



Madrid, 15 December 2010

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

**Re: ED 2010/9 *Leases***

Dear Sirs,

I am writing on behalf of Telefónica, S.A. one of the world's largest telecommunications companies by market cap. Its activities are centred mainly on the fixed and mobile telephony businesses, while its broadband business is the key growth driver underpinning both. It operates in 25 countries and its customer base exceeds 281 million globally. Telefónica's growth strategy is focused on the markets in which it has a strong foothold: Spain, Europe and Latin America. Further information about the Telefónica Group and its activities is available on our website: [www.telefonica.com](http://www.telefonica.com)

Telefónica is very pleased to provide comments to the International Accounting Standards Board on its ED 2010/9 *Leases* (the "ED").

Telefónica supports the joint work carried out by the IASB and the FASB and appreciates their efforts to develop a new approach to improve accounting for leases, addressing the limitations and application weaknesses that currently arise under the existing model in IAS 17 *Leases*. However, we are seriously concerned that the burden for financial statement preparers to apply all the aspects of the proposed model will be significant.

We would like to highlight a number of concerns regarding the proposed model. In our view, the application of the performance obligation model for the lessor is not consistent with the application of the right of use model for the lessee. Moreover, we are quite concerned that the criteria contained in the ED *Leases* are not consistent with the revenue recognition principles proposed in the ED *Revenue from Contracts with Customers*, i.e. the transfer of control, which we think should prevail.

In addition to this, we are concerned that the criteria for distinguishing between leases and service contracts are not sound and clear, and we believe that the limits between leases and service contracts will be difficult to determine in practice, the distinction being relevant given that the accounting being proposed for contracts that are leases is dramatically different from the accounting for contracts that are not.

Furthermore, the proposed model involves the use of significant estimates and judgment, increasing complexity in its practical application and potentially decreasing reliability and comparability of the financial information reported under the proposals. The high degree of



estimation and judgment required not only affects accounting but also internal controls and procedures, since entities will have to make sure that estimation techniques are used consistently across the entities within the Group.

Also, we are concerned that the application guidance provided in the ED does not seem appropriate to guarantee consistent application across entities and will likely bring diversity in practice, reducing comparability and decision-usefulness of the financial information reported.

We encourage the IASB to further enhance the proposed model by addressing these concerns in its redeliberations.

If you would like to discuss any of the issues described herein, please do not hesitate to contact Marta Soto, Head of Accounting Practice, at +34914828534 or by e-mail to [marta.sotobodi@telefonica.es](mailto:marta.sotobodi@telefonica.es).

Thank you for your attention and we look forward to your reaction on the concerns raised in this letter.

Yours sincerely,

Marta Soto



## Telefónica's responses to the questions asked in ED 2010/9 Leases

### The accounting model

#### Question 1 — Lessees

**Do you agree that a lessee should recognise a right-of-use asset and a liability for its obligation to make lease payments? Why or why not? If not, what alternative model would you propose and why?**

**Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on its liability for lease payments? Why or why not? If not, what alternative model would you propose and why?**

Telefónica believes that a right-of-use model provides useful information and meets users' needs about recognition of assets and liabilities arising from leases. However, we are concerned that the criteria for distinguishing between leases and service contracts are not sound and therefore support that the definition of lease be improved to clearly distinguish leases from services, as the accounting treatment differs significantly under the proposed model.

We agree that if the right-of-use model is applied, an amortised cost-based approach for the subsequent measurement of the right-of-use, and an amortised cost using effective interest rate method approach for the subsequent measurement of the lease liability, are appropriate and consistent with accounting for similar assets and for other non-derivative financial liabilities, respectively, providing a relevant measure of the lease assets and liabilities at each reporting period.

Nevertheless we have concerns regarding the measurement of the rights and obligations under the proposed model as it includes items that do not meet the definition of assets and liabilities of the Conceptual Framework, i.e. options to extend the lease term and contingent rentals. Please refer to our following responses to questions 8 and 9.

#### Question 2 — Lessors

**Do you agree that a lessor should apply the performance obligation approach when the lease exposes the lessor to significant risks and benefits associated with the underlying asset, and a derecognition approach otherwise? Why or why not? If not, what alternative model would you propose and why?**

**Do you agree with the boards' proposals for recognition of assets and 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?**



Telefónica does not support that a lessor may apply two different methods of accounting based on whether the lessor remains exposed to significant risks or benefits associated with the underlying asset. We do not think the application of a hybrid model for the lessor is consistent with the model to be applied by the lessee, considering that the economics of the transaction is the same for both the lessor and the lessee.

