

Dr. Ingrun-Ulla Bartölke
Leiterin Konzernrechnungswesen
und externe Berichterstattung
VOLKSWAGEN AG
D-38436 Wolfsburg

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

Exposure Draft ED/2010/9 – Leases

Dear Sir/Madam,

Thank you for the opportunity to comment on your Exposure Draft ED/2010/9: Leases. The Volkswagen Group is one of the world's leading automobile manufacturers and the largest carmaker in Europe. With our 100%-owned subsidiary Volkswagen Financial Services AG we are also the largest automobile financial services provider in Europe. Volkswagen is affected by lease accounting in multiple ways: inter alia as lessor of vehicles in B2C and B2B leases, as lessor of tenements to employees and third persons and as lessee of different leased goods all over the Group. On behalf of Volkswagen AG, Wolfsburg, we are pleased to provide you with remarks to the proposed Exposure Draft in response to your invitation to comment.

As already stated in our comment on the IASB Discussion Paper: "Leases – Preliminary Views" Volkswagen agrees to the need to improve lease accounting in principle especially as the existing accounting standard lacks comparability because of the missing of a clear distinction between finance and operate lease and gives rise to adjustments by users of the financial statements, e.g. rating agencies. But, we cannot avoid the feeling that the reformation of the accounting issues is primarily driven by the thought that leases are structured for window dressing purposes, only. This ignores the fact, that in practice legal

reasons, like the prohibition to acquire real estate as a foreign company in some states, operational reasons, like outsourcing the IT-department, or other economical reasons, when the acquisition of the asset is no alternative, are the crucial factor to assume a lease while especially for companies rated by credit agencies there is no fiscal advantage in finance lease accounting.

We also principally agree to the proposed on balance sheet accounting at least for lessee. However, we have strong concerns regarding

- a) the theoretical underpinning of the right of use approach;
- b) the complexity and the practicability of the approach and
- c) possible accounting induced negative economic consequences for the leasing business.

We still fundamentally can not agree to recognize any obligation in the balance sheet of the lessee or lessor for rights granted by the leasing contract that do not fulfill the definition of a liability of the framework as it would not provide a faithful representation of the financial position of the preparer.

Ad (a): Concerns regarding the theoretical underpinning of the rights of use approach

We have strong concerns regarding the theoretical underpinning of the rights of use model. First of all, we still have problems to see the difference between the right of using an asset and any other contractual right like long term delivery contracts or employee contracts. In our point of view, there is no difference, but the measurement of the right of use in itself derived by the IASB is flawed. Anyhow, we generally can not agree to the right of use model as long as it is not clarified that there are no conceptual consequences for the accounting of any other executory contracts.

We also can not agree to the conceptual issues deduced from the right of use model for the lessor. To say under the performance-obligation approach – even in the notes – the lessor has two assets (a) the leased asset and (b) the rights to receive lease payments means a double counting of potential future cash flows and is neither in line with the asset definition of the framework nor is it a true and fair depiction of the economic reality of the entity. To say – even in the notes – there is a present obligation out of the lease contract as long as the other party is not providing prepayments again raises the question of the treatment of other executory contracts.

Ad (b): Concerns regarding the complexity and the practicability of the approach

Compared to the existing requirements of IAS 17 for finance lease accounting at the lessee and finance and operate lease accounting at the lessor the proposed standard adds a lot of complexity to lease accounting for preparers and users without significant increase in useful information. Especially the requirement to include options into the calculation of the lease term with a reassessment on a regular basis heavily increases the costs of accounting and gives space for structuring financial statements. As a consequence the comparability of financial statements will suffer. Further we have concerns regarding the accounting of lease contracts with infinite lives but the option for both sides to end the leasing within a short period and contingent leases.

Further, the requirement of a – even simplified – retrospective adoption of the standard as mentioned in the ED means a heavy burden for preparers, as there is often no sufficient information about the lease objects available. We can not agree, that the enormous cost of a retrospective adoption can be justified by a better comparability, as IFRS accounts are highly incomparable in itself.

Ad (c): Concerns regarding possible accounting induced negative economic consequences for the leasing business.

