ASBJ Statement No. 13

Accounting Standard for Lease Transactions

and

ASBJ Guidance No. 16

Guidance on Accounting Standard for Lease Transactions

March 30, 2007

Accounting Standards Board of Japan

Remarks on the Release

The Accounting Standards Board of Japan (hereinafter referred to as the "ASBJ") has so far conducted a series of deliberations on the abolition of the accounting treatment similar to ordinary rental transactions regarding finance lease transactions that do not transfer ownership.

After publishing for public comment the tentative draft and the exposure draft of the foregoing standard and guidance on July 5, 2006 and December 27, 2006, respectively, the ASBJ reviewed the comments received, and amended part of the proposed exposure draft to reflect the comments. On March 23, 2007, at the 125th meeting, the ASBJ approved the aforementioned accounting standard and guidance (hereinafter referred to as “the Accounting Standard, Etc.”) for public release.

Outline of the Accounting Standard, Etc.

■ Repeal of the accounting treatment similar to that of ordinary rental transactions regarding finance lease transactions that do not transfer ownership

The pre-revision Standard permitted, subject to specific note disclosure requirements, finance lease transactions that do not transfer ownership to be accounted for in a manner similar to accounting treatment for ordinary rental transactions. However, such treatment is no longer applicable, and the transactions shall be accounted for in a similar manner with ordinary sale and purchase transactions.

■ Classification of Lease Transactions

- Lease Transactions
  - Finance lease transactions
    - Finance lease transactions that transfer ownership
    - Finance lease transactions that do not transfer ownership
  - Operating lease transactions

■ Summary of accounting treatment of finance lease transactions that do not transfer ownership (lessee)

- ➢ At the inception of the lease, a lessee shall recognize the leased asset and the related lease obligation as lease assets and lease liabilities.
- ➢ Leased assets and lease obligations shall be recognized at the inception of the lease at the amount equal to the lower of the present value of the total lease payments or the purchase price, etc. for the lessor (an estimated cash purchase price, etc. for the lessee if the purchase price, etc. for the lessor is not determinable).
- ➢ In principle, the total amount equivalent to interest shall be allocated over the lease term based on the interest method. However, if the total value of leased assets is considered immaterial, either of the following two methods can be adopted.
  (1) The method of not deducting a reasonable estimate of the amount equivalent to interest that is included in the total lease payment. In this case, leased assets and lease obligations shall be recognized at the amount equivalent to the total lease payments. Interest expense shall not be recognized and only depreciation expenses shall be recognized.

(2) The method of allocating the total amount equivalent to interest over the lease term under the straight line method.

- Depreciation expenses arising from a leased asset in a finance lease transaction that does not transfer ownership shall be calculated, in principle, based on the assumption that the useful life equals to the lease term and the residual value equals to zero. In this case, it is not necessary to calculate the depreciation expense based on the same depreciation method as is applied to other fixed assets owned by the lessee.
- Small-amount assets for lease transactions with the total lease payments of not more than three million yen arising from the individual lease contract or short-term lease transactions whose lease term is less than one year can be simplified and accounted for in a similar manner with ordinary rental transactions as in the case of operating leases.

■ Summary of the accounting treatment of finance lease transactions which transfer ownership (lessee)

Major differences from the treatment of finance lease transactions that do not transfer ownership are as follows:

- The total amount equivalent to interest shall be allocated over the lease term using the interest method (no special treatment allowed where the total value of leased assets is considered immaterial).
- The depreciation expense of a leased asset shall be calculated based on the same depreciation method as is applied to fixed assets owned by the lessee, in which case useful life is the expected period over which the leased asset will be economically usable.

■ Summary of the accounting treatment of finance lease transactions that do not transfer ownership (lessor)

- The total amount equivalent to interest for the lessor shall be calculated by deducting the acquisition cost of the corresponding lease asset from the aggregate of the total lease payments agreed at the inception of lease agreements and the estimated residual value.
- The total amount equivalent to interest shall be, in principle, allocated over the lease term based on the interest method. However, if lease transactions are considered to be immaterial for the lessor, such amount can be allocated over the lease term using the straight line method.
- A lessor shall recognize an “investment in leased assets” for a finance lease transaction that does not transfer ownership in a manner similar to the accounting treatment for ordinary sale transactions. Investment in leased assets arising from finance lease transactions that do not transfer ownership shall be presented as current assets if they arise

from commercial transactions that constitute the primary objective of the enterprise. If they arise from commercial transactions that do not constitute the primary business objective of the enterprise, they shall be presented as current assets if the receipt of the payment is due within one year after the balance sheet date. Otherwise, they shall be presented as fixed assets.

- Summary of the accounting treatment of finance lease transactions which transfer ownership (lessor)

Major differences from the treatment of finance lease transactions that do not transfer ownership are as follows:

- The total of the amount equivalent to interest shall be allocated over the lease term based on the interest method (no special treatment allowed where the lease transactions for the lessor are considered to be immaterial).
- A lessor shall recognize a "lease receivable" for a finance lease transaction that transfers ownership in a manner similar to the accounting treatment for ordinary sale transactions.

