2013-270
Comment Letter No. 480

SwissHoldings

Verband der Industrie- und Dienstleistungskonzerne in der Schweiz
Fédération des groupes industriels et de services en Suisse
Federation of Industrial and Service Groups in Switzerland

13 September 2013

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Comment Letter on Exposure Draft – Leases

Dear Madam, dear Sir

SwissHoldings, the Swiss Federation of Industrial and Service Groups in Switzerland, represents 57 Swiss groups, including most of the country's major industrial and commercial enterprises. We very much welcome the opportunity to comment on the above-mentioned Exposure Draft, and our response (in the appendix) has been prepared in conjunction with our member companies.

We welcome that the Board has taken into account the comments received on the first Exposure Draft on Leases. While we still agree that the current IAS 17 standard on Leases might not meet the requirements of all users of financial statements and that a revision of the standard is indeed needed, we believe that the current exposure draft II is introducing too much complexity and question whether it is in agreement with the overall IFRS conceptual framework. We consider that the proposal of the Board in its current stage leaves too many opportunities for judgment calls and is likely to result in diversity in practice.

Indeed, given the significant costs of implementing the Board's current proposals and the lack of a conceptually consistent, widely accepted and practical alternative to the current IAS 17, we wonder whether there are sufficient benefits to users of financial information to justify continuing with this project in its current form.

Furthermore, we only reluctantly accept the proposal of the Board that all material leases with a term longer than 12 months need to be recognized on the balance sheet. If the Board still continues to develop a standard addressing all such lease contracts, we would prefer a simplified method of capitalization and of the related expense recognition.

We also note that, despite calls from many quarters to reduce the size and complexity of financial statements, the Exposure Draft includes further expanded disclosure requirements compared to the current IAS 17. We would encourage the Board to reconsider the disclosure requirements in the Exposure Draft.

Postfach 402, 3000 Bern 7
Tel. +41 (0)31 356 68 68
sh@swissholdings.ch

Nägeligasse 13, 3011 Bern
Fax +41 (0)31 352 32 55
www.swissholdings.ch

We thank you for the opportunity to submit our comments on your proposal.

Yours sincerely

SwissHoldings
Federation of Industrial and Service Groups in Switzerland

Michel Demaré
Chair

Christian Stiefel
Director

APPENDIX

ANSWERS TO SPECIFIC QUESTIONS IN INVITATION TO COMMENT

Question 1

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 a lease as proposed in paragraphs 6-19.

However we believe that there should be more clarity about what constitutes a lease contract and what constitutes a service arrangement. In particular the exclusion criteria in paragraph 19, together with the examples in IE 2 and IE3, would require a high degree of judgement to apply in practice, which would in turn lead to inconsistent treatment between preparers.

Our reading of paragraph 19 of the exposure draft leads us to conclude that some arrangements that currently fall under the scope of IFRIC 4, qualifying as arrangements containing a lease, would not anymore be accounted for as lease agreements if the current exposure draft is implemented. This seems to be supported by the illustrative example 2 related to renting coffee machines. This suggests that such agreements would fall outside of the scope of a lease irrespective of whether there is a different pricing structure for the consumables used in the machine depending on whether there is an outright equipment purchase or a rental arrangement. We suggest that the Board clarifies its position in this area.

Question 2

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?

We only reluctantly accept the Board's proposal for the lessee to recognize all leases on its balance sheet. If the Board insists on such a model, we would recommend keeping a simple approach whereby all leases are recognized on the balance sheet using a single method, described as the method for Type A leases in the exposure draft.

Our view is that the current proposed model for Type B leases is not in line with the overall IFRS conceptual framework as the depreciation does not reflect the consumption of the assets and introduces unnecessary complexity with the proposed separation of the interest cost and depreciation within the total lease costs which are recorded on a straight line basis. If the Board wishes to keep the current proposal of having two distinct accounting models for lease contracts (Type A and B), we would recommend simplifying greatly the model for Type B leases by one of the following two approaches: (a) depreciate the right-to-use asset and accrete the discount on the lease liability on a straight-line basis, or (b) do not discount the right-to-use asset and lease liability recognized on the balance sheet and then subsequently recognize depreciation of the right-of-use asset on a straight-line basis and recognize the full cash payment as a reduction of the principal amount of the non-interest bearing lease liability.

These approaches result in an equal amount of expense recognized on one line in profit and loss in subsequent periods and are consistent with the current proposals but are much more practical to implement.

Question 3

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?

The Board's proposal is now very similar to the current accounting in IAS 17 with the exception of how classification is determined (see our response to the classification criteria in question 4 below). We consider that the lessor should have the same criteria as the lessee for determining classification; generally we consider that it is the correct approach for the lessor to mirror the lessee accounting treatment when more than one accounting approach exists.

We believe that the criteria to differentiate between the two models should be based upon the underlying economic substance of the business transaction and not only on the lessee's expected consumption of the economic benefits of the underlying asset. Therefore the current definition in IAS 17 regarding the transfer of risks and rewards of ownership may be a more appropriate criteria. Where the lessor's business activity is primarily around providing its customer a service (in which the asset is a necessary part) rather than financing the customer's purchase of the asset, then a more simplified model, similar to the current method of recognising income from operating leases, may be more appropriate.