The proposed changes to lease accounting can cause accounting induced negative consequences for the whole leasing business and in consequence for the whole economy.

c1) Disadvantages at the lessee caused by new accounting rules for leasing:

If the lessee is obliged to capitalize each leasing contract with higher and more complex workload compared to a financing contract there is a danger that the customers will switch from leasing to financing contracts. Due to a deterioration of KPIs the lessees may suffer with higher refinancing charges and as a consequence some investments perhaps remain undone. This could lead to a shrinking in the whole economy.

c2) Disadvantage if accounting at the lessors becomes sharply extensive compared to lending business could also lead to a switch from leasing to financing business with same consequences for the economy as mentioned in c1).

c3) The performance-obligation model may lead to additional equity need in our financial services companies as it is absolutely open how the banking supervisory authorities will treat the ‘netting’ of leasing transactions as proposed by the Board in their evaluation of risk weighted assets. As a consequence we do not agree to the hybrid-model at lessor accounting and prefer the partial-derecognition approach.

Further, the requirement of calculating the lease term including options to extend or terminate the contract in connection with a reassessment on a regular basis opens the door

for structuring financial statements. This is in contrast to the IASB objectives to start the renewal of lease accounting. As this will probably increase the suspicion of investors and rating agencies regarding lease accounting this will also decrease the attractiveness of leasing.

Given the reasons we mentioned we propose the following two alternatives for the treatment of leasing in the future by preferring Alternative 1):

Alternative 1)

We generally believe that it would be more preferable to retain the existing concept in IAS 17, but expand the definition of a finance lease to most leases.

Alternative 2)

For avoiding the unnecessary complexity and impracticability of lease accounting as written in the ED and to provide users and preparers with an understandable less complex – but like we think very well structured – approach we support the simplified right-of-use model published by Leaseurope in their Comment Letter.

Further details are included below in our responses to the questions of the Board.

Best Regards,

Ingrun-Ulla Bartölke

Questions of the Board

Question 1a: Lessees – recognising assets and liabilities

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?

We would agree to recognise the leased asset and the corresponding liability in the balance sheet of the lessee at least for most leased assets. But we can not agree to the right-of-use approach in the discussed form as it is totally artificial and leaves many questions unsolved:

First of all, the right-of-use approach does not answer the major question of lease accounting: who is controlling the leased asset. In consequence, we have inconsistencies especially in the lessor accounting.

Second, we see no valid differentiation between the right-of-use of assets provided within a lease contract and any other rights that are provided by executory contracts. To say, that the lessor has already fulfilled its obligation widely with the transfer of the leased good to the lessee, neither depicts the economic reality for some kinds of lease agreements nor is it in line with the accounting under the performance obligation approach where it is deemed, that the lessor still has an obligation to fulfill over the lease term. E.g., we share the view of the board that within a typical B2C car leasing the lessor has fulfilled its performance obligation during the lease term by financing the selling price (comparable to normal creditor), especially as the lessor is not liable for maintenance, repair or a replacement when the car gets broken or lost in an accident; but this is not true for e.g. renting a hotel room where the performance obligation connected with the room does not end with handing over the room key, but just is starting. For further concerns regarding the differentiation between the right of use and other rights from executory contracts, see our comment letter to the IASB Discussion Paper: Leases – Preliminary Views that we have reproduced in the annex.

We propose to retain the existing concept in IAS 17, but expand the definition of a finance lease for lessee and lessor to most leases. This may be done by defining in a first step that the lessee that is leasing a total unit of account is controlling that unit during the lease term, while the lessor loses control during that period. In a second step we should define a materiality threshold for short term leases of a lease period non-redeemable by the lessor of one year where the lease should be accounted for as operating lease in accordance with the existing IAS 17. We refuse to leave the length of the materiality threshold undefined, as this will be no improvement to the comparability of financial statements.

We believe in respect of the leasing of physical assets that the concept should be applied to an asset or group of assets that are physically connected and have the same useful life in total. Hence, there should be no transfer of control of parts of a hotel room or parts of an apartment building only because hotel guests/lessees are renting a single part of the building.

Question 1b: Lessees – measuring assets and liabilities

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?

We do not accept the proposed measuring of the right of use and the liability for the reasons already stated in our comment letter to the IASB Discussion Paper: Leases – Preliminary Views that we have reproduced in the annex.

