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International Accounting Standards Board
30 Cannon Street
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Dear Sir,

Comments on Exposure Draft – Leases

The following is the response of the Co-operative Performance Committee (CPC) of Co-operativesUK in relation to the Exposure Draft.

Co-operatives UK works to promote, develop and unite co-operative enterprises. It has a unique role as a trade association for co-operative enterprises and its campaigns for co-operation, such as Co-operatives Fortnight, bring together all those with a passion and interest in co-operative action.

Co-operatives are businesses that exist to serve their members, whether they are customers, employees or the local community. They work in all parts of the economy including retail, banking, food and farming, design and renewable energy. Co-operatives also deliver a range of public services including housing, social care, sport and leisure, recycling and health care.

There are already over 4,990 co-operatives in the UK, owned by nearly 13 million people and employing over 237,000 people.

Members are the owners, with an equal say in what the co-operative does. So, as well as getting the products and services they need, members help shape the decisions their co-operative makes.

Further information about Co-operatives UK and the co-operative sector can be found on our website www.uk.coop.

CPC is a standing committee of Co-operativesUK, which brings together professionals from within the co-operative movement to take responsibility for the movement's performance indicators and for promoting best practice on accounting standards. The number of co-operative organisations in membership exceeds 540 and these members have a combined turnover in excess of £13 billion. They employ over 98,000 staff trading through 4,500 retail outlets.

Co-operatives UK works to promote, develop and unite co-operative enterprises. It has a unique role as a trade association for co-operatives. Its campaigns for co-operation bring together all those with a passion and interest in co-operative action.

As many of the Co-operatives within Co-operativesUK are retail organisations, they have significant operating leases within their property portfolio both as lessor and lessee. Therefore the new standard is a very important one for Co-operatives in general.

The CPC has answered the questions in Appendix 1 attached and have provided an overall view below:

Overall view

We agree with the principle of what the IASB are trying to achieve. Non cancellable operating lease commitments could easily be defined as liabilities as there is an obligation to settle with the lessor. We also agree that the two way method in IAS 17 led to many companies manipulating their leases in order to fit the accounting method they desired. This led to a lack of comparability across financial statements. By making all leases essentially finance leases, this will lead to more comparability, if the complexity in the standard proposed is kept to a minimum.

However, the CPC disagrees with a number of the details within the Exposure Draft, mainly around the detailed work that would be involved in assessing the most likely lease term on every lease and also calculating probability outcomes for contingent payments.

For lease terms, the CPC argues that the lease term should always be up to the first break clause or lease term expiry so that there is simplicity and comparability across accounts. This would hugely reduce the extra administrative burden as companies are already required to disclose operating lease commitments and so this data is already maintained. Secondly, the CPC does not see how any rent due after a break clause or lease term expiry can be a liability as the lessee can cancel the lease and therefore there is no obligation.

Contingent payments should be accounted for as most likely, similar to IAS 37 and amended each year end when new knowledge becomes apparent.

The CPC also disagrees with the two way approach for lessors. This will lead to lessors manipulating their lease agreements so to get the preferred accounting treatment. This was exactly the reason why IAS 17 needed to be replaced. The IASB are just creating the same issue again. The CPC believes that only the derecognition approach should be used in order to increase comparability across financial statements.

APPENDIX 1 – Q&A FROM LEASES EXPOSURE DRAFT

#	Question	Response
Lessees		
1	<p>(a) Do you agree that a lessee should recognise a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?</p> <p>(b) Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?</p>	<p>Agreed. Co-operatives UK agrees with the principle of recognising an asset and a liability. Recently, analysts and many readers of accounts add the operating leases commitment when analysing debt ratios as they believe that the commitment is a liability for which there will be economic outflows.</p> <p>Agreed. This makes the treatment more consistent with IAS 16 by applying depreciation and IAS 39 by applying interest on the liability.</p>
Lessors		
2	<p>(a) Do you agree that a lessor should apply:</p> <p>(i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term, and</p>	<p>(i) Disagree.</p> <p>The proposal for the performance obligation approach will lead to the same asset being recognised on two different Statements of Financial Position (SOFP) – the lessor and the lessee.</p> <p>There is an outflow of economic assets as the lessor is giving up use of the asset and therefore it should not be included as a non-current asset.</p> <p>Also, with the subjectivity involved, the same asset could be held on two SOFPs at a different value depending on how the two separate companies interpret contingent rentals, lease terms etc.</p> <p>It is counter-intuitive for two subsidiaries in the same Group (who may have leased an asset to one another) to both hold the same asset. This treatment does therefore not represent the substance of the transaction. Only one of the lessee or the lessor has control of the asset.</p> <p>In addition, if a lessor is holding property</p>