Further we note that for the computation of the profit relating to the lease at the commencement date, paragraph 74 refers to the "present value of lease payments". In order to avoid any doubts in particular with respect to variable lease payments we suggest using instead the term "present value of lease receivables". The inconsistency is also visible in example 20 where the formula to calculate the profit refers to "the present value of lease payments" but the table below refers to "lease receivables" of CU 6313.

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?

If the Board wishes to keep a dual model where 2 types of leases need to be defined, we would recommend basing the criteria for such classification on indicators similar to the current ones. We do not agree with the introduction of a criteria based on the nature of the underlying assets (i.e. whether property or not). We would recommend including clear guidance on such classification, which could be based on the current criteria included in IAS 17 to distinguish between finance and operating leases.

Furthermore, if the Board wishes to keep classification criteria based on nature of the underlying asset, we note that due to the requirement to always use the economic life of the building in paragraph 33 to assess classification, strategic lease agreements which include both land and property, in which the land is deemed to be the primary asset, are likely to be accounted for as Type A leases. This would not appropriately reflect the economics of the transaction when the property is of negligible value compared to the land and the lease agreement is primarily entered into to secure the right to use the land covering a longer period.

Question 5

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 understand that the Board has proposed to determine the lease term as being not only the non-cancellable period, but also periods covered by options to extend in order to avoid lease structuring opportunities. However we consider that the concept of "significant economic incentive" introduced by the Board to distinguish which options to include in the lease term is not clear enough to avoid diversity in practice and may result in recognizing amounts not consistent with the definitions of an asset or a liability.

From a lessee perspective, we consider that the lease term should include the non-cancellable period as well as any renewal option that are "reasonably certain" to be exercised. This concept, already used in IFRS, raises the threshold to a level significant enough to avoid structuring of lease contracts and will ensure that relevant lease commitments are appropriately reflected on the lessee's balance sheet. Similarly we would recommend using such a concept also to determine whether a lease would fall into the short-term lease exception.

Consider a 12 month lease with an option to renew for an additional period. Such a lease should benefit from the short-term lease exception if it is not reasonably certain that the lessee will exercise the renewal option.

From a lessor perspective, we consider that the lease term should include the non-cancellable period as well as any renewal option that are "probable" to be exercised by the lessee. The lessor will only rarely have sufficient information on the lessee's intention, with respect to exercising a renewal option, which would be sufficient to conclude that the renewal is "reasonably certain". We consider that the inclusion of any probable renewal options will help achieve a fair presentation of the lease receivables to be expected by the lessor.

Furthermore, we would also like to mention that we strongly support the short-term lease exemption in paragraphs 118-120 of the ED as a practical expedient. This is necessary for preparers in order to only focus on material transactions and to at least partly limit the extensive costs of introducing and complying with this new standard.

Question 6

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 agree with the proposals in relation to the measurement of variable lease payments, unless the index at the commencement of the lease term is not considered to be reflective of the market in the medium term – for example if there are any short-term factors influencing the index which may be considered abnormal. In this case we believe an average index over an appropriate period of time may be a fairer reflection of the market in general.

Question 7

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?

The current proposals appear reasonable subject to a suitable transition date which would allow preparers to accumulate the substantial amount of information that will be required by the new standard.

We would recommend including further guidance on transition for any contracts currently accounted for as leases that would fall out of the scope of the new exposure draft and would need to be accounted for as service agreements going forward.

Question 8

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 understand that by replacing IAS 17 with this new standard, the Board wishes to ensure that amounts currently disclosed as lease commitments are recognized directly on the balance sheet. With the new requirement of recognizing almost all lease contracts on the balance sheet, we would have expected that fewer disclosures would have been required in the notes to the financial statements in comparison with IAS 17 requirements. This does not appear to be the case and in particular we question whether the roll-forward disclosure requirements for the lease receivables/liabilities and related residual assets are adding value for the readers of the financial statements, especially for entities that are not active in the leasing/financing industry. Generally we would welcome that the final standard stresses that only material amounts that are important for understanding the activities of the entity need to be disclosed.

While not specifically requested by the question above, we would like to point out that paragraph 56 as currently worded might be interpreted in a prescriptive manner as requiring new lines to be added to the face of the profit and loss statement. We consider that more flexibility is introduced allowing such disclosures in the notes. Consequentially we suggest that paragraph 56 should be redrafted to be more in line with the wording in paragraph 90, which refers to presentation by lessors.

Furthermore, in consideration of certain member companies' requirement to file Form 20-F with the SEC and to comment on the impact of future accounting changes we consider that there is currently insufficient information and guidance with regard to retrospective application in order that an assessment can be made on the impact of the introduction of the standard for these disclosure purposes.

Questions 9 - 11 inclusive are FASB only and therefore have not been considered.

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.

Other SwissHoldings comments

We note that paragraph 36 requires that an entity should account for a modified contract as a new contract at the date modifications become effective. We recommend clarifying that the date the modifications become effective is deemed to be the signing date of the revised agreement or the date when the modifications start applying. Contract modifications are usually discussed before the end of the non-cancellable period of the contract and when the option to renew the existing contract is due. The new contract actually becomes effective only after the end of the non-cancellable period of the existing contract and replaces usually the terms of the option to extend the existing period.