

Barbara Davidson  
International Accounting Standards Board  
30 Cannon Street

London EC4M 6XH  
United Kingdom

Weinheim, 12/14/2010

Dear Barbara,

### **ED/2010/9 – LEASES**

We appreciate the opportunity to comment on the IASB's ED/2010/9 on Leases.

The Association for Participation in the Development of Accounting Regulations for Family-owned Entities (VMEBF) was founded in 2006 and consists of German companies with a strong family shareholder background. Beyond its members, the association represents the majority of family-owned large and medium-sized entities in Germany, often legally organised in the form of partnerships. The aim of the VMEBF association is to act as constructive partner for the standard setters and to make the role of German family businesses as stakeholders in the development of international accounting more visible. We work closely together with the German standard setter ASCG and the German Institute of Chartered Auditors (IDW) as well as other political institutions.

Already today, a large number of non-publicly listed entities are preparing IFRS consolidated financial statements as they are supposed to converge external financial reporting and internal management information and therefore are likely to provide users of financial statements with decision-useful data. However, we believe that the obvious turn towards a widely legalistic approach within the joint projects on leases or revenue recognition (cf. our comments on ED/2010/6) would rather reduce decision-usefulness as a legalistic approach will in many cases not necessarily reflect the economic substance of the underlying transaction.

We agree with the boards' objective to report decision-useful and representationally faithful information to users of financial statements about the amounts, timing and uncertainty of cash flows arising from leases. However, we principally believe that the

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transition of the risks and rewards of a leased asset best reflects the economic substance of the underlying lease contract and we see differences in the economic substance of finance and operating lease transactions. Nevertheless, despite our severe concerns regarding the appropriateness of the proposed approach providing decision-useful information, we understand that minimum lease payments of all lease contracts should be reflected in the statement of financial position for standardisation purposes. However, if the boards should decide to pursue this approach, we would recommend at least to redeliberate the following:

- the approach proposed for lessor accounting (hybrid model) as we understand it as not consistent with the approach for lessee accounting and it therefore contradicts the efforts to implement a single approach.
- the measurement of receivables and liabilities under consideration of contingent payments and renewal options. Such measurement requires assumptions and judgments by the accountant that cannot be objective and that can hardly be specified as notes in a useful way (for a huge number of contracts it is necessary to provide aggregated information). Moreover, considering contingent payments and renewal options adds complexity to current lease accounting. Thus, the benefits of these proposals do not appear to outweigh the costs and administrative burden arising from implementing and applying the new model in this respect.
- the reassessment of receivables and liabilities in case of changes to the underlying terms. This causes high volatility and diminishes reliability of financial statements.
- the absence of a useful exemption for lessees in accounting for short-term leases.
- the (even simplified) retrospective application of a new standard on leases.

Please refer to the appendix to this letter for our detailed answers to the questions asked in the exposure draft.

Yours sincerely,

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**Appendix:  
VMEBF comments on the boards' additional questions**

**The accounting model**

*The exposure draft proposes a new accounting model for leases in which:*

- (a) a lessee would recognise an asset (the right-of-use asset) representing its right to use an underlying asset during the lease term, and a liability to make lease payments (paragraphs 10 and BC5–BC12). The lessee would amortise the right-of-use asset over the expected lease term or the useful life of the underlying asset if shorter. The lessee would incur interest expense on the liability to make lease payments.*
- (b) a lessor would apply either a performance obligation approach or a derecognition approach to account for the assets and liabilities arising from a lease depending on whether the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected term of the lease (paragraphs 28, 29 and BC23–BC27).*

**Question 1: Lessees**

- (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?*
- (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?*

(a) and (b): Despite our severe concerns regarding the appropriateness of the proposed approach providing decision-useful information, we understand that minimum lease payments of all lease contracts should be reflected in the statement of financial position for standardization purposes. However, if the boards should decide to pursue this approach, we would recommend at least to redeliberate the issues pointed out in our cover letter.

**Question 2: Lessors**

- (a) Do you agree that a lessor should apply (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 (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?*
- (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?*

(a) and (b): The former objective to simplify and standardise lease accounting, especially by reducing the number of accounting models should be reconsidered as it has been failed in the ED for lessor accounting. Again, lessors have to review each single transaction regarding risks and benefits and decide which accounting model – Derecognition Approach (DA) or Performance Obligation Approach (POA) – to use. Moreover, lessor accounting is no longer consistent with lessee accounting.