#	Question	Response
	<p>(ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?</p> <p>(b) Do you agree with the boards' proposals for the recognition of assets, 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?</p>	<p>using the revaluation method and then takes up the performance obligation approach, the book value of the property will be based on market values that will be arrived at by taking account of the likely market rental of the asset grossed up by its assumed yield. Would it therefore be incorrect to receive another asset that is then double counting the market value calculation (at least to some extent) by taking account of the rental income again? We believe that this may cause some double counting.</p> <p>(ii) Agree. The lease contract transfers a portion of the leased item from the lessor, therefore it should be derecognised. The present value of the future rentals should be transferred to finance receivable.</p> <p>(b) Allowing a choice of approach will lead to a lack of comparison between businesses and thus propose that only the derecognition approach be permitted whereby if an asset is leased out then this should now only be an asset in the lessee's accounts whether previously a finance or operating lease, but should not still be held on the lessor's balance sheet.</p>
Short term leases		
3	<p>The exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is twelve months or less:</p> <p>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 or loss over the lease term (paragraph 64).</p> <p>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</p>	<p>Agreed. We support the fact that treatment is specifically defined for short-term leases to ensure consistency in Financial Statements.</p>

#	Question	Response
	<p>recognise assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit or loss over the lease term (paragraph 65).</p> <p>Do you agree that a lessee or a lessor should account for short-term leases in this way?</p> <p>Why or why not? If not, what alternative approach would you propose and why?</p>	
Definition of a Lease		
4	<p>(a) Do you agree that a lease is defined appropriately? Why or why not?</p> <p>If not, what alternative definition would you propose and why?</p> <p>(b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?</p> <p>(c) Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not?</p>	<p>(a) Agree. In line with current definition with additional clarification of ‘control’ of the asset and the presence of a ‘contract’.</p> <p>(b) Agree.</p> <p>(c) Agree.</p>
Scope Exclusions		
5	<p>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, leases of 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?</p>	<p>Agreed.</p>

#	Question	Response
	If not, what alternative scope would you propose and why?	
Contracts that contain service components and lease components		
6	Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?	No comment.
7	<p>The exposure draft proposes that a lease contract should be considered as 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).</p> <p>Do you agree with the boards' tentative decision to initially measure the lessee's right-of-use asset at cost?</p> <p>If you disagree, please explain why and describe how you would initially measure the lessee's right-of-use asset.</p>	Agreed.
Lease Term		
8	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?	<p>Disagree. This is open to manipulation and will lead to much administrative burden.</p> <p>The proposed amortisation of assets approach will lead to a significant impact on EBITDA and financial ratios (e.g. Gearing) and thus potentially affect current bank covenants or the ability to obtain finance. Allowing such subjectivity in the process will allow the preparer to choose the lease term option that will suit them best with the above measures in mind.</p> <p>With a personal opinion being applied to each and every lease it will make it very difficult to audit and thus difficult to ensure</p>

#	Question	Response
		<p>consistency and comparability across businesses.</p> <p>There would also be an immense administrative burden if a company was forced to consider the longest possible term for every lease it possessed. For a company with thousands of leases this could take months to compile. In most cases, it will be impossible to tell what is most likely until a lot nearer the extension date.</p> <p>It is our opinion that the obligation should be assumed to be the first break clause or lease term expiry as this is a definite, justifiable, known date. Adjustments can then be made when updates /extensions are acted upon. This will also reduce the administrative burden too as a Company would not have to assess the likelihood of every lease scenario.</p>
Lease Payments		
9	<p>Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease 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?</p> <p>Do you agree that lessors should only include contingent rentals and expected payments under term option penalties</p>	<p>Estimating contingent rental arrangements could become a costly and complicated exercise. If contingent rental arrangements are to be included, they should be accounted for on a most likely basis. It would be too complicated and costly to base it on probability outcomes, especially if these are to be recalculated every period.</p> <p>The proposal is open to manipulation and it will be difficult to get a consistency and comparability across businesses if an expected outcome technique is used.</p> <p>We consider a better method would be to arrange the obligation as the minimum lease commitment and then make changes each period (as per 'Reassessment in section 10') when such contingencies are known.</p> <p>Under the performance obligation approach an additional complication is that a lessor and a lessee may disagree on the expected outcome and thus exactly the same asset given a different value on two different companies' Statements of Financial Position.</p> <p>An asset should only be recognised if future economic benefits are expected to flow to the entity and a liability when the settlement is 'expected' to result in an outflow of resources. This being the case, future</p>