Question 2a: Lessors (The hybrid model adopted in the ED)

(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?

We do not agree. The hybrid-model adopted in the ED does not represent an alternative to current regulation in IAS 17 even if it focuses also on risks and rewards but in another definition. In addition the performance-obligation approach at the lessor is not in line with the conceptual framework nor with the right-of-use model proposed for the lessee. There is no reason available why a leasing contract should produce an additional asset and liability at the lessor when the lessor has already fulfilled its obligation to convey the leased asset to the lessee. Further, the model is not in line with the asset definition of the framework as it provides a double counting of the cash flows provided by the leased asset realized via the lease contract.

In contrary to this the derecognition model is – under the premise of a right-of-use model – able to account in a proper way for all leasing transactions especially for manufacturer/dealer leasing. As a consequence, if the Board retains its right of use model it must cancel the performance-obligation model.

Question 2b: Lessors (Performance obligation and de-recognition)

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?

We do not agree with the performance-obligation model. For the reasons we refer to Q2a.

We support the derecognition model with an accretion of the residual assets for all the leases accounted for as finance lease under the modified approach discussed under 1a as this would lead to an income recognition like under a finance lease contract in IAS 17.

For all other lease contracts discussed under 1a (lease contracts where the period transferring control is immaterial or that are not transferring controlling over the total asset) the board should retain the existing accounting for operate leases.

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 elect on a lease-by-lease basis not to 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).

(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?

We appreciate the simplified requirements. However, we see no valid reasons for refusing lessees using the simplified method under paragraph 65.

Question 4a. Definition of a lease (general)

Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?

We do not agree as the definition of a lease in the ED is too broad. Due to the different accounting consequences between a lease and an executory contract the definition of a lease should be made in more detail. For a possible solution regarding definition of a lease we refer to the “Simplified right-of-use model for all leases” in Leaseurope’s Comment Letter.

Question 4b. Definition of a lease (leases vs purchases/sales)

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?

We do not agree. By using this definition it may happen that Finance Leases under current IAS 17 will no longer be treated as leases. From our point of view the reason for doing this distinction is the usage of the performance-obligation model at manufacturers/dealers to allow them to show sales revenues in some circumstances. The only usage of the derecognition model would make this distinction obsolete.

Question 4c. Definition of a lease (leases vs services)

Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

We do not think that the proposed criteria is sufficient as there is the hazard that from an economical point of view equivalent transactions may be accounted for in some cases as service contracts (e.g. renting of transport capacity incl. a driver) and in other cases as leases (e.g. lease of a specified truck for transporting goods). From this point of view a clearer definition is necessary.

Question 6: Contracts that contain service components and lease components

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?

For the lessor we do not see any problems as the lessor is always able to determine the service component. Otherwise he could not calculate the contract in the right way. The

lessee in contrary does normally not know the calculation of the lessor. As a consequence the lessee must be allowed to do rough estimations of the service component. The lessee must not be punished by capitalising the service component within a lease contract as this would lead to an overstatement of right-of-use assets and lease obligations at the lessee.

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?

We can not agree to measure the lease obligation based on the possible use of any extending option as this is not in line with the liability definition of the framework. There is an operational necessity for the preparer to lease the asset over the whole period the asset is expected to be needed, what some people seem to understand as an “economic obligation”. However, this is true irrespective if there is an option for extending the leased period or if the lessee must enter into a new contract when the old has ended. And this is also true for every other depreciable asset of the company. Hence, the information about expected cash flows is no justification to capitalize an obligation for the optional period. Nor can it be justified by the fact, that there is no separate recognition of the embedded option. An option, that has an initial value will be prized within the rate of the first lease term and the option therefore is already recognized when the lessor measures the lease obligation without taking into account the effect of any options. We agree that not taking into account the effect of options bears the potential of structuring contracts; but this will be also the case with the proposed regulation, where lessee will start avoiding options irrespective if this is economically wise. Options grant flexibility to the lessee improves its risk position and are a fundamental criterion for the leasing business. Accounting such options would rob this issue at the lessee and will induced negative economic consequences for the leasing business.