- Accounting for leases of real estate

Leases of real estate such as land and buildings (hereinafter, reference to leases of real estate shall mean to include leases under rental contract for real estate) shall also be classified whether they are finance lease transactions or operating lease transactions; provided that leases of land shall be presumed to be operating lease transactions unless provisions for transfer of ownership or a bargain purchase option are contained in the lease terms. The total lease payments of a lease of real estate in which both land and a building are leased together (hereinafter, reference to such lease shall mean to include a lease under rental contract for the buildings) shall be, in principle, divided into the portion attributable to the land and the portion attributable to the buildings, etc. based on a reasonable method, for the purpose of the application of the present value criterion. .

- Accounting for finance lease transactions that do not transfer ownership prior to the initial year of application (lessee)

In cases when finance lease transactions that do not transfer ownership have been accounted for in a manner similar to the accounting for ordinary rental transactions, but will have to be accounted for in a manner similar to the accounting for ordinary purchase transactions as a result of the change in the accounting standard, either of the following two methods shall be adopted.

(Rule) The accounting treatments prescribed in the Standard and its Guidance shall also apply to such lease transactions for which the inception of the lease predates the beginning of the initial year of application of the Standard. In this case, the effect of changes in accounting standards shall be accounted for as an extraordinary gain or loss.

(Exception) With respect to lease transactions whose commencement day falls prior to the first year of implementation of this accounting standard, the balance of future minimum lease payments as at the balance sheet date of the accounting year preceding the initial year of implementation of this accounting standard or the future minimum lease payments at the end of the year (after deduction of the interest element) shall be regarded as the acquisition cost, at which leased assets are recognized as if acquired at the beginning of the year, or the accounting treatment similar to that used for ordinary rental transactions shall continue to be applied subject to specific disclosure in the notes.

■ Accounting for finance lease transactions that do not transfer ownership prior to the initial year of application (lessor)

When the accounting treatment for finance lease transactions that do not transfer ownership is to be changed from the method which is similar to that used for ordinary rental transactions to the method similar to that used for ordinary sale and purchase transactions, either of the following two methods shall be adopted.

(Rule) Lease transactions are accounted for under the method prescribed in this accounting standard and the guidance and the effect of such change is treated as an extraordinary gain or loss, even when the commencement day of lease transactions falls prior to the first year of implementation of this accounting standard.

(Exception) With respect to lease transactions whose commencement day falls prior to the first year of implementation of this accounting standard, the appropriate book value (net of accumulated depreciation) of the fixed assets as at the balance sheet date of the accounting year preceding the initial year of implementation of this accounting standard shall be recognized as the value of leased assets at the beginning of the year, or the future minimum lease payments at the end of the year, or the method similar to that used for ordinary rental transactions shall continue to be used, subject to specific disclosure in the notes (entities engaged primarily in lease transactions cannot adopt the latter exceptional method).

■ Effective Date

1) This Standard shall be applied for annual periods beginning on or after April 1, 2008. Earlier application is permitted for annual periods beginning on or after April 1, 2007 (hereinafter referred to as “earlier application with respect to annual financial statements”).

2) Notwithstanding the provisions of the preceding paragraph, this Standard shall be applied to quarterly consolidated financial statements and quarterly non-consolidated financial statements issued for periods beginning on or after April 1, 2009. However, earlier application of this Standard is permitted to quarterly consolidated financial statements and quarterly non-consolidated financial statements for periods beginning on or after April 01, 2008 (hereinafter referred to as “earlier application with respect to quarterly financial statements”).

If a company does not choose earlier application with respect to quarterly financial statements for periods beginning on or after April 1, 2008 (excluding periods beginning on or after April 1, 2009), with respect to the balance related to finance lease transactions that do not transfer ownership (for those accounted for in a manner similar to the accounting for ordinary rental transactions) that has changed significantly as compared with the balance at the end of the previous year, the note disclosure items as required by “Accounting Standard for Lease Transactions” (as issued by the First Subcommittee of the Business Accounting Council on June 17, 1993; hereinafter referred to as the “pre-revision Standard”) (excluding the disclosure items related to operating lease transactions) shall be disclosed in the notes to the quarterly financial statements. It is considered that among the listed companies that are subject to Article 24-4-7 of the Financial Instruments and Exchange Law, which is scheduled to be enacted in accordance with Article 3 of the Law to Amend Part of the Securities and Exchange Law, companies engaging in a business or businesses to be specified by Cabinet Office Ordinance may have to take separate treatment for the preparation of quarterly financial statements for the second quarter.