#	Question	Response
	and residual value guarantees in the measurement of the right to receive lease payments if they can be measured reliably? Why or why not?	payments must be able to be measured reliably.
Reassessment		
10	<p>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 liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not?</p> <p>If not, what other basis would you propose for reassessment and why?</p>	<p>Agreed for changes in the lease terms. Changes to assets and liabilities arising under a lease should be recognised on a periodic basis.</p> <p>Changes in contingent rental payments should be when there are indicators to show the obligation has changed.</p>
Sale and Leaseback		
11	Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?	Agreed. This appears to reflect the substance of the transaction.
Presentation		
12	<p>Statement of Financial Position</p> <p>(a) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment or investment property as appropriate, but separately from assets that the lessee does not lease (paragraphs 25 and BC143–BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?</p>	<p>(a) The leased assets should not be shown separately to property, plant and equipment so that the Statement of Financial Position is as simplified as it can be. The obligation to make lease payments should be shown separately to other loans and borrowings in the Statement of Financial Position so that readers can easily identify actual bank debt and debt built up from leases.</p>

#	Question	Response
	<p>(b) Do you agree that a lessor applying the performance obligation approach should present 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? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?</p> <p>(c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?</p> <p>(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (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?</p>	<p>(b) Disagree with the performance obligation approach for lessors. See question 2.</p> <p>(c) We would prefer the amount owing to be included within receivables in the Statement of Financial Position. It should be presented separately in the notes. A reconciliation should be provided so users can easily see how the receivable changed in the period. Again, residual assets should be considered an asset of the business and therefore included within non-current assets.</p> <p>(d) Again, this will start to over complicate the Statement of Financial Position if there are separate entries for assets and liabilities under sublease in addition to all other leased assets. There should be full disclosure in the notes to the accounts.</p>
13	<p>Statement of Comprehensive Income</p> <p>Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead?</p> <p>Why or why not?</p>	<p>The income statement should be as simplified as possible so that readers of the accounts can easily see the main items in the primary statement. By adding more detail to the income statement, the reader will be overloaded with information. It would be preferable to include the income and expenses within other income and expenses and then separate them out in the note.</p>

#	Question	Response
14	<p>Statement of Cash Flows</p> <p>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?</p>	<p>As per the same reasons as question 13, the statement of cash flows should be as simplified as possible. Therefore, we believe that the items should not be separated from other cash flows.</p>
Disclosure		
15	<p>Do you agree that lessees and lessors should disclose quantitative and qualitative information that:</p> <p>(a) identifies and explains the amounts recognised in the financial statements arising from leases; and</p> <p>(b) describes how leases 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?</p>	<p>(a) The CPC agrees that some disclosures should be made to help readers understand the nature of the company's leases. However, the disclosures mentioned in paragraphs 70-86 go way too far, will make readers of the accounts lose interest and will force too much administrative burden on the preparer.</p> <p>For example, it is hard to gauge exactly what level of detail is required in para 73. The IASB needs to be explicit in what it requires the preparer to disclose. The items here are very general and descriptions of leases will not be specific nor detailed enough for purpose. By making the disclosure requirements too general, preparers will make up generic sentences to get round any sensitivities there may be. The IASB needs to come up with specific disclosures which are easy to prepare.</p> <p>(b) If there is uncertainty then this must be disclosed in the accounts. However, as noted above, we consider that commitments should be prepared up to the first break clause to remove the opportunity to manipulate/allow different interpretation. This thus prevents the need to disclose uncertain cashflows.</p>
Transition		

#	Question	Response
16	<p>(a) 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?</p> <p>(b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?</p> <p>(c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?</p>	<p>(a) No issue with this proposal.</p> <p>(b) As the IASB are happy with the simplified approach this should be the sole recognised model used by all to ensure consistency across all financial statements.</p> <p>(c) None noted.</p>
Benefits and Costs		
17	<p>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 would outweigh the costs? Why or why not?</p>	<p>Yes. The key factor here is that the former 'operating leases' should be recognised as assets on the Statement of Financial Position.</p> <p>The CPC agrees with BC 203 and that there will be a significant administrative burden arising from implementing the model.</p> <p>The CPC questions the logic in BC 205. The paragraph argues that a detailed examination of every lease is not required unless a significant change is expected to occur. However the CPC argues that how would any entity know there has been a significant change in what is expected to occur without going through every lease.</p>
Other comments		

#	Question	Response
18	Do you have any other comments on the proposals?	<p>Break clauses - There is no specific reference to break clauses in the exposure draft whereas we consider this to be the key indicator for the expected life of a lease.</p> <p>Repair costs – would this be done on a probability outcome if there was a probable chance of repair costs or will it be expensed when incurred?</p> <p>Enhancement costs – if a lessee knows that it is probable that the right of use asset will need enhancing at some point during the lease and the lessee is legally obliged to, will this be calculated within the obligation? Some guidance beyond treatment within sale and leaseback is required on this.</p> <p>Peppercorn rent – no specific guidance on this. This should presumably be considered as an asset sale as now a reference to substance of the lease.</p>