



# *Straight away*

## An overview of financial reporting developments

### ***IASB and FASB propose substantial changes to the Leases exposure draft***

#### **What's new?**

At a joint meeting in London last week, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB), collectively the boards continued their redeliberation of the Leases exposure draft. The boards addressed specific concerns raised by constituents, particularly in regard to complexity and operationality. Key decisions include:

- Definition of lease term and criteria for including extension options
- Criteria for including contingent rent payments in the lease asset and obligation

These decisions are tentative and subject to change, as the boards have not yet concluded their redeliberations or issued a final standard. A complete summary of the boards' decisions on the leases project is available on the IASB's website at [www.ifrs.org](http://www.ifrs.org) or the FASB's website at [www.fasb.org](http://www.fasb.org).

#### **Key Provisions**

The redeliberation plan identified five key areas for discussion: (1) definition of a lease, (2) lessor accounting, (3) profit and loss recognition pattern, (4) lease term (extension options), and (5) variable/uncertain cash flows. The boards have discussed each of these items in their redeliberations and have identified possible alternative approaches which may reduce complexity and address certain application issues. For several of these areas, the boards have agreed that additional targeted outreach will be conducted.

The key decisions made last week relate to lease term and variable lease payments:

Major area	Summary of decisions
Lease term	The boards decided to raise the threshold for inclusion of extension options in the lease term. The exposure draft required the inclusion of extensions that were "more likely than not" to be exercised. The revised definition would include the non-cancellable lease term and any extension options where there is a significant economic incentive for the lessee to extend the lease. A list of indicators of economic incentive will be provided in the standard. Reassessment of lease term would be performed on a basis consistent with the initial measurement when there is a significant change in one or more of the indicators such that the lessee would now have, or no longer have, a significant economic incentive to extend the lease.

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Major area	Summary of decisions
Variable/ uncertain lease payments	<p>The boards decided that variable lease payments should be included in the measurement of the obligation, based on a best estimate approach, as follows:</p> <ul style="list-style-type: none"> <li>· Contingencies that are based on rate or index</li> <li>· Contingencies that are, in substance, minimum lease payments (i.e., anti-abuse provisions)</li> <li>· Any portion of residual value guarantees that are expected to be paid by the lessee</li> <li>· Any other contingencies (i.e., usage or performance) that are "reasonably certain" (as that term is used in IFRS) or "probable" (as that term is used in U.S. GAAP) to be paid</li> </ul>

### Am I affected?

All companies that enter into leasing arrangements will be affected by these decisions. Some companies will be impacted more than others depending on the number and type of leases. The boards have yet to decide on an effective date, but it likely will not be before 2014. Subsequently, Ind AS may be modified in line with these provisions.

### What do I need to do?

The comment letter period ends on March 9, 2011, and a final standard is expected mid-2011. Given the potential impact on accounting and operations, management should assess the implications of the proposals on existing hedging strategies and consider commenting on the exposure draft.

If you have questions about this issue, please contact the PwC IFRS team or your engagement partner.

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