



Sir David Tweedie
Chairman
International Accounting Standards Board
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Ref.: ACC/PRJ/TSI/IDS

Dear Sir David,

Re: FEE Comments on the IASB Exposure Draft Leases

- (1) FEE (the Federation of European Accountants) is pleased to comment on the IASB Exposure Draft Leases (the “ED”).
- (2) As a founding organisation of EFRAG we have also contributed to the EFRAG consultation process by submitting the FEE comments on EFRAG’s Draft Comment Letter of 24 September 2010. EFRAG has issued its final comment letter on 15 December 2010. We have considered the EFRAG Final Comment Letter in our response and make reference to the EFRAG comments where relevant.
- (3) We support the IASB’s effort to improve the standard for accounting for leases. Further, conceptually, we see merit to a right-of-use model for certain types of simple leases. However, we have significant concerns with important aspects of the proposals in the ED, namely the definition of what constitute a lease, recognition and measurement of complex leases (renewal options and variable payments) and the proposed dual approach model from the lessor perspective.
- (4) We question whether the assets and liabilities that would result from the application of the right-of-use model proposed in the ED to complex leases (in particular those including renewal options and contingent rentals) would meet the definition of such items in the Conceptual Framework.
- (5) Further, the extensive use of judgement surrounding the determination of the lease term and contingent rentals adds to the complexity of the standard.
- (6) Additionally, while we generally support the definition of a lease, we find that the guidance provided for distinguishing leases from service contracts is insufficient. Similarly, it would be important to clearly establish why a lease contract does not constitute an executory contract. Providing more robust guidance on these distinctions is fundamental to apply the right-of-use model adequately.
- (7) Further, we believe that at this stage the model for lessor accounting is insufficiently developed. Like EFRAG, we are not convinced by the arguments put forward to support the hybrid model for lessor accounting.

- (8) In our view, the IASB must aim to establish a single model for lessor accounting that is consistent with lessee accounting. In particular, we do not support the performance obligation model since it comprises many fundamental conceptual flaws. At this point, we see more conceptual merits in the derecognition model since it is more consistent with the right-of-use approach and it has the potential of being applicable to all lease contracts. We believe that consistency between the treatment of leases by the lessees and the lessor should be a significant consideration.
- (9) We support a meaningful simplification to the general model for short-term leases on practical grounds. However the ED does not appear to provide a real simplified approach. Therefore we recommend that the IASB revisit this issue and give further thoughts to the development of more robust principles for short term leases.
- (10) We are also concerned that the ED has many inconsistencies with the content of other relevant proposals that are still under development, in particular with the standard on revenue recognition.
- (11) Accordingly, in order to ensure that the project results in an improvement over current accounting, we believe that significant changes must be made to the ED before it becomes a final standard. This additional work is essential if the IASB wants to meet its objective of developing a standard that provides more relevant information with respect to lease contracts.
- (12) We would also like to emphasise that we do not support the issuance of a standard addressing only lessee accounting as a temporary measure until the model for lessor accounting is completed.
- (13) Finally, we believe that it is imperative that the IASB performs field testing before the completion of the project. This will ensure that any issues related to practical application are properly identified. This will also serve to facilitate acceptance of the proposals by all those affected.
- (14) The IASB should also consult various constituency groups, including users, to ensure that the benefits of the proposed model exceed its costs. The cost-benefit analysis needs to consider the system changes and procedures that will need to be put in place to ensure that all leases are accounted for properly and consistently on an on-going basis.

Our responses to the questions in the Invitation to comment section of ED are contained in the Appendix to this letter.

For further information on this letter, please contact Tibor Siska, Project Manager, at FEE Secretariat on +32 2 285 40 74 or via email at tibor.siska@fee.be.