We recommend the implementation of the DA only. We reject the POA for the following reasons:

- a single future cash flow is being recorded twice (asset and lease receivable),
- PO is no liability according to the framework, and
- the value of a net asset to be recorded is a mathematical construction composed of three economically very different parts and is therefore of little (economic) sense.

### **Question 3: Short-term leases**

***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:***

- (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).***
- (b) At the date of inception of a lease, a lessor that has a short-term lease may select on a lease-by-lease basis not to recognise assets and liabilities arising from a short-term lease in profit or loss, 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).***

***(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?***

(a) and (b): Although we appreciate the simplification for short-term leases, we prefer to implement the same simplification for lessees and lessors alike. Recording the undiscounted lease asset and liability provides no relief for lessees. Especially, for transactions such as

- an overnight stay at a hotel,
- car rental for a couple of days or weeks,
- rental of coffee machines, or

- photocopier or other equipment without operating purpose.

The cost of recording the undiscounted asset and liability dramatically exceeds the benefits for users. We understand that each single transaction that occurs during the fiscal year and that is already finished at balance sheet date is to be additionally recorded in the books and must be shown in the reconciliation of opening and closing balances as right-of-use assets and liabilities. Moreover, amortization and reversal of a liability would also be necessary for short-term leases and lead to a very high administrative burden for companies but provide only little – if any – useful information to users.

Furthermore, short-term leases are in general of minor importance and comparability of short-term leases – as proposed to be shown according to the ED – is limited due to the „choice on lease-by-lease basis“.

Therefore, we suggest the recognition of lease expenses for short-term leases in P/L statement analogous to current operating leases according to IAS 17.

**Question 6: Contracts that contain service components 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, B5–B8 and BC47–BC54). If the service component in a contract that contains service components and lease components is not distinct:***

- (a) the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.***
- (b) 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? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?***

(a) and (b): We neither support the approach of the FASB nor that of the IASB. We recommend no unbundling of combined contracts containing service and lease components that are not distinct. From our point of view, the contract should be recorded according to the predominant component, either as lease contract considering the lease standard or as service contract according to the revenue recognition standard.

### **Question 7: Purchase options**

***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).***

***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?***

We agree that the lease contract is terminated when a purchase option is exercised. We also agree that during the lease term the lessee and lessor do not account for purchase options separately. The price for purchase options is usually included in the lease contracts and the information about the separate price of the purchase option is not available to the lessee.

We believe that there is no conceptual reason for making a difference in the accounting treatment between a purchase option and a lease extension option. In both a lessee gains control over the leased asset beyond the initial lease term (see our response to question 8).

### **Measurement**

***The exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that:***

- (a) assumes 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 (paragraphs 13, 34, 51, B16–B20 and BC114–BC120).***
- (b) includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21 and BC121–BC131). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be measured reliably.***
- (c) is updated 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 (paragraphs 17, 39, 56 and BC132–BC135).***

### **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?***

For pragmatic reasons we agree with the boards that options should not be separated from the underlying lease contract. However, we believe that the determination of the lease term should not consider extension or termination options for the following reasons:

- amounts due under renewal options in the measurement of lease payable and receivable is inconsistent with the Conceptual Framework (there is no control as a result of a past event resp. no present obligation arising from past events),
- furthermore, these amounts do not provide relevant and reliable information to users of financial statements (consider a 20-year lease would be accounted for in the same way as a 10-year lease with a 10-year extension period despite the reduced risk involved),
- estimation of probabilities provides wide scope of discretion as a broad variety of factors has to be considered (the new approach intends to limit scope of discretion),
- options are regularly considered when determining/pricing minimum lease payments,
- estimating the probable lease term and contingent rentals is principally perceived open to subjectivity in CLs (cf. Fehr/Fülbier, p. 14).

In terms of reliable and relevant information, we believe that amounts due under renewal options should not be included in measurement and lease terms should be limited to the non-cancellable period. However, general information on existing renewal options could be disclosed in the notes.

**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 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?***

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

We disagree that contingent rentals are to be included in measurement of assets and liabilities resulting from a lease contract for the following reasons:

- from our point of view, contingent rentals do not meet liability criteria due to their dependency on future events,
- most contingent payments are within the control of the lessee,
- it is not possible to estimate future indices such as inflation or rent levels and there is no public information about these figures for a lease term of e.g. 15 years or more.