We therefore recommend using as lease term the agreed contractual term in the lease contract or the period till the contract can be cancelled. We appreciate that the board has decided not to separate this embedded options from the host contract as this avoids unnecessary complexity and ask the board to retain this decision. Please take into account that – contrary to complex derivatives – lease contracts are written throughout the smallest companies. Hence, lease accounting must be kept simple.

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 do not agree. Contingent rentals need at least to be split between index oriented obligations and rentals that are contingent on a performance factor. The former the lessee is not able to avoid and therefore it could be included in the measurement whereas the latter can not be included in the measurement because they either do not represent liabilities for the lessee or assets for the lessor as it is at the lessee's decision to avoid such payments. In addition it is totally unfeasible in praxis e.g. to include exceeded mileage in a car lease contract on a regular basis during the lease contract as it is at the lessee's decision when he is using his car during the lease term. Only at the end of a contract the exceeded mileage will be calculated and charged (or benefited) to the lessee. In praxis car-lease contracts are calculated on a most realistic basis for the regular instalments to keep exceeded mileage as small as possible because if calculation is not made in a proper way at the beginning of the contract the lessee has to pay higher amounts for the exceeded mileage or on the other hand the lessor suffers residual value risks.

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 do not agree. For the reasons we refer to questions 8 and 9.

Question 15 Disclosure

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?

We do not agree as the required disclosures are too burdensome for preparers and users. By keeping out options and contingent rentals as written in questions 8 and 9 there is no necessity for such extended disclosures.

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?

From a lessee point of view a retrospective application is very extensive as the data needed for an on balance sheet accounting e.g. the calculation for the distinction between leasing and service component was not archived. We can not believe that the use of a better comparability can justify that enormous cost as IFRS accounts as a result of the permanent changes to the accounting system as well as the possibilities of earlier adoption are highly incomparable at all. We ask the board therefore not to apply the new accounting system at least for leases that will end within a specified period (e.g. 3 years).

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?

As stated in our answer to Question 8 we can not agree to measure the lease obligation based on the possible use of any extending option as it is neither in line to the definitions of the framework nor provide useful information's to the user. Therefore, the enormous costs of

(a) considering options within the initial recognition and especially (b) a yearly reassessment are not justifiable. For the cost of transition, we refer to our answer to Question 16.

In general, with respect to the role of the IFRS and the exceeding costs decisions of the IASB may have to the global economy today, we are not convinced that a cost-benefit considerations that seems to be based rather on hearsay than on valid facts is appropriate.

Annex

Volkswagen Comment letter on the IASB Discussion Paper: Leases – Preliminary Views

Karl Gadesmann
Leiter Konzernrechnungswesen
und externe Berichterstattung
VOLKSWAGEN AG
D-38436 Wolfsburg
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Discussion Paper: Leases

Dear Sir/Madam,

Thank you for the opportunity to comment on the IASB Discussion Paper: Leases – Preliminary Views. On behalf of the Volkswagen AG, Wolfsburg, we are pleased to provide you with remarks on the proposed Discussion Paper in response to your Invitation to Comment.

Volkswagen agrees to the general need to improve lease accounting. However we have strong concerns regarding the implications of the discussed new conceptual underpinning of the accounting for contractual rights. As the discussion paper focuses only on lessee accounting and several important questions (like timing of initial recognition or recognition at the lessor) are not fully addressed, we are not sure about the implications especially

1. on the general accounting for other long term contractual relationships;
2. on the general accounting for executory contracts;
3. on the separation of rights regarding to an asset and the underlying asset (question of the unit of account).

Since possible changes to the existing concept are too broad to discuss them only in the context of lease accounting – to avoid further inconsistencies in IFRS – a much broader discussion is needed for the accounting for contractual rights and executory contracts. However, we generally cannot agree to the proposed measurement of the right to use asset as the cost from the general right to use the asset and the costs of leasing it are mixed up and the right to use asset is overvalued. Further the proposed accounting for the lease

obligation and especially the proposed accounting for more complex leases is not in line with the existing definition of liabilities. We strongly disagree to these issues. Anyhow there should also be a discussion on a much broader basis on this point. Last there should be no discussion on the accounting for leases at the lessee without fully discussion on the accounting at the lessor, as these are two sides of the same transaction.