Yours sincerely,



Philip Johnson
President

Appendix 1

The accounting model

Question 1: Lessees

- a. **Do you agree that a lessee should recognise a right-of-use asset and a liability for its obligation to make lease payments? Why or why not? If not, what alternative model would you propose and why?**
- b. **Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on its liability for lease payments? Why or why not? If not, what alternative model would you propose and why?**

- (15) Conceptually we see merit in a right-of-use model for certain types of simple leases. We believe that it is a model that could appropriately reflect the substance of lease transactions and increase transparency. We agree that under this model, the lessee should recognise amortisation of the right-of-use asset and interest on its liability for lease payments.
- (16) However, at this point, we have some significant conceptual concerns that need to be addressed before completion of the project.
- (17) One such concern relates to whether the assets and liabilities that would result from the application of the right-of-use model proposed in the ED to complex leases (in particular those including renewal options and contingent rentals) would meet the definition of such items in the Conceptual Framework. Our responses to questions 8 and 9 provide more details on the issue.
- (18) We also believe that it is necessary to clearly establish the distinction between leases, sales/purchases and service and other executory contracts as explained in our response to question 4.
- (19) Finally, we have concerns about the practical application of the requirements in the ED, including with respect to short-term leases. As such, we believe that it is imperative that the IASB performs field testing before the finalisation of the project. This will ensure that any issues related to practical application are properly identified. This will also serve to facilitate acceptance of the proposals by all those affected.
- (20) The IASB should also consult various constituency groups, including users, to ensure that the benefits of the proposed model exceed its costs. The cost-benefit analysis needs to consider the system changes and procedures that will need to be put in place to ensure that all leases are accounted for properly and consistently on an on-going basis.

Question 2: Lessors

Do you agree that a lessor should apply the performance obligation approach when the lease exposes the lessor to significant risks and benefits associated with the underlying asset, and a derecognition approach otherwise? Why or why not? If not, what alternative model would you propose and why?

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Do you agree with the boards' proposals for recognition of assets and liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

- (21) In our response to the Discussion Paper Leases, we had expressed concerns if the requirements for lessor accounting were to be directly introduced at the stage of the Exposure Draft. We regret that this is the route the IASB has chosen to follow. Indeed, we believe that the model for lessor accounting, as currently drafted, is insufficiently developed.
- (22) Like EFRAG, we fail to be convinced by the arguments put forward to support the dual-approach model for lessor accounting. It would seem that, if the substance of all lease arrangements require a dual approach from the lessor perspective, the same would be necessary for the lessee. We believe that consistency between the accounting treatment of leases by the lessees and the lessor should be a significant consideration.
- (23) We strongly believe that the dual-approach model creates more complexity and may provide opportunities for inappropriate structuring. There is a risk therefore, that one of the main reasons for revising IAS17 is negated as a result.
- (24) We believe that the IASB must aim at establishing a single approach for lessor accounting that is consistent with lessee accounting. At this point, we see more conceptual merits to the derecognition approach since it is more consistent with the right-of-use model and it has the potential of being applicable to all lease contracts.
- (25) We do not believe that the performance obligation can appropriately reflect the substance of all lease contracts. The introduction of the "in-substance sale" exemption is a recognition of the limitations of the performance obligation approach.
- (26) The performance obligation comprises many fundamental conceptual flaws. In particular, considering that the ED proposals for lessee accounting are set on the premise that the lessee has an unconditional obligation to pay at inception because it has received the asset, it is inconsistent to consider that the lessor will satisfy its performance obligation continuously over the term of the lease.
- (27) Despite the linked presentation, the performance obligation results in double counting assets (the underlying asset and the receivable), with the result that the total assets exceed the cash inflows expected from the assets
- (28) While we believe that the derecognition approach is more sound conceptually, certain key aspects of this approach need to be developed further. In particular, the nature of the residual asset must be clearly established. Only when the nature of the residual asset is established, will it be possible to evaluate the appropriate accounting for this asset (e.g. should it be revaluated, should it accrete interest or on the contrary should it be depreciated).
- (29) With respect to the lessor model, we question why the IASB has decided to use retention of significant risks or rewards to establish whether the leased asset is transferred and the lessor's performance satisfied. This decision appears inconsistent with the control approach proposed in the ED on revenue recognition and with the Conceptual Framework. We believe that this is a further example of the negative consequences of proceeding directly to the ED stage for lessor accounting.

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- (30) Since we believe that lessee and lessor accounting must be developed together to ensure consistent treatment, additional work is required before issuance of a final standard in order to ensure that the project results in an improvement over current accounting. We do not support the issuance of a standard addressing only lessee accounting as a temporary measure until the model for lessor accounting is completed.

Question 3: Short-term leases

The exposure draft proposes that a lessee or a lessor should apply simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term is twelve months or less:

(a) At the date of inception of a lease a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognise lease payments in profit and loss over the lease term (paragraph 64).

