

Milan, December 16, 2010

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

**Comments by the Italian Association of Financial Analysts (AIAF)**

Dear Madam, dear Sirs:

The Italian Association of Financial Analysts (AIAF) represents more than 1.000 investment professionals in the areas of equity and bond research, asset management as well as investment advice. It welcomes the opportunity to comment on the International Accounting Standards Board Exposure Draft "Leases" published in August 2010.

Through leasing a substantial part of investments in property, plant and equipment is financed. IAS 17 provides information, mainly in the notes, of the amounts involved. Analysts have therefore been able to adjust financial statements in order to show a more relevant picture of leverage.

However, not all users are comfortable with doing their own adjustments. The main criticism to IAS 17 is that there is a possibility that financial risks remain unnoticed especially for the less sophisticated investor.

AIAF strongly supports the efforts of the IASB to improve International Financial Reporting Standards but it is not persuaded that some of the proposal included in the exposure draft offer an effective improvement in comparability or provide additional relevant information to the users of financial statements.

AIAF considers that there are conceptual merits in some of the proposal included in the exposure draft but the current standards works and is an established and accepted standard also if requirements for supplementary disclosure should be developed.

In order to support the IASB's effort AIAF has reviewed the ED, *Leases* and is not persuaded that the ED offers an effective improvement.

The exposure draft does not however address the broader issue of executory contracts. AIAF remembers that when it was decided to start working on a revised IAS 17 the question on how to draw a borderline between such contracts and lease contracts was raised.

We also expressed concern about several specific ED aspects such as:

- presenting as a solution the de-recognition for the lessor if the lessee doesn't have a mirroring accounting as the underlying idea is a unique economic approach for each contract;
- the absence of a rationale to exclude intangibles from the scope and a guideline to support the accounting of the lease of intangibles in execution;
- the absence of a rationale to recognize a contract to rent office space as a lease. We believe that this is a standard executory contract;
- the Ed does not provide any guideline on the treatment or disclosure of prepayments made between the inception and the commencement date;
- the concepts of assets, liabilities, derecognition, "more than" should be coherent with the Framework and all other IFRS. The criticism arose to concepts as "more than" [IAS 37] are valid also for what is proposed by the ED "*Lease*". The definition of sale is not symmetrical with the ED "*Revenue from contract with customers*";
- the analysis of a sale and leaseback transaction as a sale of the asset followed by a lease contradicts the analysis of an asset as bundle of rights;
- a lessening of reclassification and adjustments in the financial statements.

Also if are a regulatory matter clarification would be helpful about:

- tax implications of the proposed changes on our domestic constituents;
- potential impact for regulated entities (i.g. banks, financial entities etc.) needs to be considered. ED does not clarify whether the right-of-use is a intangible asset;

As a result we do not believe that the proposal are effective in reduce the complexity of leasing and implement the comparability of information. Furthermore, we are convinced that the inclusion of different contractual economical substances in a unique accounting model will force users to utilize the information included in disclosure as the current IAS requires.

Following several discussions, AIAF would like to present its comments to the ED questions, as follows:

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**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?*

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**Our response**

AIAF supports the recognition of a liability to make lease payments as this would lead to a balance sheet presentation that better represents the leverage position of the lessee. We support the recognition of a right-of-use asset, subject to the development of robust criteria to distinguish between lease and service contracts.

We agree, as a natural consequence, the proposal for amortisation but users need for comparative purposes with entities that bought similar assets, a disclosure about the useful life of the underlying asset.

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**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?*

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**Our response**

No. AIAF does not support the proposal.

Our understanding is that the possibility for a lessor to apply one of two approaches depending on the circumstances will not lead to a significant change compared to IAS 17. That might be seen as an advantage as users are accustomed to it.

However, if the standard has two approaches for the lessor, we think that - in respect of an unique economical substance for each contract - it would be logical to have two approaches for the lessee, also we are aware that such solution does not change from IAS 17.

In absence of such an alternative and in coherence with the methodologies that support the right-of-use, we suggest to eliminate the derecognition model also for the lessor.

We are aware that paragraph BC 25 states that a single approach to lessor accounting would not be appropriate for all the leases because of differences in the economics of the business models for different lessor. IASB thinks that the performance obligation approach is appropriate for lessor in some circumstances and the partial recognition approach is appropriate in others.

The propose is that lessor should determine the appropriate approach to apply on the basis of whether the lessor retains exposure to significant risks or benefits associated with the underlying asset.

We think that if the lessor does not retain exposure to significant risks or benefits associated with the underlying asset, the lessee bears such risks and benefits and the lessee must recognize the asset.

In term of fact, with a limited exception of few specific contracts, financing lease are contract that fit such transfer of risk and benefits, viceversa in operating leases lessors bear risk and benefit. Thus, the driver that will discriminate different leases is, again, the definition of lease.

If the IASB is convinced that there are valid arguments to support the derecognition model for lessor but not mirroring it with the lessees' recognition, it should provide a clear rationale for why it is the case and a strong and robust guideline.

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### **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?*

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**Our response**

AIAF supports the proposal also if our opinion is that the relief for the lessees are minimal and a more meaningful proposal should be advanced by the IASB.

The amounts of short-term leases are normally immaterial and we see no need to recognize them in the financial statements. A note disclosure of the contractual payments provides enough information.

One concern about the term is that the expiring date should include any option to extend the term beyond 12 months.