For the reasons stated above, we generally can not agree to the preliminary views of the IASB.

Before answering several questions in detail, let us provide you with some general remarks on the right to use approach.

- (1) In Chapter 3 the IASB identifies the “right to use the leased item” as an economic resource of the lessee because the lessee can use it to generate cash inflows or reduce cash outflows. The boards tentatively concluded that:
1. the lessee controls the “right to use the leased item” during the lease term because the lessor is unable to recover or has access to the resource without the consent of the lessee (or breach of contract).
 2. the control results from past events – the signing of the lease contract and the delivery of the item by the lessor to the lessee.
 3. future economic benefits will flow to the lessee from the use of the leased item during the lease term.

Accordingly, the boards tentatively concluded that the lessee’s “right to use a leased item” for the lease term meets the definitions of an asset. Further the IASB states in Chapter 8.13 that “the asset arising in a lease contract is not the underlying asset itself; rather, it is a right to use the underlying asset” and therefore is an intangible asset.

- (2) The argumentation of the IASB automatically raises several questions: In Germany and in many other jurisdictions with the conclusion of a contract the signing parties normally receive several rights and accept several obligations. This is true for lease contracts, where the lessee inter alia receives the right to use the leased asset for a while and accepts the obligations for the lease payments, but this is also true for all other kind of contracts. **Hence we wonder if the proposed treatment of the lessees using right has no implication on the accounting for all other rights arising in a contract.** For example when we look at a long term delivery contract following the same argumentation as provided in Chapter 3 the right of the consignee

to receive items is an asset of the consignee, as the consignee controls the right during the contractual term because the deliverer is unable to resign from the contract without the consent of the consignee (or breach of contract); the control results from past events – the signing of the long term delivery contract; and future economic benefits will flow to the consignee by the use of the delivered items during the contractual term. So if a lessee has to recognize a right to use as intangible asset, has not by the same argumentation in a long term delivering contract the consignee to recognize an intangible asset? And in a service contract has the party receiving the services not to recognize as an intangible asset its rights to receive services? We can not see if there is any difference in concept.

- (3) Maybe in this context the board will argue that with the new concept before delivery of the leased item by the lessor or payment by the lessee, the contract is an executory contract and that until delivery of the item no right is recognized as discussed in Chapter 9. But this discussion was not finalized and hence raises the question on the **future treatment of executory contracts under the new concept**. Further, even if an intangible asset is recognized when the leased asset was received, will not a consistent treatment of other contractual relationships mean for the delivery contract example to recognize an intangible asset when the first item was delivered or for the service contract example to recognize an intangible asset when the first service was rendered?
- (4) **As the question how to account for contractual rights and executory contracts is too broad only to discuss them in the context of lessee accounting we demand – if the board retains its preliminary view – that there should be a broader discussion on these issues first before the work on lease accounting is to be continued.**
- (5) From our point of view an intangible asset rises with every contractual right a company receives. But frequently these intangible assets have a value of nil or nearly nil or at least cannot measured reliable and therefore do not fulfill the recognition requirements on their own (though they are often connected to another asset as the “right to use” as part of the “right of ownership” is normally not separated from the asset owned). This is also true for the “right to use a leased item”, but can be shown more clearly with the “right of delivery” example: When a company enters in a long term delivery contract the “right of delivery” may has a value of its own for the consignee (as uninterrupted delivery, better quality and favorable conditions). But as

these contracts are interchangeable and often can be signed on similar terms every day, they have – beyond transaction costs – a value of nearly nil at the inception date (so when market condition change we can have a positive value or an onerous contract). Hence it is false to value the costs of the right of delivery with the total present value of the obligation to pay for the received goods as the payments are in substance consideration for the received items. This would totally overestimate the intangible asset. For comparison: a potential investor in a business combination would pay only for long term contracts if there were favorable conditions that could not be reached if the contract was signed at the acquisition date. He would never pay the present value of the considerations for the items received in future.