(b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognise assets and liabilities arising from short-term leases in the statement of financial position, nor derecognise any portion of the right to use the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit and loss over the lease term (paragraph 65). (See also paragraphs BC41-BC46.)

Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

- (31) On practical grounds, we support the development of a meaningful simplification to the general model for short-term leases.
- (32) The proposal to permit lessees to forgo discounting for short-term leases is not a significant simplification.
- (33) It is important that the IASB give further thoughts to the development of a robust simplification for all short-term leases, both from the lessee and lessor perspective. One avenue that the IASB may investigate is whether certain short-term contracts are more in the nature of service contracts because the interest of the lessee is more in the output rather than in the assets that produce the output (e.g. photocopies vs photocopiers).

Definition of a lease**Question 4**

(a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?

(b) Do you agree with the criteria for distinguishing a lease from a purchase or sale in paragraphs B9 and B10? Why or why not? If not, what alternative criteria would you propose and why?

(c) Do you think that the guidance provided for distinguishing leases from service contracts in paragraphs B1-B4 is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

Is the lease defined appropriately?

- (34) Subject to the comments we make below regarding the distinction between leases and services, we generally support the definition of a lease.
- (35) However, we believe that it is essential that the IASB establishes clearly what makes leases executed contracts and explains the difference in relation to executory contracts.
- (36) We also believe that clarification is required on what constitutes the “underlying asset” in the contract. In certain cases, the contract relates to a portion of a larger asset (e.g. a floor in a building). It would be important to understand how the definition applies to these contracts. This may have a significant impact, in particular in terms of lessor accounting (e.g., how does the derecognition model apply to part of a larger asset).

Do you agree with the criteria for distinguishing a lease from a purchase or sale?

- (37) The ED proposes to distinguish leases from in-substance purchase and sale contracts using control and risks and rewards criteria. This proposal appears inconsistent with the Exposure Draft “Revenue from Contracts with Customers” that relies only on control.
- (38) Further, consistent with the view expressed in response to Question 8, we believe that the threshold for establishing whether a purchase option will be exercised should be “virtual certainty” rather than “reasonable certainty” as currently proposed in paragraph B10(b). This would ensure that the scope of the standard on leases would exclude only arrangements that are truly purchase and sale.

Do you think that the guidance provided for distinguishing leases from service contracts in paragraphs B1-B4 is sufficient?

- (39) We do not believe that the criteria in paragraphs B1 to B4 are sufficiently robust to permit a consistent distinction between leases and service contracts.
- (40) IFRIC 4 has proven to be difficult to apply in practice. The consequences of these difficulties would be accentuated under the proposal in the ED because the accounting for a contract that qualifies as a service contract is very different from the

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accounting for a lease contract in the ED (contrary to what was the case when the lease was treated as an operating lease under IAS 17).

- (41) The main difficulties in the application of IFRIC 4 are as follows:
- a. Are “output” necessarily physical assets or could output also include intangible assets (such as renewal energy credits)?
 - b. What does “contractually fixed per unit” mean? Can it include indexation (for example based on inflation) or a fixed escalation clause?
 - c. What is a “specified asset”?
 - i. There are different interpretations of the extent to which the asset must be specified (e.g. warehousing of data, store-in-a-store arrangements).
 - ii. Ability of the “lessor” to move the lessee (e.g. in a physical warehouse).
- (42) As part of the integration of IFRIC 4 within the ED, the IASB appears to have made one change to the criteria to specify that “an asset is implicitly specified if a lessor can substitute another asset for the underlying asset but rarely does so in practice”. The IASB should explain why it felt it was necessary to make this change (even though it did not make any other significant changes to IFRIC 4). Further, the frequency at which changes are made may be difficult to evaluate at the inception of a contract. Hence it is necessary for the IASB to clearly explain the purpose of this modification to IFRIC 4.

Scope

Question 5: Scope and scope exclusions

The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33-BC46).

Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and why?