If the Boards consider that a risks and benefits assessment is needed for the lessor in order to determine the method of accounting, we wonder why it should not be the same case for the lessees. Once the Boards have considered that when the lessor provides access to the underlying asset, the lessee has an unconditional right to use it and the lessor cannot prevent the lessee from using the asset, then the lessor should derecognize the corresponding asset or part of it.

We believe that the requirement for lessees to recognise a right of use asset implies that the lessor has completed a transfer of such asset and therefore he has executed its obligations under the contract, so he should derecognize the underlying asset. We think that the performance obligation model for the lessor is not consistent with the right of use model for the lessee.

Considering the issues mentioned above, we believe that a single derecognition model should be applied by the lessor for all leases under the scope of the ED.

Furthermore introducing a risks and benefits assessment would lead to the same concerns raised currently by many users in regards of the IAS 17 distinction between an operating lease and a finance lease.

In addition to this, we believe that the measurement of the right to receive lease payments recognized by the lessor should be consistent between lessors and lessees (see our responses to Questions 8 and 9). We agree that subsequent measurement should be on an amortised cost basis.

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

**The exposure draft proposes that a lessee or a lessor should apply simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term 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 and 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 short-term leases in the statement of financial position, nor derecognise any portion of the right to use the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit and 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?**

Given the complexity of the proposed accounting model, Telefónica supports the exception provided for short-term leases for practical reasons, to prevent that the cost of applying the right-of-use model to short-term leases may exceed the benefit. We believe that today's IAS 17 "operating lease" guidance should be applied to short-term lease contracts.

However, we are concerned that this exception could be extended to other leases in the absence of a sound definition of short-term leases. We suggest specifying that entities should consider the economic substance of the arrangement in order to determine if contracts include any options to extend the term beyond 12 months.

In addition to this, paragraphs 64 and 65 of the ED allow both lessors and lessees to choose on a lease-by-lease basis whether to use the simplified requirements or not. This option might affect comparability and therefore we support that the decision to use the simplified requirements should be an accounting policy choice for both lessees and lessors, thus applying such simplified criteria to all short-term leases.

#### **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 for distinguishing a lease from a purchase or sale in paragraphs B9 and B10? Why or why not? If not, what alternative criteria would you propose and why?**

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

In our view, the proposed definition and the criteria to distinguish leases from sales/purchases or service contracts require further assessment. We would suggest the final standard provides



further guidance for the definition and identification of a lease, including additional clarification and guidance for determining whether an arrangement is or contains a lease. In our view, the final standard should further clarify and improve the criteria in paragraphs B2 to B4, as we believe that the limits between leases and service contracts will be difficult to determine in practice, the distinction being relevant given that the accounting being proposed for contracts that are leases is dramatically different from the accounting for contracts that are not. We are concerned that the criteria indicated in IFRIC 4 *Determining whether an Arrangement contains a Lease*, carried forward to the ED, will not provide the necessary distinction required in practice to determine which accounting treatment is appropriate for each specific transaction. We suggest that the criteria included in the final standard remark the importance of identifying the economics of the transaction, meaning that when the lessee is mainly interested in receiving a service – and is indifferent as to the specific asset used as it is merely a means for receiving a service – the transaction should be treated as a service arrangement. We believe that additional application guidance and examples are required to guarantee consistent application of the proposed model.

In addition to this, we note that the proposed accounting model identifies purchases/sales in those arrangements that transfer the control of the underlying asset and all but a trivial amount of the risks and benefits associated with the underlying assets. We are concerned that the proposal does not seem to be fully consistent with the Revenue Recognition ED which only requires the transfer of control as a condition to recognise a sale. Moreover, we do not support the decision to distinguish and out-scope from the ED those lease contracts that represent a purchase/sale of the underlying asset. In fact, the determination of which leases are in substance purchases/sales is what lies under the current finance-versus-operating lease classification within current lease accounting, and it is what has led to many of the criticisms of the current model. We believe that trying to distinguish between these types of contracts will simply bring us back to an area of judgment that is one of the main weaknesses of the current approach because distinction is difficult to operate and leads to accounting arbitrage.

## Scope

### Question 5 — Scope and 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, 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?**

Telefónica agrees with ED paragraph BC36 that there is no conceptual grounds for excluding intangible assets from the scope of the proposals, as certain leases of intangible assets appear



to be economically similar to leases of tangible assets. We therefore think that the exclusion may lead to inconsistencies in the accounting treatment of transactions that have similar economic substance.