- (6) The same certainly is true for “rights to use an item”, though maybe it is not as obvious as you have to differentiate between the consideration for the general right to use an asset over a specific period of time agreed in the contract (the costs of the right to use) and the consideration paid for the use of an asset in the actual period. Again, the (general) right a company receives when it enters into a lease contract can have a value of its own for the lessee (like planning dependability). But with most interchangeable leasing objects, this value is not very high as a similar contract can be reached at any point of time. Consequently, a potentially investor would recognize an intangible asset for an (operating) lease only if the terms of the leasing contract are favorable (IFRS 3.B29), but will not recognize the present value of the residual lease obligation as fair value of the leasing contract. You may argue that we are comparing apples with oranges when we refer to fair value while the board is talking about cost accounting, but please keep in mind, that fair value and cost are under normal circumstances not very different at least at the inception date. Therefore, to mix up the measurement of the general right to use with the consideration for using the asset leads to an overvaluation of the asset. **As the rights to use can normally not be measured reliable (meaning for the avoidance of doubt not only objectively but also faithfully) at initial recognition it should not be recognized.**
- (7) Based on the argumentation above we cannot agree that in general the recognition criteria for the total obligation to pay rentals out of a leasing contract are fulfilled at the inception date or the commencement date. Only a minor part (if any) of the total rental to pay are the consideration for receiving the right to use. The majorities of the payments are considerations for using the asset in the different periods and are executory until the lessor fulfills his obligation to provide an asset in the agreed period. **Until than they do not result in an outflow of economic benefits if the**

lease does not become onerous and therefore do not qualify for recognizing any liability (see IAS 37IE Example 8).

- (8) We fundamentally can not agree to recognize any obligation in the balance sheet of the lessee for rights granted to him by the leasing contract that do not fulfill the definition of a liability of the framework. If e.g. the lease contract grants the lessee the right (but not the obligation) to extend the lease beyond the initial leasing period, **this is not a present obligation of the lessee until he uses the option and therefore should neither be recognized by measurement nor through recognition.** Though it can be argued that for example when an asset is needed for production there is economically an obligation either to use the option or to lease a similar asset when the initial lease period ends and that this information is useful to the users; however, when an asset essential for production is damaged there is economically also an obligation to repair or replace it, an information what may be also useful; however, to recognize an provision for operating expenses is not allowed by existing framework. **Again, a change to this fundamental principle has to be addressed in broader conceptual basis than a project on lease accounting.**
- (9) We can not agree that accounting at the lessee is discussed nearly without fully discussion on the treatment at the lessor, as both are the different sides of the same transaction. Anyway, as stated above, we demand to discuss the treatment of contractual rights on a broader basis and this discussion should consider in any case the accounting of both parties of a contract. Incidentally the short discussion on lessor accounting at the end of the discussion paper rises more questions on the general accounting for other long term contractual relationships and on the general accounting for executory contracts. The proposals show again how immediate a broad discussion is needed before work on lessee and lessor accounting should be continued.

Best Regards,

Karl Gadesmann

Questions

Chapter 2: Scope of lease accounting standard

Question 1

The boards tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards.

Do you agree with this proposed approach?

This depends. As stated above, the discussion paper rises a lot of questions on how to apply the proposed right to use approach consistently on other situations than lessee accounting. We therefore demand a discussion on a broader basis on these issues. However, if the IASB does not answer the question how to apply the right to use approach on consistent basis before it finalizes its leasing project (what we reject), a more robust definition of leasing is needed.

Question 2

Should the proposed new standard exclude non-core asset leases or short-term leases?

This depends. The concept of materiality is applied in practice very differing. Further it is a very cost intensive concept in itself as even for non material issues an evaluation of potential effects is needed. If it is obvious that the application of the new standards for example on short term leases is non material this should be stated directly in the standard to avoid these costs and to secure a consistent application. However, scope exclusion is never an appropriate way to deal with materiality as it leaves the question on how to deal with non material transactions unsolved.

Chapter 3: Approach to lessee accounting

Question 3

Do you agree with the boards' analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract? If you disagree, please explain why.

We disagree. We agree that a right to use (as every right) can be an asset. However it is not clear when a right in relation to an asset is an asset on its own and when it is part of a bigger unit of account. We disagree that the right to use a lease item fulfills normally the recognition requirements as it can not be measured reliable. We disagree that the obligation to pay rent

fulfills the definition of a liability at the commencement date. See for a more detailed discussion our remarks on the right to use approach above.