- (43) Like EFRAG, we note that the exclusion of all intangible assets from the scope of the lease ED appears to represent a step backward compared to IAS 17 that excluded only certain intangible assets.
- (44) At this point, we do not believe that the Board have given enough consideration as to whether certain intangible assets should be within the scope of this guidance, in particular with respect to arrangements such as certain licensing arrangements that are currently within the scope of IAS 17.
- (45) Further, the exclusion may lead to inconsistent accounting treatment for transactions with similar economic characteristics. Hence, the IASB should take the time to evaluate whether contracts involving intangible assets could be accounted for consistently and appropriately under the proposals in the ED. If not, it should explain why. This would have the further advantage of providing an indication of whether the future standard on leases could be applied by analogy to contracts involving intangible assets.

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- (46) We support the proposed exclusion for investment properties measured at fair value under IAS 40. However, we note that this exclusion may require a consequential amendment to IAS 40.

Question 6: Contracts that contain both service and lease components

The exposure draft proposes that lessees and lessors should apply the proposals in *Revenue from Contracts with Customers* to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B6-B8 and BC47-BC54). If the service component in a contract that contains service components and lease components is not distinct:

The FASB proposes that the lessee and lessor should apply the lease accounting requirements to the combined contract.

The IASB proposes that (i) a lessee should apply the lease accounting requirements to the combined contract; (ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract; (iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements and the service component in accordance with the proposals in *Revenue from Contracts with Customers*.

Do you agree with either approach to accounting for leases that contain service and lease components appropriate? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

- (47) We agree that an entity (lessee or lessor) should assess whether a service component is distinct or not based on the criteria in revenue recognition, subject to the comments that we made with respect to these criteria in our response to the Exposure Draft Revenue from Contracts with Customers.
- (48) Like EFRAG, we disagree with a rule to apply lease accounting to the entire contract whenever it includes both a lease and non-distinct service components. Instead, we believe that in such situations the entities should portray the economic substance of the transaction.
- (49) We believe that when a contract includes both a lease and non-distinct services, a lessee should identify, based on information available, the predominant component and treat the whole contract accordingly.
- (50) Like EFRAG and the IASB, we would expect that lessors are generally able to determine the information required to account for the services and lease components of a contract separately even when there is no market for these services because they need the information on the cost of all service components to price their contracts and handle a much larger volume of transactions than lessees.
- (51) On the matter of whether certain payments contemplated in lease contracts represent payments for services, we believe that the IASB should clarify whether certain amounts frequently included in real estate leases, such as insurance, maintenance and taxes, represent lease payments or not.

Question 7

This exposure draft proposes that a lease contract should be considered terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraphs 8, BC63 and BC64).

Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?

- (52) Consistent with our response to the DP, we believe that purchase options should be accounted for in the same way as options to extend or terminate the lease because a purchase option is in-substance similar to a renewal option for the remainder of the asset's life.

Question 8: Lease term

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

- (53) Except in certain circumstances, we disagree with the proposal to recognise payments due under renewal options as a liability (asset) in the financial statements of a lessee (lessor) because we do not believe that these amounts meet the definition of such items in the Conceptual Framework. Indeed the lessee does not have an unconditional obligation to pay the rentals related to optional renewal periods until the option is exercised. Similarly, the lessor does not have a contractual right to receive these amounts until the renewal option is enacted by the lessee.
- (54) Further, we believe that the requirement to include lease payments payable and receivable during the renewal periods would require assessment of the likelihood of the exercise of the option. This assessment is complex and judgemental because the decision to renew a lease is often not solely based on whether or not the terms of the renewal are favourable. It involves assessment of various other business factors.
- (55) We are not suggesting that renewal options should be ignored. Indeed, we believe that to the extent that renewal options represent a right that the lessee would not have received without entering in the original contract, they should be recognised as an asset.
- (56) In particular, any renewal options that are virtually certain to be exercised would be included in the lease term and recognised as part of the right-of-use asset and liability. We envisaged that the criteria used to establish whether it is highly likely that an option would be exercised would be similar to those currently included in IAS 17. We believe that the threshold in IAS 17 is similar to the "virtually certain" threshold in IAS 37 and therefore this threshold justifies recognition of the right-of-use asset (and consequently the related liability).

Measurement

Question 9: Lease payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease contract should be included in the measurement of lease assets and lease liabilities using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?

Do you agree that lessors can only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the lease receivable if they can be measured reliably? Why or why not?

