

Exposure Draft

Leases

Comments to be received by 13 September 2013

Securities and Exchange Board of India (SEBI) welcomes the opportunity to respond to the above exposure draft.

Question 1: identifying a lease

This revised Exposure Draft defines a lease as “a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration”. An entity would determine whether a contract contains a lease by assessing whether:

(a) fulfillment of the contract depends on the use of an identified asset; and

(b) the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.

Do you agree with the definition of a lease and the proposed requirements in paragraphs 6–19 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

We agree with the definition of the lease. However, the definition of control is not sufficiently supported by meaningful guidance that would mitigate diversity in practice. We therefore feel

that more guidance is required for explaining the principle of control. Illustrative examples 2 (contract for coffee services) and 3 (contract for medical equipment) are particularly confusing. These examples illustrate that the determination of whether a contract contains a lease may depend on a party outside the arrangement supplying goods or services. Further we note that examples of certain types of arrangements (e.g., power purchase agreements, telecommunication towers, time charters, drilling contracts) are not included in the ED. It would help practice if such examples are included.

We believe the principle of identifying a lease is an improvement compared to IFRIC 4 *Determining whether an Arrangement contains a Lease* in that it is intended to narrow the population of contracts that qualify as a lease. However, this improvement can be achieved even without a new standard, i.e., by simply making appropriate amendments to IFRIC 4.

Question 2: lessee accounting

Do you agree that the recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

The accounting model for leases proposed in the ED is to recognize all assets and liabilities on leases other than for very short term leases (12 months). As per the Board this provides financial statement users with more decision-useful information. However, we believe that the Boards should articulate a clear conceptual basis for the differentiation between leases and other non-lease executory contracts, such as a service contract. We also believe that users can get decision useful information through simpler means (e.g. disclosures) rather than the preparers having to go through the rigors of a new standard which is highly complex and confusing.

We believe the classification based on the nature of the underlying asset is arbitrary. It does not appropriately reflect the principle of consumption of the underlying asset. Having two

approaches (Type A & B; if the exception for short-term leases is also included there are really three types of leases) is inconsistent with one of the objectives of the Leases project, which was to eliminate the arbitrary distinction that exists under current accounting between operating and finance leases. We believe that property leases should be covered in *IAS 40 Investment Property* and that the leasing standard should only deal with Type A leases.

Question 3 : lessor accounting

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

We believe lessor accounting should be conceptually consistent with lessee accounting. An example being the recognition of lease liabilities by lessees in Type B leases for which lessors do not recognise receivables. We do not see a conceptual basis for the lessee in a Type B lease recording a right-of-use asset because the lessor has made that asset available to the lessee, and the lessor in a Type B lease not reflecting on its books that it has made that asset available.

We believe the proposed lessor approach for Type A leases is overly complex. For example, the accounting for a lease with initial direct costs, expected variable lease payments based on usage, lease payments depending on an index and a residual value guarantee would be very complex. The primary cause of the complexity results from the requirement to reassess the lease receivable, which requires periodic recalculations. In addition, the complexities of multiple discount rates and calculations would be very difficult to apply and we believe the costs would out-weigh the benefits.

Question 4

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out

in paragraphs 28–34, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

We see a general lack of support from preparers on this ED because they feel that the costs out-weigh the benefits. Further, the ED is very complex and confusing. The requirement to constantly change the right to use and the liability recognized due to change in various factors can be very cumbersome and costly to operate.

Question 5: lease term

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

We are concerned that the reassessment requirements (i.e., requirement to reassess the lease term upon a change in relevant factors) may be burdensome. We believe the Boards should explore whether practical expedients (e.g., allowing lessees to apply an annual reassessment similar to requirements under IAS 16 and IAS 38 and requiring additional periodic reassessment only when renewals are exercised or contractual terms change) could be included to simplify the process, reduce the costs of compliance yet still provide relevant and representationally faithful information to users of the financial statements.

Question 6: variable lease payments

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

We are concerned that the reassessment requirements (i.e., requirement to reassess the variable lease payments if there is a change in an index or a rate) may be burdensome. Therefore some practical expediency should be provided.

Question 7 : transition

Paragraphs C2–C22 state that a lessee and a lessor would recognise and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?

Are there any additional transition issues the boards should consider? If yes, what are they and why?

We believe that the all leases on the transition date shall be recognized for the unexpired period, and any difference between the asset and liability recognized should be adjusted to retained earnings.

Question 8 : disclosure

Paragraphs 58–67 and 98–109 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments; reconciliations of amounts recognised in the statement of financial position; and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

We would request the Board to look at disclosures across all the IFRS standards as a separate project. Though we broadly agree with the disclosure requirements in this ED, we believe that on an overall basis disclosures across various IFRS standards should be reduced.

Question 9 (FASB-only): nonpublic entities

To strive for a reasonable balance between the costs and benefits of information, the FASB decided to provide the following specified reliefs for nonpublic entities:

(a) To permit a nonpublic entity to make an accounting policy election to use a risk-free discount rate to measure the lease liability. If an entity elects to use a risk-free discount rate, that fact should be disclosed.

(b) To exempt a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability.

Will these specified reliefs for nonpublic entities help reduce the cost of implementing the new lease accounting requirements without unduly sacrificing information necessary for users of their financial statements? If not, what changes do you propose and why?

We do not have any comment to offer.

Question 10 (FASB-only): related party leases

Do you agree that it is not necessary to provide different recognition and measurement requirements for related party leases (for example, to require the lease to be accounted for based on the economic substance of the lease rather than the legally enforceable terms and conditions)? If not, what different recognition and measurement requirements do you propose and why?

We do not have any comment to offer.

Question 11 (FASB-only): related party leases

Do you agree that it is not necessary to provide additional disclosures (beyond those required by Topic 850) for related party leases? If not, what additional disclosure requirements would you propose and why?

We do not have any comment to offer.

Question 12 (IASB-only): Consequential amendments to IAS 40

The IASB is proposing amendments to other IFRSs as a result of the proposals in this revised Exposure Draft, including amendments to IAS 40 Investment Property. The amendments to IAS 40 propose that a right-of-use asset arising from a lease of property would be within the scope of IAS 40 if the leased property meets the definition of investment property. This would represent a change from the current scope of IAS 40, which permits, but does not require, property held under an operating lease to be accounted for as investment property using the fair value model in IAS 40 if it meets the definition of investment property.

Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

We agree with the proposal.