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EACB Comments on IASB ED on Leases 15 December 2010

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The voice of 4.200 local and retail banks, 50 million members, 160 million customers

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General Remarks

The members of the European Association of Cooperative Banks (EACB) are pleased to comment on the Exposure Draft on Leases (ED/2010/9) published by the International Accounting Standards Board in August 2010.

In our comment letter to the 2009 Discussion Paper: *Leases Preliminary Views* (hereafter called DP), EACB members expressed their concerns on the called “right-of-use approach”. In fact, from a preparer perspective we fear that the accounting for leases with options and conditions would become far too complex, if a component approach to account for them were adopted. Instead, we recommended that a linked approach to subsequent measurement of leases should be adopted.

In our opinion, the proposed Exposure Draft standard for *Leases* (hereafter referred to as the ED) is far more too burdensome for preparers, thus we expect a lot of implementation cost and effort. Moreover, in contrast to the declared intention of the IASB, the proposals of the ED as a whole do not appear to make financial reports significantly easier to compare. They also do not seem to serve the purpose of providing more decision-useful information for users.

Furthermore, we want to stress that financial institutions are not only affected by the effects of the proposals on their financial statements. Financial institutions will have to use IFRS as the basis of their prudential reports in the near future. Therefore, additional regulatory capital could be required in order to accommodate the right-of-use assets recognized by lessees.

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EACB responses to the ED questionnaire

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?

Many transactions which are currently classified as operating leases are ordinary rental agreements. Under such agreements, the lessee does not acquire enough rights to effectively control the leased item. Therefore, the definition of an asset as contained in the framework is not met. Such transactions should thus give rise to periodic expenses as they do today. The proposed amortization method would lead to differing amounts in profit or loss, which would not reflect the actual use of the leased item over time.

We think that the introduction of the right-of-use approach would add a lot of unnecessary complexity to financial reporting. This is especially the case when it comes to accounting for non-core assets, where no significant gain in useful information seems to justify the extra work and effort for preparers. We think that financial reports should not be inflated with leased items that are not in the centre of the business activities of an entity. We fear that such accounting could make financial reports less understandable.

Beyond that we want to point out that preparers would have to use a lot of judgement in order to comply with the proposed treatment of options, contingent rentals and residual value guarantees. Reliable data for such judgement is sometimes unavailable on a contract-by-contract basis. The proposals would also lead to the recognition of items which do not even meet the definition of an asset, because the lessee can still avoid these optional or contingent future payments. The proposed measurement rules would cause additional volatility in the income statement as well.

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?

Considering the fundamental changes proposed to lessor accounting, there would have been a need to publish a discussion paper containing these proposals as a first step before including them in an exposure draft.

Conceptually, we regard the performance obligation approach as not in line with the right-of-use approach. To our understanding there would be a double counting of assets and the rights thereof. We would prefer an approach that mirrors lessee accounting. Accordingly, a lessor should have to derecognize an asset, to the extent that this asset must be recognized by the lessee, if the right-of-use model would be implemented.



Question 16: Transition

(a) The exposure draft proposes that lessees and lessors should recognize 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?

The new standard should become effective no earlier than 2014 in order to give preparers enough time to make the necessary adjustments to their data processing systems and contract management.

We finally advocate that entities should not be obliged to apply the new rules retrospectively. We consider it too burdensome in practice to collect the required data for past periods for many lease arrangements.