- (57) We disagree with the proposal to treat all variable lease amounts in the same way. We believe that the different types of contingencies have very distinct attributes that deserve distinct consideration and accounting treatments. Further, consistent with our response to question 8, we believe that contingent rent payments should be included in the measurement of lease asset/ liability only when these amounts represent virtually an unconditional obligation to receive/pay the rentals.
- (58) In addition to our disagreement with the recognition of variable payments proposed in the ED, we believe that the proposed measurement approach is also flawed. Applying an analysis of probabilities will in reality be extremely difficult and the outcome could be entirely spurious. The most likely outcome approach reflecting the management's best estimate of the probable cash flows generally provides more reliable data.
- (59) In terms of recognition, we believe that contingent rentals based on an index or a rate represent unavoidable obligations and accordingly would be included in the measurement of the lease asset/liability.
- (60) We are of the view that rental payments contingent on performance of the leased asset are under the control of the lessee and become an unavoidable obligation of the lessee (and an unconditional right of the lessor) only when the performance is achieved. Accordingly, these amounts do not meet the definition of asset and liability in the Conceptual Framework and their inclusion in the measurement of the lease asset/liability are not justified at the inception of the lease.
- (61) We believe that rental payments contingent on usage of the leased asset are also under the control of the lessee and would generally not meet the definition of a liability (asset) in the Conceptual Framework. In our view, contingencies based on usage are akin to renewal options: the variable payment reflects the fact that the lessee has essentially the right to use an additional part of the underlying asset. Therefore, we believe that rental payments contingent on usage should be accounted for in a manner consistent with renewal options, i.e. contingent payments related to usage that are virtually certain to arise would be included recognised as part of the right-of-use asset and liability.
- (62) In addition, including this type of contingent payments as part of the right-of-use asset and liability would not in our opinion provide relevant information about the economic substance of the underlying lease agreement. We share the alternative view expressed by Stephen Cooper in paragraph AV5 of the ED.

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- (63) The ED proposes that a lessor recognise contingent rentals only if it can be measured reliably while the Exposure Draft Revenue from Contracts with Customers provides that a seller includes variable consideration in the transaction price only if it can be estimated reasonably. It is unclear whether “measure reliably” and “estimate reasonably” are intended to have different meanings. We recommend that the IASB use the same wording if they do not intend that “measure reliably” and “estimate reasonably” should result in different recognition thresholds.

Question 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the obligation or receivable arising from changes in the lease term or contingent payments since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

- (64) As mentioned in our responses to questions 8 and 9 above, we have concerns with the proposal in regard to options to extend and contingent rentals in certain circumstances.
- (65) However, should the IASB proceed with the ED without making any changes to the proposal, we agree with EFRAG that it would be onerous to perform periodic reassessment of changes in the obligation or receivable arising from changes in the lease term or contingent payments. Therefore, we support the proposal that the reassessment should be carried out only if there is an indication that there is a significant change in the lease payments. To ensure that this is clearly understood, we suggest that the sentence in BC133 stating that *“a detailed examination of every lease is not required unless there has been a change in facts or circumstances that would indicate that there is a significant change in the lease asset or lease liability”* should be included in the core of the standard.
- (66) Further, we think that any change in the expected contingent rental payments based on usage of the asset should be treated in a manner consistent with changes in the lease term. Indeed, in substance, these changes result in the lessee acquiring more or less of the right-to use asset. Accordingly, under the derecognition model, the impact of such changes should not be recognised fully in the profit and loss as is proposed in the ED. In our view, changes in the expected contingent rental based on usage should result in an adjustment to the estimates of the fair value of the rights that have been transferred and the fair value of the rights that have been retained and accordingly the adjustment should be made in part to the carrying amount of the residual asset and in part to profit or loss.

Sale and lease back**Question 11**

The exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents the sale of the underlying asset, the leaseback would also meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66–67, B31 and BC160–BC167)

Do you agree with the criteria for classification as a sale and leaseback transaction? Why or not? If not, what alternative criteria would you propose and why?