Question 4

The boards tentatively decided to adopt an approach to lessee accounting that would require the lessee to recognize:

(a) an asset representing its right to use the leased item for the lease term (the right-of-use asset)

(b) a liability for its obligation to pay rentals.

Appendix C describes some possible accounting approaches that were rejected by the boards.

Do you support the proposed approach?

We do not support the approach for the reasons stated above.

Question 5

The boards tentatively decided not to adopt a components approach to lease contracts.

Instead, the boards tentatively decided to adopt an approach whereby the lessee recognises:

(a) a single right-of-use asset that includes rights acquired under options

(b) a single obligation to pay rentals that includes obligations arising under contingent rental arrangements and residual value guarantees.

Do you support this proposed approach? If not, why?

Chapter 4: Initial measurement

Question 6

Do you agree with the boards' tentative decision to measure the lessee's obligation to pay rentals at the present value of the lease payments discounted using the lessee's incremental borrowing rate?

If you disagree, please explain why and describe how you would initially measure the lessee's obligation to pay rentals.

We can not agree as we do not agree that we have a liability at all at commencement date. See for a more detailed discussion our remarks on the right to use approach above.

Question 7

Do you agree with the boards' tentative decision to initially measure the lessee's

right-of-use asset at cost?

If you disagree, please explain why and describe how you would initially measure the lessee's right-of-use asset.

We agree to cost accounting. However, we disagree how the board is measuring the costs as the boards mixes the costs of the right to use and the fee for using the asset. See for a more detailed discussion our remarks on the right to use approach above.

Chapter 5: Subsequent measurement

Question 8

The boards tentatively decided to adopt an amortised cost-based approach to subsequent measurement of both the obligation to pay rentals and the right-of-use asset.

We generally agree to an amortized cost-based approach but we disagree to the context it is used as we do not agree to the proposed concept.

Question 9

Should a new lease accounting standard permit a lessee to elect to measure its obligation to pay rentals at fair value? Please explain your reasons.

We generally object to any fair value accounting of obligations apart from the rare circumstances to avoid accounting mismatches.

Question 10

Should the lessee be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate? Please explain your reasons.

If the boards decide to require the obligation to pay rentals to be revised for changes in the incremental borrowing rate, should revision be made at each reporting date or only when there is a change in the estimated cash flows?

Please explain your reasons.

Question 11

In developing their preliminary views the boards decided to specify the required accounting for the obligation to pay rentals. An alternative approach would have been for the boards to

require lessees to account for the obligation to pay rentals in accordance with existing guidance for financial liabilities.

Do you agree with the proposed approach taken by the boards?

If you disagree, please explain why.

Question 12

Some board members think that for some leases the decrease in value of the right-of-use asset should be described as rental expense rather than amortization or depreciation in the income statement.

Would you support this approach? If so, for which leases? Please explain your reasons.

Chapter 6: Leases with options

Question 13

The boards tentatively decided that the lessee should recognize an obligation to pay rentals for a specified lease term, ie in a 10-year lease with an option to extend for five years, the lessee must decide whether its liability is an obligation to pay 10 or 15 years of rentals. The boards tentatively decided that the lease term should be the most likely lease term.

Do you support the proposed approach?

We do not support the proposed approach. We disagree to put any potential obligation on the balance sheet that does not fulfill the definition of a liability. See for a more detailed discussion our remarks on the right to use approach above.

If you disagree with the proposed approach, please describe what alternative approach you would support and why.

Question 14

The boards tentatively decided to require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances. Changes in the obligation to pay rentals arising from a reassessment of the lease term should be recognized as an adjustment to the carrying amount of the right-of-use asset.

Do you support the proposed approach?

If you disagree with the proposed approach, please describe what alternative approach you would support and why.

Would requiring reassessment of the lease term provide users of financial statements with more relevant information? Please explain why.

Question 15

The boards tentatively concluded that purchase options should be accounted for in the same way as options to extend or terminate the lease.

Do you agree with the proposed approach?

We do not support the proposed approach. We disagree to put any potential obligation on the balance sheet that does not fulfill the definition of a liability. See for a more detailed discussion our remarks on the right to use approach above.