Additionally, we believe that lease contracts that are cancellable without penalties should be scoped out as the right of use model would not be appropriate in this case where there is no obligation for the lessee to pay rentals in the future. We think that the definition of assets and liabilities in this case is not met for any future payment.

#### **Question 6 — Contracts that contain both service 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, B6-B8 and BC47-BC54). If the service component in a contract that contains service components and lease components is not distinct:**

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

Telefónica agrees that entities should assess if services are distinct using the criteria in the Revenue Recognition ED. However, as we expressed in our comment letter on the Revenue Recognition ED, we definitely believe that unbundling performance obligations should be based solely on an entity's own business practices rather than considering as well what other entities do, as suggested by paragraph 23 (a) of the Revenue Recognition ED.

In addition to this, Telefónica does not support the proposal that if the contract includes both lease and non-distinct service components, lease accounting should be applied to the whole contract. We believe that when a contract includes both, lease and non-distinct services, entities should rather depict the economic substance of the transaction, assessing what the predominant component is, and then treating the whole contract accordingly. Identifying the predominant component requires a lesser degree of precision than identifying the relative fair values of each component, and lessees should be able to achieve it in most cases.



Telefónica believes that the lessor should always be required to account for the lease and service components separately, whether they are distinct or not, as the lessor will likely be able to obtain the required information to allocate payments reliably.

Furthermore, executory costs (insurance, taxes), which are common in many types of lease contracts, should be excluded from lease accounting and expensed as incurred, rather than being considered as “distinct services” under the proposals. We suggest the Boards provide guidance on executory costs paid by the lessor and the lessee in connection with lease contracts.

#### **Question 7 — Purchase options**

**The exposure draft proposes that a contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus a contract is accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraph 8 and BC63 and BC64).**

**Do you agree that a lessee or a lessor should account for purchase options when they are exercised? Why or why not? If not, when do you think that a lessee or a lessor should account for a purchase option and why?**

Telefónica does not see a conceptual reason to treat options to purchase and options to extend or terminate a lease differently.

We believe that purchase options provide the lessee with the contractual ability to acquire additional rights in connection with the leased asset, and should therefore be considered an extension of the lease term on a basis similar to renewal options. Under the proposals, renewal options and purchase options, which are economically similar in practice, have different accounting treatments, therefore giving rise to opportunities for entities to structure lease contracts to achieve desired accounting results that are not consistent with the economic substance of the contract.

Also, under the proposals, the presence of a bargain purchase option results in treating the arrangement as a purchase; but when the option is not considered a bargain purchase option, then it is to be ignored until it is exercised. This difference in treatment is likely to give rise to application issues.

In summary, we are concerned that the proposals regarding purchase options result in very different accounting for scenarios that are similar.

Therefore, we propose to apply the same treatment as the options to extend the contract period as proposed in our answer to Question 8.



## Measurement

### 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?**

Telefónica does not agree with the proposed lease term definition, as we believe that the lease term should only include the non-cancellable period, as we stated in our comment letter to the Discussion Paper on Leases.

We do not support the proposal that amounts due under unexercised renewal options should be included in the measurement of the lease payable or lease receivable, as this would not be consistent with the Conceptual Framework. The lessee does not have an unconditional obligation to pay as long as it does not exercise the option. For this reason we believe that lease payments payable in an extension period do not meet the definition of a liability included in the Conceptual Framework. Similarly, the lessor has neither an unconditional right to receive nor control over these amounts as long as the lessee does not exercise the option. For this reason, we believe that lease payments receivable in an extension period do not meet the definition of an asset included in the Conceptual Framework.

Also, the proposed approach is likely to result in increasing volatility as very often entities would have to reassess and change their estimations. This entails diversity in practice, because entities in similar situations with similar leases may end up accounting for them differently, reducing the comparability of financial information.

Notwithstanding the facts above, we believe that options should be accounted for, their measurement reflecting their intrinsic values, rather than the gross cash flows resulting from their exercise. If amounts payable under optional extension periods were ignored, entities would have the opportunity to structure agreements with a short initial period and renewal options only to achieve a certain accounting result.

### 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 contract should be included in the measurement of lease assets and lease liabilities 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 can only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the lease receivable if they can be measured reliably? Why or why not?**

Telefónica does not support the proposal that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease contract should be included in the measurement of lease assets and lease liabilities using an expected outcome technique. The arguments presented above in the reply to Question 8 apply to the different categories of contingent rentals.