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**Definition of a lease**

*The exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1–B4 and BC29–BC32). The exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59–BC62) and on distinguishing a lease from a service contract (paragraphs B1–B4 and BC29–BC32).*

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**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?*

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**Our response**

- a) No. AIAF does not agree that a lease is defined appropriately. Our opinion is that the definition fits more to a rental than a lease and that a correct definition of lease cannot avoid including the economical model. We guess that the definition of lease should be based whether the main interest of the lessee is to receive a service the transactions should be considered as a service agreement.
- b) No. AIAF considers the criteria to distinguish sale/purchase incoherent with those set in ED “Revenue from contracts with customers”.

Our opinion is that the barrier between lease and service contracts is difficult to determine. We think that the criterion exposed in ED to identify a lease is addressed to the physical access or delivery to the underlying asset instead of the concept of benefit or right-of-use that should drive the ED.

What defines a lease is the business purpose of the transaction. Applying this approach the lessee interested to receive a service the transaction should be treated as a service arrangement.

One key in understand the transaction is whether the asset used is easily replaceable by another that can provide the same goods or service. When the transaction involves non-specialized assets or non-core assets it is easier that the lessee is interested in obtain a service rather than the right-to-use the underlying assets.

These contracts are classifiable as operating lease and examples are copiers, lap top, computers, etc. In such contracts, the supplier signs an operating lease and when the underlying asset has been damaged, or the cost of maintenance is higher than the average value, the asset is substituted without any kind of information.

AIAF considers that the ability of the supplier to substitute the asset and continue providing the goods or service is a declaration whether the lessee is interested in the asset or in the item from which receive a service.

AIAF considers that the criteria defined in ED do not deal with the exposure of risk and rewards.

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### **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?*

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### **Our response**

AIAF does not support the proposal. We do not see fundamental reason why intangibles have been scoped out.

As stated in BC36 IASB have not identified conceptual reason why a lease accounting standard should exclude intangible assets and that they will be excluded until IASB had considered the accounting for intangible assets more broadly.

AIAF agrees with IASB and does not see conceptual reason why intangible have been scoped out. Viceversa it notes that the absence of a future guidance for such leases – currently many exist - will force the lessee to continue using the current IAS 17, in the mean time, lessors should apply the revenue recognition as stated by the ED "Revenue from contracts with customers". The result will be a discrepancy and a loss of comparability.

An other concern is about the contract that includes tangible and intangible – i.g. IT industry – in such hypothesis entity will have to segment those contract and apply different requirements to each component. The increase of complexity is not balanced by the benefits for issuers and users.

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#### ***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?*

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**Our response**

AIAF supports the recognition of distinct service components according to the standard "Revenue from Contracts with Customers". However, we realize that it might be difficult to make such a separation.

AIAF considers that what drives the correctness of recognition is the economical substance of the transaction. When a combined contract includes non-distinct lease and service AIAF suggests that, accordingly with the economical substance criteria, the lessee considers the predominant component and treats the whole contract as defined by the business model.

As exposed in answer to question 4 there are lease contracts in which the service component is the main purpose. In such hypothesis the lessee should recognize the contract applying the proposals in ED "Revenue from contract with customers".

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**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?*

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**Our response**

No, AIAF does not support the proposal that a purchase option is considered only when exercised.

AIAF considers the proposal a short cut to reduce complexity. On a conceptual basis, the purchase option is a lease component and included in finance the lease as well as in compute the IRR.

We do not see any reason to exclude a purchase option that is a fundamental economical transaction in any lease. We consider that the fair value of the asset, or item, is a clear indicator whether the option will be exercised and that the ED requires to the parties to consider the eventual option to extend a lease.

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**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?*

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**Our response**

AIAF does not support assuming the longest possible term while supports the alternative view as presented in AV2ff. We believe that options to extend leases should not be considered as they reflect the operational flexibility and the risk management policy of the company.

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**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?*

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**Our response**

AIAF does not support that contingent rentals are included in the measurement of a lease as they are dependant on future events. We support the alternative view as presented in AV5ff.

We add that the inclusion of such large use of estimation will increase discrepancies between competitor instead of reduce them.

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**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?*

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**Our response**

AIAF supports that a reassessment is required only when there is a significant change in the circumstances.

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**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).*

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**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?*

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**Our response**

In our experience, sale and leaseback transactions - more often than not - are borrowing transactions. The proposals in the exposure draft would not change this. AIAF supports the alternative approach proposed by EFRAG.

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**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).*

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**Our response**

AIAF finds the proposal essential and supports it.

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**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?*

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**Our response**

AIAF supports the proposal as it provides useful information.

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**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?*

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**Our response**

AIAF supports the presentation of lease income and lease expense separately from other income and expenses only when the amounts are material.

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**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?*

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**Our response**

AIAF supports the presentation of cash flows arising from leases separately from other cash flows only when the amounts are material.

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**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?*

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**Our response**

AIAF supports the proposals for disclosure and suggests, as exposed in answer to question 1, that the lessees shall give disclosure about the useful life of the underlying assets.

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**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?*
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### **Our response**

Although by and large AIAF does not favour options we believe that if an entity would prefer a full retrospective application that should be permitted.

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### **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?*

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### **Our response**

For users, the benefits certainly exceed the costs.

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### **Other comments**

#### **Question 18**

*Do you have any other comments on the proposals?*

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### **Our response**

AIAF does not have any further comment.

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Whether additional comments might be necessary, AIAF will be willing to participate.

**Associazione Italiana  
degli Analisti Finanziari**

Yours sincerely,

Ivano Francesco Mattei  
Member of Board of Directors



Mario Noera  
Chairman Board of Directors