Chapter 7: Contingent rentals and residual value guarantees Contingent rentals

Question 16

The boards propose that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements.

Do you support the proposed approach?

We do not support the proposed approach. We disagree to put any potential obligation on the balance sheet that does not fulfill the definition of a liability. See for a more detailed discussion our remarks on the right to use approach above.

Question 17

The IASB tentatively decided that the measurement of the lessee's obligation to pay rentals should include a probability-weighted estimate of contingent rentals payable. The FASB tentatively decided that a lessee should measure contingent rentals on the basis of the most likely rental payment. A lessee would determine the most likely amount by considering the range of possible outcomes.

However, this measure would not necessarily equal the probability-weighted sum of the possible outcomes.

Which of these approaches to measuring the lessee's obligation to pay rentals do you support? Please explain your reasons.

Question 18

The FASB tentatively decided that if lease rentals are contingent on changes in an index or rate, such as the consumer price index or the prime interest rate, the lessee should measure the obligation to pay rentals using the index or rate existing at the inception of the lease. Do you support the proposed approach? Please explain your reasons.

Question 19

The boards tentatively decided to require remeasurement of the lessee's obligation to pay rentals for changes in estimated contingent rental payments. Do you support the proposed approach? If not, please explain why.

Question 20

The boards discussed two possible approaches to recognizing all changes in the lessee's obligation to pay rentals arising from changes in estimated contingent rental payments:

(a) recognize any change in the liability in profit or loss

(b) recognize any change in the liability as an adjustment to the carrying amount of the right-of-use asset.

Which of these two approaches do you support? Please explain your reasons. If you support neither approach, please describe any alternative approach you would prefer and why.

Residual value guarantees

Question 21

The boards tentatively decided that the recognition and measurement requirements for contingent rentals and residual value guarantees should be the same. In particular, the boards tentatively decided not to require residual value guarantees to be separated from the lease contract and accounted for as derivatives. Do you agree with the proposed approach? If not, what alternative approach would you recommend and why?

Chapter 8: Presentation

Question 22

Should the lessee's obligation to pay rentals be presented separately in the statement of financial position? Please explain your reasons.

What additional information would separate presentation provide?

In General the question what is presented on the balance sheet and what is presented in the notes is a question of materiality. There should be no general rule.

Question 23

This chapter describes three approaches to presentation of the right-of-use asset in the statement of financial position.

How should the right-of-use asset be presented in the statement of financial position?

The right to use is an intangible item and should be shown within the intangible assets.

Please explain your reasons.

What additional disclosures (if any) do you think are necessary under each of the approaches?

Chapter 9: Other lessee issues

Question 24

Are there any lessee issues not described in this discussion paper that should be addressed in this project? Please describe those issues.

Chapter 10: Lessor accounting

Question 25

Do you think that a lessor's right to receive rentals under a lease meets the definition of an asset? Please explain your reasons.

The right to receive rentals (as every right) can be an asset. Again, it is not clear when a right in relation to an asset is an asset on its own and when it is part of a bigger unit of account. In our few at least this depends if the right to receive rentals is separable from the underlying lease asset. However, the question is normally of no interest as the right to receive rentals has cost of nearly nil.

Question 26

This chapter describes two possible approaches to lessor accounting under a right-of-use model: (a) derecognition of the leased item by the lessor or (b) recognition of a performance obligation by the lessor.

Which of these two approaches do you support? Please explain your reasons.

We disagree to both approaches. The lease item is (as long as it is not under the control of the lessee) under the control of the lessor and should be recognized at him. If the leased item should be exchanged against the right of cash flows generated by this item this is a very fundamental approach that again needs a broader discussion than only lease accounting. We also reject approach (b) as the cash flows from the lease item are double counted, the

right to receive rentals is overvalued and the obligation does not fulfill the definition of a liability.

Question 27

Should the boards explore when it would be appropriate for a lessor to recognize income at the inception of the lease? Please explain your reasons.

Question 28

Should accounting for investment properties be included within the scope of any proposed new standard on lessor accounting? Please explain your reasons.

Question 29

Are there any lessor accounting issues not described in this discussion paper that the boards should consider? Please describe those issues.