Depending on the nature of the contractual arrangements and the number of reasonably possible scenarios, the expected outcome calculation can be a very complex and costly process. We are concerned that entities would find it very difficult to obtain accurate estimations.

In our view, lease payments included in the liability to make lease payments recognised by the lessee and included in the right to receive lease payments recognised by the lessor should only include payments for the recognised lease term that represent a present obligation of the lessee. Accordingly, we would propose that the nature and potential amount of uncertain lease payments (contingent rentals and other expected payments) would be disclosed as appropriate in order to provide users with information about amounts that could become payable in a future.

This would be consistent with IAS 37 requirements regarding contingent assets and contingent liabilities.

#### **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 obligation or receivable arising from changes in the lease term or contingent payments since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?**

Telefónica understands that regular reassessment is crucial to guarantee that the rights and obligations arising under lease contracts are accurately shown in the balance sheet, especially considering the significant use of estimates and judgment required by the proposed model.

Besides, we believe that the requirement of periodic reassessment under the model, as proposed, would be very onerous for entities. As mentioned in our responses to Questions 8 and 9 above, we do not support the proposal that options to extend the lease term and contingent rentals are included in the measurement of lease receivables and payables. In other words, we



find that a more practical definition of lease term and lease payments (as proposed in our responses above) would contribute to mitigate part of the practical difficulty of the periodic reassessment required in the ED.

## **Sale and lease back**

### **Question 11 —**

**Do you agree with the criteria for classification as a sale and leaseback transaction? Why or not? If not, what alternative criteria would you propose and why?**

Although we agree that a sale must occur for a seller/lessee to account for a transaction as a sale and leaseback transaction, we are concerned that the criteria to determine whether or not a sale occurs contained in the Leases ED are not consistent with the criteria in the Revenue Recognition ED. We believe that the principles and guidance included in the proposed revenue recognition model should prevail, meaning that if a seller/lessee meets the relevant criteria from a revenue recognition standpoint, the seller/lessee should account for the sale under the applicable guidance for revenue recognition, accounting separately for the leaseback transaction in accordance with the proposed right-of-use model. Similarly, if the appropriate revenue recognition criteria are not met, the seller/lessee should account for the whole transaction as a financing transaction.

In addition to this, from the buyer/seller standpoint, we believe that the purchaser of an asset should still recognize the asset it purchased even if the seller/lessee does not meet relevant criteria, from the revenue recognition perspective, to recognize the sale of the asset.

Finally, we suggest the final standard clarifies the transition requirements for sale and leaseback transactions entered into prior to the date of initial application.

## **Presentation**

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

- (a) Do you agree that a lessee should present its liability to make lease payments separately from other financial liabilities and present right-of-use assets as if they were tangible assets within property, plant and equipment, or investment property as appropriate, but separately from other assets that the lessee does not lease (paragraphs 25-27, 42-45, 60-63 and BC142-159)? Why or why not? What alternative presentation do you propose and why?**
- (b) Do you agree that a lessor applying the performance obligation approach should present its 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? 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 residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? What alternative presentation do you propose and why?
- (d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease separately (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?

#### *Lessees*

Telefónica agrees with the presentation proposals for lessees. We believe that there are differences between owned assets and assets held under a lease and between lease liabilities and other borrowings that justify a separate presentation.

#### *Lessors*

Regarding the presentation requirements for lessors applying the performance obligation approach, Telefónica thinks that requiring a net presentation of the underlying asset and performance obligation on the face of the statement of financial position, and providing a breakdown in the notes to the financial statements, would be more appropriate.

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

**Do you think that lessees and lessors should present lease income and expense separately from other income and expenses in the statement of comprehensive income (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? 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?**

Telefónica supports the separate presentation requirements proposed in the ED and believes that they provide relevant and useful information in connection with lease related amortization and interest expense, separately from other amortization expense and other interest expense.

### **Question 14 — Statement of cash flows**

**Do you think that cash flows arising from lease contracts should be presented on 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?**



Telefónica agrees that the cash flows arising from leases should be presented in the statements of cash flows separately from other cash flows when significant, as we believe that they provide useful information in connection with lease related cash flows, separately from other cash flows.

## **Disclosures**

### **Question 15 —**

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

- (a) identifies and explains the amounts recognised in the financial statements arising from lease contracts; and**
- (b) describes how lease contracts 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?**

Telefónica considers that the ED requires a significantly increased volume of disclosures in comparison to current standards, and we are not sure that all of the required disclosures are necessary or useful. We acknowledge that a number of the disclosure requirements are considered necessary to ensure that users fully understand the estimates and judgments applied by preparers, feature that reflects the complexity of the accounting model proposed. In fact, we believe that required disclosures would be reduced if the Boards agreed to simplify the model to account for leases. Besides this, we definitely think that the Boards should work with preparers and users in performing an analysis to make sure that the benefits of the additional disclosures exceed the costs of preparing the disclosures.

