and reached the following tentative decisions:

1. A lessor would recognize an asset representing its right to receive rental payments (a lease receivable).
2. A lessor would recognize a liability representing its performance obligation under the lease—that is, its obligation to permit the lessee to use one of its assets (the leased item). The lessor will satisfy that performance obligation (and will recognize revenue) over the lease term.
3. A lessor would not recognize any revenue at the inception of a lease contract.

The Board will discuss at a future meeting:

1. How a lessor would initially and subsequently measure the leased item, the lease receivable, and the performance obligation.
2. How a lessor would present the leased item, the lease receivable, and the performance obligation in its statement of financial position.
3. What differentiates a sale of an asset from a lease.
4. Whether a lessor would apply a right-of-use model to a short-term or immaterial lease.

Objective of the Meeting:

The objective of the meeting was for the Board to discuss lessor accounting under the right-of-use model. The objective of the meeting was met.

Matters Discussed and Decisions Reached:

Issue 1: Lessor's Right to Receive Rental Payments during the Lease Term

1. **Staff Recommendation:** The staff asked the Board to confirm a previously reached tentative decision that the right to receive rental payments from the lessee meets the definition of an asset for the lessor.

2. **Board Vote:** The Board unanimously agreed that the right to receive rental payments from the lessee meets the definition of an asset for the lessor.

Issue 2: The Corresponding Credit

3. **Staff Recommendation:** The staff presented two approaches to lessor accounting under the right-of-use model. Under Approach A, the lease contract transfers a portion of the leased item from the lessor to the lessee and under Approach B, the lease contract creates a new right and obligation of the lessor. A more detailed description of the approaches can be found in the Board meeting handout. The staff recommended Approach A.

4. **Board Vote:** The Board decided that lease contract creates a new right (the lessor's right to receive rental payments from the lessee), a lease receivable, and a new obligation (a performance obligation for the lessor to permit the lessee to use one of its assets, the leased item). The lessor will satisfy its performance obligation and will recognize revenue over the lease term. A lessor would not recognize any revenue at the inception of a lease contract. The Board directed the staff to develop a third hybrid approach to be discussed at a future meeting. That hybrid approach would focus on the presentation of the leased item, the lease receivable, and the performance obligation in the lessor's statement of financial position.

5. **Board Comments:** Ms. Seidman observed that a lease contract clearly creates a new right for a lessor: a right to receive a stream of rental payments. The question to be resolved is whether the lessor sold a part of the leased asset or incurred an obligation in exchange for this right. Ms. Seidman further stated that the lessor exchanged a right to use its asset for a stream of rental payments, and that a lease contract does not give rise to a gain or loss on day one.

6. Mr. Linsmeier suggested that a distinction should be made between lease contracts that in effect transfer ownership of the leased asset to the lessee (for example, leases that provide for title transfer at the end of the lease term or contain a bargain purchase option that is likely to be exercised) and those that do not. While it may be appropriate to derecognize the leased asset on lessor's books for leases that transfer

ownership of the asset to the lessee, it would not be appropriate to do so for those leases that do not transfer ownership. Additionally, Mr. Linsmeier noted that while the lessor should continue allocating the cost of the asset (amortizing), that expense should not be labeled as depreciation because depreciation of an asset is linked to its use, and the lessor transfers the right to use the asset to lessee.

7. Mr. Herz supported the principle behind Approach A. Mr. Herz stated that the lessor's assets under a lease contract consist of a lease receivable and a right to the residual. Even if a lease does not transfer the title to the leased asset, the leased asset does not convey benefits to the lessor beyond those reflected in the lease receivable and the right to the residual interest in the asset. However, Mr. Herz was concerned about the application of Approach A to short-term leases of long-term assets and immaterial leases, such as hotel rooms and car rentals.

8. Mr. Siegel supported Approach B and suggested that credit could be presented as a valuation allowance against the leased asset. Mr. Siegel said that the asset should not be derecognized because it continues to generate a stream of cash flows for the lessor.

9. Mr. Smith suggested an approach under which the lessor would record the lease receivable, reduce the carrying value of the leased asset proportionate to the right of use given up (for example, if a building is leased for half of its useful life, the carrying value of the building on the lessor's books would be reduced by 50 percent), and record the difference between the two amounts as a performance obligation, which would be recognized over the lease term as revenue. Mr. Smith noted that the drawback of this approach would be the inconsistency between the amount of cash received by the lessor over the term of the lease and the amount of revenue recognized.

Follow-up Items:

None.

General Announcements:

None.