



MINISTERIO
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INSTITUTO DE CONTABILIDAD
Y AUDITORÍA DE CUENTAS

**Instituto de Contabilidad y Auditoría de Cuentas' (ICAC) comments on IASB's
Exposure Draft ED/2010/9 Leases**

First of all, we would like to highlight that we are of the view that any change to be introduced in a Standard should be argued and justified enough. Costs and benefits of implementing changes in the standards by users, needs to be taken into account.

Nevertheless, we recognise the importance and relevance of the issue, and therefore we will support the IASB on changes that would solve any possible deficiencies detected in current standards for accounting leases.

The proposal implies for the lessee the recognition of an asset that represents its right to use the leased item for the lease term. This asset is initially recognised at cost, and subsequently measured at amortised cost-based, being amortised for the shorter period between the lease term and the economic life of the asset leased.

Additionally, the lessee must recognise a liability for its obligation to pay rentals, whether they are contingent or not, and including in the obligation, any option to extend or terminate the lease term.

The asset and the liability will be measured at the present value of the lease payments discounted using the lessee's incremental borrowing rate, a reasonable approximation to fair value of the obligation to pay rentals, and also a reasonable approximation to the cost of the right to use the asset.

From the other side, depending on the extent to which a lessor retains exposure to risks or benefits associated with the underlying asset, a lessor should apply a performance obligations approach or a derecognition approach.

According to the first approach, the lessor would continue to recognise the underlying asset and also a right to receive lease payments and a lease liability. It is supposed the lessor satisfies the lease liability continuously over the lease term.

Regarding the derecognition approach, the lessor does not retain exposure to significant risks or benefits associated with the underlying asset, in consequence the lease would be accounted for in a way similar to the current accounting for finance leases.

Our main concerns raised on the discussion paper are set out below, by answering those questions that ask for views on the related issue.



IASB questions for respondents

The accounting model

Question 1: Lessees

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?

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?

ICAC supports this approach to this matter if under the lease contract the lessee controls the right to use the item and it meets the definition of assets. In such case, it should be recognised as ED suggests. Notwithstanding, we believe meeting the definition of assets will depend on the terms of each contract. The same treatment should be applied to the amounts to be paid by the lessee under the contract if they meet the definition of a liability.

We agree that if that model is applied, a lessee should recognise amortisation of the right-of-use and interest on the lease liability.

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?

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?

In relation to the use of a hybrid model from the lessor side, the board justifies it on the different level of exposure to the risks associated with the underlying asset, based on the differences in the economics of the transactions (or business models for different transactions).



ICAC's point of view is that there exists a contradiction from the performance obligation model to be consistent with the premise that an asset is a bundle of rights. According to that, if the lessee controls de right of use from the date of the commencement of the lease, the lessor has completed the execution of its part of the transaction at this moment. However the IASB understands that the lessor's obligation is satisfied continuously during the lease term. In addition to that, the performance obligation should include the derecognition of part of the underlying asset to avoid a duplicated accounting from the asset side i.e the underlying asset and the receivable.

In conclusion, ICAC supports a single model for all leases based on the derecognition model.

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?

ICAC believes the standard should include all kind of leases, it means also short term leases. Relating to the way to simplify requirements to short- term leases, it is necessary to evaluate how much relief in practice is reached with the method proposed by the board, because the cost in terms of comparability and complexity when the lease contract includes contingent rentals. The accounting of operating leases in the existing IAS 17 would be an alternative way for lessees.



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?

From ICAC's point of view, the criteria to identify a lease in a first moment may be acceptable but problems appear when we need to distinguish between leases (IAS 17 or the future new standard) and purchase or sale of an asset (IAS 16), and also when we need to distinguish between leases and service contracts (IAS 18 or the future new standard). We believe that this problem is due to the identification of purchases/sales with the transfer control, and not with the exposure to risks and benefits, and also to the inconsistency of this proposal with the Revenue Recognition ED.

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?

ICAC is of the view that in considering scope and scope exclusions, IASB should reconsider to include intangible assets in the scope.

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?

ICAC believes that if a contract includes both service and non-distinct service components, it is crucial to reflect the economic substance of the transaction accordingly. From the lessor side, it is supposed that as it handles much larger volume of transactions than lessees, then it should be able to separate both components. From the lessee side, taking into account an analysis of cost and benefits, it should not be obliged to separate both components.

Question 7: Purchase options

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

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

It is crucial a consistent accounting treatment between a purchase option and an extent term option.

A purchase option should be recognised and measured as the rest of the lease payments regarding the likelihood expected to exercise it.



Measurement

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?

Yes we agree, a lease contract with an option to extent or cancel the term has got different value that another contract which does not contain option, then according with probability should be valued.

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?

In order to be consistent with question 8, contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease contract, only in case they are not under control on the lessee or the lessor, meet the definition of an unconditional obligation. Thus, depending on the type of contingent rentals i.e if they are under the lessee o lessor control or not, the accounting treatment should be different.



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?

ICAC supports the remeasurement of assets and liabilities, although we believe that the standard should indicate the nature of the revenue or expense (operating, financing) related to a change in the asset or liability that is taken to profit or loss.

Neither paragraphs 17-18, that relate to lessees, nor paragraphs 39-40 that refer to lessors' accounting, refer to it, they just refer to profit or loss. On this issue, paragraph B30 when giving an example of reassessments, talks about "revenue" when decreasing the lease receivable because of a minoration of the lease term. But, nevertheless we appreciate the need for clarification for practical reasons.

Sale and lease back

Question 11

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?

ICAC believes that the approach for the treatment of sale and leaseback transactions should be based on the commercial substance of the arrangements, it is crucial to determine if there is a link between transactions or not.

Presentation

Question 12: Statement of financial position

(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?

ICAC supports the IASB's proposal. it would give more useful information to users of financial statements, if the liability arisen from leases was clearly shown on the face of the statement of financial position. Notwithstanding, we are not convinced about presentation requirements for lessors in case of performance obligation approach, which give rise to the same presentation under the derecognition approach. This would be an additional argument to support only the latter.

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?

ICAC agrees with the proposal because it would give more useful information to users.

Question 14: Statement of cash flows

Do you think that cash flows arising from lease contracts should be presented on 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?

The same respond that in question 13.



Disclosures

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?

We support the proposal about disclosures in general.

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?

We are of the view that the full retrospective transition model as an option should be permitted, in which each outstanding lease agreement would be considered since inception or, in cases in which the initial term has been completed, since the last option to extend was exercised.

We believe that the retrospective option model would contribute to offset in some cases the positive and negative impacts of the lease accounting model transition.



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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?

In our opinion, a deeper analysis and assessment of the costs and benefits of the proposed requirements should be taken into account, particularly with the different sectors affected by the change, and we suggest the IASB to explain more thoroughly the conclusions of the analysis, specially in the case of the costs.

Other comments

Question 18

Do you have any other comments on the proposals?

We also missed in the proposal a deeper study about the impact in profit and loss account.

Madrid, 14 December 2010