Furthermore, we suggest the final standard clarifies whether the disclosure requirements should be regarded as mandatory in all situations or not.

## **Transition**

### **Question 16 —**

**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?**

**Do you think that full retrospective application of lease accounting should be permitted? Why or why not?**



**Are there any additional transitional issues the boards need to consider? If yes, which ones and why?**

From a strictly technical standpoint, Telefónica agrees that the final requirements should be applied fully retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. It is true that a full prospective approach would lead to inconsistent information for the reporting periods presented in the financial statements. However, the costs of a full retrospective application of the proposed lease accounting model would be excessive for certain entities and the benefits provided by the information obtained would not outweigh the costs. Also, we believe that mandatory full retrospective application would be onerous for long-term leases, and welcome the relief given to preparers. We therefore support that full retrospective application of lease accounting requirements should be permitted where applicable, but not required.

**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 outweigh the cost? Why or why not?**

Telefónica is not certain that the benefits would outweigh the costs. Preparers will incur in a number of costs to implement the new proposals. Not only those costs related to determining on a contract-by-contract basis an appropriate discount rate; reassessing contingent rentals and options; or gathering and compiling lease information, but also costs related to training preparers and analysts, upgrades of IT accounting systems, and designing and implementing new internal procedures and controls. In addition to this, we consider that the proposals are also likely to impact financial ratios and debt covenants of entities, affecting capital requirements based on local regulation and possibly even increasing the cost of capital for some entities.

In summary, we are concerned that the burden for preparers to apply all aspects of the model as proposed in the ED will be significant.

Telefónica believes the IASB should expand its outreach activities to collect additional information on the costs associated with the implementation of the proposals and their potential effects, to make sure that the costs of the proposals do not outweigh their benefits.



## Other comments

### Question 18 — Do you have any other comments on the proposals?

#### *Implications for the statement of comprehensive income*

The application of the proposed model for leases, as described in the ED, would have a significant impact on the statement of comprehensive income of issuers of financial statements. However, we consider that this matter has hardly been addressed in the analysis of the IASB.

In order to assist in the consideration of the effect of the ED on the statement of comprehensive income, we set out below a brief summary of the most noteworthy matters.

Under the current IAS 17, if the lease is classified as an operating lease, monthly lease payments are recognised in the statement of comprehensive income as an expense on a straight-line basis over the lease term. No asset or liability is recognised, except for the difference between the accumulated lease expense recognised on a straight-line basis and the actual amount paid.

Under the proposed model, the lessee would recognise a right-of-use asset and a corresponding obligation to pay rentals. The right-of-use asset would initially be measured at the present value of the future lease payments with a corresponding liability for the obligation to make lease payments, discounted using the lessee's incremental borrowing rate. The right-of-use asset would subsequently be amortised over the lease term, and the financial debt subsequently measured at amortised cost, with the corresponding charge to finance costs in the statement of comprehensive income.

The projected impact of this new accounting model on the lessee's statement of comprehensive income is that the sum of the amortisation of the right-of-use asset and the interest expense arising from the obligation to make future payments will exceed the rental expense recognised under the current IAS 17 during the first half of the lease but will subsequently be lower due mainly to:

- Amortisation of the right-of-use asset on a straight-line basis;
- Decreasing finance costs due to the measurement at amortised cost of the future lease payment obligations, as opposed to
- Rental expense recognised on a straight-line basis under the current IAS 17.

The analyses performed indicate that the new accounting model brings the lease expense forward to a considerable extent. This effect does not begin to reverse until approximately 55% of the lease term has elapsed and the expense is fully offset only at the end of the lease term.



This effect may have a highly considerable impact on profit before tax, entailing much lower returns on standard projects during more than the first half thereof, followed by higher returns. Consequently, under the proposed new accounting model a project with a sustained cash-generating capacity over time would be heavily penalised in the statement of comprehensive income for a number of years, improving subsequently to reach a significantly higher rate than the actual performance of the project transactions, resulting in confusing and counter-intuitive information that does not represent the reality of the business.

Unfortunately, it seems that the proposed new accounting model for leases would not contribute to presenting transactions fairly because it alters the pattern of returns over time to a growth rate that does not coincide with the actual revenue generated by the projects.