- (67) We agree that a transaction should be treated as a sales and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset.
- (68) We note that the additional criteria provided in paragraph B31 to establish whether a sale as taken place, like those in B9 and B10, mainly refer to a risk and rewards approach whereas the recent ED Revenue with Contracts with Customers proposed a control approach. As indicated in our response to question 4(b) we question why the IASB has chosen different criteria for the two exposure drafts.
- (69) Further, we do not understand why paragraph 68(a) imposes that the transferee/lessor would use the performance obligation approach to account for leases arising in sales and leaseback transactions. This restriction would appear to be based on presumption that if the “sale/purchase” part of the sales and leaseback transaction meets the conditions to qualify as a sale, then the lessor in the lease part of the transaction is necessarily exposed to significant risk or rewards on the leased asset. This conclusion appears to be flawed since, to be consistent with the ED “*Revenue with Contracts with Customers*”, the condition for a sale should be based on control, whereas the determination of the approach to be used by the lessor, as presented in the ED Leases, is based on risk and rewards. The Board should therefore reconsider whether it is appropriate to require the use the performance obligation approach to account for leases arising in sale and leaseback transactions.
- (70) We do see conceptual merits to the EFRAG’s alternative model for the accounting treatment of a linked sales and leaseback transaction since sale and leaseback transactions are necessarily negotiated together and therefore represent a bundle of rights. Further, this approach appears consistent with the derecognition approach and ensures that no gain/loss is recognised on the portion of the asset which has not been transferred in substance. However, we believe that the accounting for the purchaser/lessor side of the transaction needs to be further developed to ensure that it is consistent with the treatment proposed by EFRAG for the seller/lessee. Indeed, if the seller/lessee is considered to have sold only a portion of the asset, we question why the purchaser/lessor appears to be considered as having acquired the entire asset.

Presentation**Question 12: Statement of financial position**

The exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25–27, 42–45, 60–63 and BC142–BC159).

- (a) Do you agree that a lessee should present its liability to make lease payments separately from other financial liabilities and present right-of-use assets as if they were tangible assets within property, plant and equipment, or investment property as appropriate, but separately from other assets that the lessee does not lease (paragraphs 25-27, 42-45, 60-63 and BC142-159)? Why or why not? What alternative presentation do you propose and why?
 - (b) Do you agree that a lessor applying the performance obligation approach should present its underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? What alternative presentation do you propose and why?
 - (c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? What alternative presentation do you propose and why?
 - (d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease separately (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?
- (71) As a general statement, we think that the requirements of IAS 1 *Presentation of Financial Statements* should always be considered when the entity makes a judgement about whether to present items separately or in aggregate in the statement of financial position. In fact, we question whether it would not be preferable to address the presentation of items related to leases within IAS 1 (rather than as part of the specific standard on leases) so that all presentation issues be addressed in one single standard in a consistent manner.

Lessee

- (72) We agree with the proposal that the lessee should present the right-of-use assets separately from those assets that are not leased if they are considered significant.
- (73) To the extent that the IASB goes ahead with the proposals in the ED with respect to renewal options and contingent rental payments, we believe that separate presentation on the face of the statement of financial position would be necessary so as not to present together items that meet the definition of liabilities in the Conceptual Framework with others that do not. However, if the IASB amends its proposal as suggested in our response to questions 8 and 9, we consider that the proposed distinction on the face of the statement of financial position would no longer be necessary. IAS 1 *Presentation of Financial Statements* already would provide sufficient guidance as to what should be separately disclosed on the face of the primary statements.

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Lessor

- (74) Conceptually we do not support the performance obligation approach. However, if the IASB decides to pursue this option then we can consider that the proposed 'linked presentation' would be appropriate as it would minimise the impact of the double counting of assets referred to in our response to Question 2.
- (75) Under the derecognition model, similar to the comment made above with respect to the lessee, we believe that, if no changes are made to the proposals in the ED with respect to renewal options and contingent rental payments, rights to receive lease payments should be presented separately from other financial assets. To the extent that changes are made to ensure that the rights to receive lease payments meet the definition of assets in the Conceptual Framework, the separate presentation may not be necessary.

Question 13: Statement of comprehensive income

Do you think that lessees and lessors should present lease income and expense separately from other income and expenses in the statement of comprehensive income (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

- (76) In general we support the proposed separate presentation to the extent the items involved are significant.
- (77) Similar to our comment on the statement of financial position, the requirements of IAS 1 *Presentation of Financial Statements* should always be considered for presentation.