We do not agree with the use of the expected outcome technique due to the following reasons:

- the method is extremely complex and therefore costly and time-consuming (assume a company with thousands of lease contracts),
- the result of the expected outcome technique is a fictitious and artificial value,
- furthermore, these values would be calculated for (lease) accounting purposes only and are of no interest for management, i.e. financial controlling according to IFRS would not be possible any more due to lease accounting.

Our suggestion:

- contingent lease expenses should be recognized in P/L statement when they are incurred,
- to give additional information on contingent lease payments the present value of contingent lease payments on the basis of the value of the parameters at the end of the reporting period could be disclosed in the notes.

#### **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 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? If not, what other basis would you propose for reassessment and why?***

We disagree with the proposed reassessment for the following reasons:

From our point of view, as mentioned under question 9, contingent lease payments do not meet the definition of liabilities in the Conceptual Framework. Furthermore, it is far too complex to reassess lease contracts.

Consider the process of a lessee with thousands of lease contracts. At each reporting date the accountants are to request all departments dealing with lease contracts to review all lease contracts in case

- there are any circumstances that indicate changes in value of the lease liabilities,
- any of the formerly made estimates about lease term or probability of exercising an option have changed,
- any of the used index levels have changed.

Thus, in case of any changes the accountant has to ensure the updating of all necessary data in a database.

We apprehend this as a highly complex model that is difficult to implement and execute. The possibilities of IAS 8 to anticipate significant changes regarding lease accounting are sufficient.

### **Sale and leaseback**

*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).*

### **Question 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?*

We agree with the proposal.

### **Presentation**

*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).*

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

- (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?*
- (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?*
- (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?***

***(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?***

(a) We do not support the suggested presentation for the following reasons:

- in case of insolvency, creditor and shareholders have no opportunity to liquidate leased items because leased items are not owned by the company,
- presentation of leased assets within the respective asset category in the statement of financial position might confuse users of financial statements,
- the way of preparing the statement of financial position as suggested in the ED would lead to considerable additional administrative burden without additional information benefits, as the information is already presented in the notes.

We suggest a „one-line“-presentation of leased assets and lease liabilities in the statement of financial position (similar to IFRS 5).

Regarding segment reporting (IFRS 8) we point out that the proposed lease accounting for lessees may cause an enormous burden for companies preparing consolidated financial statements in the case of intra-group leases. If the data reported to the CODM does not include intra-group leasing items the reported segment data resp. the otherwise mandatory reconciliation would be calculated for accounting purposes only and is of no interest for management or other users.

(b): We disagree with the presentation proposed for the POA as we disagree with the POA in general (see our remarks under question 2).

(c) - (d): We agree with the proposals.

### **Question 13: Statement of comprehensive income**

***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? Why or why not?***

We agree with the proposals.

### **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?***

We agree with the proposals.

## **Disclosure**

### **Question 15**

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

- (a) identifies and explains the amounts recognised in the financial statements arising from leases; and**
- (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?**

From our point of view, it makes sense to disclose qualitative information about the character of the lease contracts. However, we disagree with the scope of information to be disclosed in order to explain the recorded assets and liabilities. It seems that the complexity of the recorded items valuation requires a significantly too high amount of additional explanation.

## **Transition**

### **Question 16**

- (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?**
- (b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?**
- (c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?**

We presume that the simplified retrospective approach (compared to the full one) would even increase the measurement complexity of lease contracts, especially for lessors. Furthermore, this simplified approach does not enhance comparability.

We recommend prospective application for new lease contracts in order to avoid an enormous burden for companies caused by any retrospective application. Especially, due to the scope of the ED, most companies have hundreds to thousands of lease contracts.

We acknowledge the benefits of the right-of-use approach for users of financial statements, but we have substantial concerns to the time frame available to implement reliable processes and IT-systems that meet all requirements of the new standard.

## **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 would outweigh the costs? Why or why not?***

We acknowledge that there are some benefits to users as outlined in paragraph BC204. But from the point of view of preparers, the right-of-use approach is associated with very high costs, e.g. for

- implementation of a new database and IT system,
- higher documentation effort.

Estimating benefit in advance is hardly possible but we expect that there will only be little benefits resulting from the application of that standard (information on leasing and future lease payments is already given in the notes).