Sir David Tweedie International Accounting Standards Board 30 Cannon Street London EC4M 6XH Deutsche Bank AG London Winchester House 1 Great Winchester Street London EC2N 2DB Tel. +44 20 7545 8000

15 December 2010

Exposure Draft ED/2010/9 Leases (the ED)

Dear Sir David,

Deutsche Bank appreciates the opportunity to comment on the Exposure Draft ED/2010/9 Leases (the ED). The Bank acts as lessee and therefore the proposals in the final standards will have a significant impact on our financial statements.

We welcome the IASB's efforts to enhance the transparency and comparability of lease accounting. However we have the following significant concerns about the ED which we would like the Board to consider before moving to a final standard:

• The proposals in the ED to determine contingent rental payments and the 'more likely than not lease term' will introduce high levels of subjectivity in the financial statements. Any additional information provided to the user is outweighed by the reliability and comparability issues and costs to implement. Moreover we believe that inclusion of these items in the lease term during the extended period will result in amounts reported in the financial statements which do not meet the definition of asset and liabilities in the Framework. While we are supportive in general of the recognition of a right of use asset and a corresponding liability in regards to lessee transactions, we suggest that the lease payments and the contingent rentals to be paid during the extended lease term to be excluded from the right of use asset and liability recorded on the balance sheet. We would prefer if the IASB retained the current rules contained in IAS 17 on the lease term.

- The provisions for the simplified requirements using the 12 months threshold is too restrictive to provide relief to preparers of accounts. As the counterparty to thousands of small amount/high volume leases, we believe that the time threshold is too short of a period for many of our leases. Moreover we note that the existing simplified requirements only allow for relief of discounting over a 12 month period. Therefore we ask that the Board to extend the threshold to 3 years to allow entities with small balance high volume leases with adequate relief.
- Clarification is needed with respect to the transition accounting for sale and leaseback
 contracts. As currently drafted the final standard is unclear about whether sale and leaseback
 transactions executed under the current IAS 17 guidelines prior to the transition date will need
 to be reassessed under the new requirements for sale treatment. However we would expect
 that entities should not be required to re-assess the sale treatment on such transactions as
 these were appropriately assessed and de-recognised under the then existing rules.
- The proposals in the ED are significantly different to the current requirements in IAS 17 and internal processes and IT systems of preparers will need to be adapted accordingly. Therefore, the preparers will require an adequate lead time to prepare for the new standard. The earliest date that the Bank could implement the proposals is the period commencing from 01 January 2014 (with comparatives for the period commencing 01 January 2013).

We hope you find our comments useful and relevant, and look forward to continue working with you in the future. Should you want to discuss in more detail the contents of the letter, please do not hesitate to contact Cynthia Mustafa on the following email address Cynthia.mustafa@db.com and phone number 020 754 50978.

Please see the appendix for detailed answers to the guestions posed in the ED.

Yours sincerely,

Cynthia Mustafa Managing Director

Global Head, Accounting Policy and Advisory Group

Deutsche Bank AG

Appendix

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) We are broadly in agreement with the recognition of a 'right of use' asset and a liability for the obligation to make lease payments. We believe that this asset and liability facilitate the comparison of financial statements between entities that own an asset outright and those who lease the asset.

However we have both conceptual disagreement and practicability issues with the proposals around the lease term, which we explain more fully in our response to Question 8 below.

b) We are in agreement with the proposals of the ED for these items.

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) We do not support the 2 model approach proposed in the ED for lessors for two reasons:
 - One of the criticisms of the current IAS 17 model is that the distinction between operating leases and finance leases can be made on an arbitrary basis. The distinction between the use of the performance obligation and the derecognition approaches can also be made on an arbitrary basis. Therefore, we do not believe that the proposals in the ED represent an improvement in financial reporting over the current standard.
 - 2. We also believe that the performance obligation approach for the lessor is flawed conceptually, in that it requires recognition of two assets which are supported by only a single set of cash flows. Therefore we do not support the performance approach as it overstates the assets of the entity.