3) If a company chooses earlier application with respect to annual financial statements stated in 1), the company may choose not to apply this Standard to semi-annual consolidated financial statements and semi-annual non-consolidated financial statements issued for semi-annual periods that pertains to the annual period of the earlier application. However, in this case, the application of this Standard for the purpose of the preparation of consolidated financial statements and non-consolidated financial statements shall start at the beginning of the annual period. For consolidated financial statements and non-consolidated financial statements issued for annual periods in which the company chooses earlier application, note disclosure with respect to the consistency of the accounting treatments for the semi-annual and annual periods may be omitted, while the fact that this Standard has not been applied to the semi-annual consolidated financial statements and semi-annual non-consolidated financial statements and that the note disclosure items as required by the pre-revision Standard are disclosed in the notes to the semi-annual financial statements shall be disclosed.

View Concerning the Application to Small- and Medium-Sized Enterprises

The treatment when applying this accounting standard to small- and medium-sized enterprises shall be determined by “Guidance on the Accounting for Small- and Medium-Sized Enterprises” (issued by the Japanese Institute of Certified Public Accountants, Japan Federation of Certified Public Tax Accountants' Associations, Japan Chamber of Commerce and Industry and Accounting Standards Board of Japan) as needed in line with the content of this accounting standard. Requests for simplified accounting treatment for avoiding excessive burden were frequently voiced during the deliberations conducted so far. The ASBJ is going to participate in the discussion for the revision of “Guidance on the Accounting for Small- and Medium-Sized Enterprises” keeping these opinions in mind.

＜Reference＞ Major Changes from Earlier Treatment

	Earlier treatment	**New accounting standards, etc.**
① Repeal of the accounting treatment similar to ordinary rental transactions regarding finance lease transactions that do not transfer ownership	In principle, finance lease transactions that do not transfer ownership are to be accounted for in a similar manner with ordinary sale and purchase transactions. However, such finance lease transactions can be accounted for in a similar manner with ordinary rental transactions, subject to specific disclosure in the notes.	The accounting treatment similar to that of ordinary rental transaction described in the left box shall be repealed.
② Allocation of the amount equivalent to interest between accounting periods	Where finance lease transactions are accounted for in a similar manner with ordinary sale and purchase transactions, the interest element shall be, in principle, allocated between accounting periods using the interest method.	(Lessee) In principle, allocation shall be made in the same manner as before. However, where the total value of leased assets for finance lease transactions that do not transfer ownership is considered to be immaterial, either of the following two methods can be applied. ・The method of not deducting a reasonable estimate of interest element from total lease payments. In this case, leased assets and lease obligations are recognized at the amount equivalent to the total lease payments. Interest expense shall not be recognized and only depreciation charges shall be recognized. ・The method of allocating the total amount of interest element over the lease term under the straight line method.

	Earlier treatment	**New accounting standards, etc.**
		(Lessor) In principle, allocation shall be made in the same manner as before. However, where the lease transactions for finance lease transactions that do not transfer ownership is considered to be immaterial, the method of allocating the total amount of interest element over the lease term under the straight line method can be applied.
③ Accounting for the costs equivalent to the services provided such as normal maintenance	—	In principle, such costs shall be separated from the total lease payments in a similar manner with the treatment of the amount equivalent to maintenance and administration costs.
④ Accounting for leases of real estate	—	Leases of real estate such as land and buildings (hereinafter, reference to leases of real estate shall mean to include leases under rental contract for real estate) shall also be classified as finance lease transactions or operating lease transactions; provided that leases of land shall be presumed to be operating lease transactions unless provisions for transfer of ownership or a bargain purchase option are contained in the lease terms. The total lease payments of a lease of real estate in which both land and a building are leased together (hereinafter, reference to such lease

	Earlier treatment	**New accounting standards, etc.**
		shall mean to include a lease under rental contract for the buildings) shall be, in principle, divided into the portion attributable to the land and the portion attributable to the buildings, etc. based on a reasonable method, for the purpose of the application of the present value criterion.
⑤ Balance sheet presentation of finance lease transactions	(Lessee) Leased assets shall be shown in the appropriate tangible fixed asset category. (Lessor) They shall be shown as lease receivables.	(Lessee) In principle, leased assets shall be subdivided into tangible fixed asset and intangible fixed asset categories and shown collectively as leased assets in each category. However, they can be included in the appropriate line items of the tangible or intangible fixed asset category. (Lessor) Leased assets related to finance lease transactions which transfer ownership should be shown as lease receivables, and those related to finance lease transactions that do not transfer ownership as investment in leases.

	Earlier treatment	**New accounting standards, etc.**
⑥ Note Disclosure for finance lease transactions	Where the accounting treatment in a similar manner with ordinary rental transactions is adopted for finance lease transactions, specific disclosure is required in the notes.	(Lessee) Except where leased assets are immaterial, specifics of leased assets (types of primary assets, etc.) and the depreciation method shall be disclosed in the notes. (Lessor) ・Except when investment in leases is immaterial, the amounts of lease receivables and the estimated residual value as well as the amount equivalent to interest income shall be disclosed in the notes. ・Except when lease receivables and the lease payments receivable component of the investment in the lease are immaterial, the amounts expected to be collected in each year within five years and the amount expected to be collected beyond five years, after the balance sheet date shall be disclosed in the notes.

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