Question 14: Statement of cash flows

Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

Paragraph 44 of IAS 7 *Statement of Cash Flows* requires treating the acquisition of an asset by means of a finance lease as a non-cash transaction. The proposals do not change the requirement. Do constituents agree with the treatment? Or do constituents believe that a lease is essentially a financing transaction and therefore should be presented in the statement of cash flows in the same way an entity presents the purchase of an asset financed by way of a bank loan?

- (78) In general we support the proposal to the extent the items involved are significant.
- (79) Similar to our comment on the statement of financial position, the requirements of IAS 1 *Presentation of Financial Statements* should always be considered for presentation.
- (80) We also believe that the acquisition of an asset by means of a lease and the related financing should continue to be treated as a non-cash transaction.

Appendix – Responses to the questions in the Invitation to comment of IASB
Exposure Draft on Leases

**Disclosure:
Question 15**

Do you agree that lessee and lessors should disclose quantitative and qualitative information that:

- (a) identifies and explains the amounts recognised in the financial statements arising from lease contracts; and**
- (b) describes how lease contracts may affect the amount, timing, and uncertainty of the entity's future cash flows?**

(paragraphs 70-86 and BC168-BC183) Why or why not? If not, how would you amend the objectives and why?

- (81) We welcome the requirement to disclose relevant quantitative and qualitative information as this will provide useful information to users of the financial statements and enhance their understanding of the role and impact of lease arrangements on the entity.
- (82) However if entities were to comply with all of the proposed requirements it would add up to a very onerous task. Therefore, we welcome the requirement in paragraph 71 that states that "an entity shall consider the level of detail necessary to satisfy the disclosure requirements" as this allows some flexibility and will ease the reporting burden in many cases.
- (83) In order to ensure that the spirit of paragraph 71 is properly conveyed in the paragraphs that follow, we suggest that the IASB reconsider the use of "shall" in paragraphs 73 to 86.
- (84) Further, we suggest that the IASB perform field testing to establish the costs required for preparers to comply with the disclosure requirements and to ensure that the disclosure meets the need of users.

Transition

Question 16

The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88-96 and BC186-BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?

Do you think that full retrospective application of lease accounting should be permitted? Why or why not?

Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

- (85) Unlike EFRAG, we agree with the Board assessment that mandatory full retrospective application would be too onerous in many cases and therefore we agree with the simplified transitional arrangements as proposed.
- (86) However, we think that the full retrospective application of lease accounting should be *permitted* (but not required) if relevant information is available.

Benefits and costs

Question 17

Paragraphs BC200-BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals outweigh the cost? Why or why not?

- (87) We are concerned that insufficient work has been done to collect information about the costs and benefits of the proposed requirements. As mentioned before, we believe that the IASB should also consult various constituency groups, including users, to ensure that the benefits of the proposed model exceed its costs.
- (88) We are also concerned that there has been no proper impact assessment of the wider affect of these proposals on businesses. In addition, consideration should be given to the possibly high cost of changing systems and processes to accommodate the proposed requirements. We believe that it is imperative that the IASB performs field testing before finalisation of the project.

Other comments

Question 18

Do you have any other comments on the proposals?

Initial direct cost

- (89) The ED proposes that a lessee measures the right-to-use asset initially at the amount of the liability to make lease payments, plus any initial direct costs incurred. Meanwhile a lessor includes initial direct costs in its initial measurement of its lease receivable. We observe that the accounting treatment of costs of obtaining a contract is not unique to leases. The recently issued Exposure Draft Insurance Contracts requires inclusion of incremental acquisition costs in the present value of the fulfilment cash flows and exclusion of all other acquisition costs. The Exposure Draft Revenue from Contracts with Customers, on the other hand, allows capitalisation of certain contract costs, but requires that the costs of securing a contract are expensed as incurred. In view of the different approaches proposed for these three projects, we urge the IASB to establish the principles that ensures consistency.

Lease modifications

- (90) The ED does not address the treatment of lease modifications. However, paragraph 29 indicates that "a lessor shall not change the lessor accounting approach after the date of inception of the lease". We suggest that the IASB should clarify whether this paragraph also applies in case of a modification to a lease.

IFRS for SMEs

- (91) We think that the proposals in the ED would impose disproportionate costs on SMEs if any new leasing standard affects the updating of the IFRS for SMEs. We recommend that the IASB consider developing a simplified model for SMEs that recognises their limited resources and the realistic needs of users.