However we support the derecognition approach and we believe that the accounting outcomes can be supported conceptually. Therefore we recommend that the Board consider removing the performance approach and consider retaining only the derecognition approach.

b) Considering our comments in a) above and our rejection of the performance obligation approach, we agree with the proposal for the recognition of assets and liabilities, income and expenses for the derecognition approach to lessor accounting only.

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?

The 12 months threshold for the application of simplified requirements is too restrictive to provide relief to preparers of accounts. Specifically the time threshold is too short of a period for most small amount/high volume leases. Moreover the existing simplified requirements only allow for relief of discounting. Therefore we ask that the Board consider the threshold to be extended to 3 years instead, to allow entities with small balance high volume leases with adequate relief. The extension of a simplified approach for leases up to 3 years will capture a more significant portion of lease of IT equipment and would provide a real benefit in reducing the cost of implementation of the new proposals in the ED.

Question 4

- (a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?
- (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?
- (c) 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?
- a) We are generally in agreement with the definition of leases. We welcome the inclusion of the wordings 'for consideration' instead of 'for cash' as this will reduce structuring opportunities. However, we would welcome some additional guidance on transactions that are currently governed by SIC 27. The proposed final lease standard is intended to replace SIC 27 but we could not find any guidance currently in the ED.
- b) We are generally in agreement with the criteria established. The criteria require both the transfer of control and all but a trivial amount of risks and benefits.
- c) We believe that the existing guidance contained in IFRIC 4 is considered to be sufficient and as such the guidance in IFRIC 4 should be incorporated into the ED.

Scope

Question 5: Scope exclusions

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? If not, what alternative scope would you propose and why?

We are generally in agreement with the scope exclusions in the ED. We also welcome the initiative taken by the IASB to analyse intangibles separately.

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?

We do not believe that lease accounting should be applied to the combined contract. We believe that the lease component needs to be separated from the service component. Moreover the Board should incorporate more of the guidelines already contained in IFRIC 4; these are well understood and are sufficient.

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 fully support the proposals in the ED.

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?

We believe that the proposed approach will introduce a high degree of subjectivity as the lessee and the lessor will need to (initially and subsequently throughout the life of the lease) estimate the probabilities of extending lease options. Making such decisions at the outset of a long term lease is bound to have a high degree of inaccuracy and will this will prevent the user of the accounts benefit from this additional information. Different estimates made by the lessee and the lessor may give different amounts in their respective accounts in relation to the same contract.

Moreover on a conceptual basis we do not agree that the lease term should include extension options and all contingent rentals as this will result in items being recorded in the financial statements which do not meet the definition of asset and liability as defined in the Conceptual Framework. Specifically, where a lessee has an option to extend a lease, we do not believe the future lease payments during the extended term meet the definition of a liability as set out in the Framework, regardless of whether or not the lessee expects to exercise the option. Accordingly it would be inappropriate to incorporate the lease payments during the extended term as a liability. On a similar note we believe it inappropriate for a lessor to recognise an asset for future lease payments which are contingent on the lessee exercising an option to extend.

While we are supportive in general of the recognition of a right of use asset and a corresponding liability in regards to lessee transactions, we suggest that the lease term and the contingent rentals to be paid during the extended lease term to be excluded from the right of use asset and liability recorded on the balance sheet. We would prefer if the IASB retained the current rules contained in IAS 17 on the lease term. However we would support disclosure in the footnotes of the nature and terms of the contingent rentals and extension options for the benefit of users.

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?

In regards to contingent rentals, as stated in our response to Question 8 we believe that only contingent rentals during the contractual lease term should be included in the right of use asset and liability. In regards to term option penalties, we would argue that until the date it becomes probable that the term will not be extended, the term extension option is not a liability as defined in the Framework. However for residual value guarantees that have a material present value at the inception of the lease, we are in agreement that the amounts should be included in the measurement of lease assets and lease liabilities as these are liabilities to the entity. This would reduce structuring opportunities as contracts could be structured to contain the guarantees instead of rental payments.

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 are in agreement with the proposals for reassessment. However, we would request the board to clarify what constitutes a 'significant change'.

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 are in agreement with the criteria set for sale and leaseback contracts. However, we do not agree with the suggestion that the sale and leaseback contracts should only be accounted for under the performance obligation approach. See our response to Question 2.

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?

We are in agreement with the separate presentation of the assets and liabilities if the numbers are material from the user of the accounts' perspective. However whether this information is presented on the face of the statement of financial position or in the notes should be determined by the requirements of IAS 1 (IAS 1.57 requires separate presentation on the statement of financial position when the size, nature or function of an item is such that separate presentation is relevant to an understanding of the entity's financial position. For part b), we would refer the board to our comments under Question 2.

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 are in agreement with the separate presentation of lease income and lease expense, if the information is material to the financial statements. Similar to our response to Question 12, the standard should refer to the requirements of IAS 1 to determine whether the information should be presented on the face of the statement of comprehensive income or in the notes.

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 are in agreement with the separate presentation of cash flows arising from lease contracts if the numbers are material from the user of the account's perspective. See also our response to Questions 12 and 13.

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?

The additional disclosures required by the ED, specifically the requirement to show a reconciliation of the opening and closing balances of the right of use assets and liabilities in regards to leases from the lessee standpoint, will require significant additional effort and cost with limited benefit to the user. This information is not used by management and so would be produced solely for disclosure requirements. Therefore we ask that the Board re-consider the proposals regarding this specific disclosure requirement.

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?
- a) and b) We generally agree with the simplified retrospective approach. However, we also believe that in the case of lessors applying the derecognition approach, it is operationally easier to apply a full retrospective approach. This is because it may be difficult to determine the fair value of an asset that is in use currently whereas the fair value at inception can simply be derived from the purchase cost of the asset. So, we believe that the full retrospective approach should also be allowed to preparers of the accounts.
- c) The proposals in the ED are significantly different to the current requirements in IAS 17 and internal processes and IT systems of preparers will need to be adapted accordingly. Therefore, the preparers will require an adequate lead time to prepare for the new standard. The earliest date that the Bank could implement the proposals is the period commencing from 01 January 2014 (with comparatives for the period commencing 01 January 2013).
- d) Clarification is needed with respect to the transition accounting for sale and leaseback contracts. As currently drafted the final standard is unclear about whether sale and leaseback

transactions executed under the current IAS 17 guidelines prior to the transition date will need to be reassessed under the new requirements for sale treatment. However we would expect that entities should not be required to re-assess the sale treatment on such transactions as these were appropriately assessed and de-recognised under the then existing rules.

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?

While certain of the proposals, namely the notion of recognising a right of use asset and liability in regards to the lessee side will provide benefit from a users' perspective, as stated in our responses above there are several points which, due to the practicability issues around implementation, the benefits from the proposals do not outweigh the costs. Specifically,

- As stated in Question 8, the benefits to the user of the accounts from the additional information
 are not justified considering the high degree of subjectivity and costs that are involved in the
 new concepts such as the lease term estimation and contingent rentals. Moreover the costs for
 the ongoing monitoring of the likelihood of exercising options to extend a lease or changes in
 contingent rental amounts are likely to exceed any related benefit.
- As stated in Question 3, the current simplified approach provided for 12 month leases does not
 go far enough to provide any real relief for entities, and in particular for entities such as the
 Bank who small amount/high volume leases.
- Finally as per the response to Question 15 the costs of preparing all the additional disclosures, in particular the reconciliation of the right of use asset and liability, are substantial and question whether the benefits outweigh the costs to preparers.

Other comments Question 18

Do you have any other comments on the proposals?

We have noted that the ED as drafted did not contain any guidance on the below items and as such would welcome some guidance on the following items:

- Lease incentives These features are common in many leases but the ED does not make any mention of such incentives. Lease incentives are part of the contractual agreement with the lease counterparty and as such should be included in the definition of the lease term.
- 2. Treatment of lease contracts that contain put/call options- The ED does not make mention of how to account for these.