



International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

17 December 2010

Dear Sirs

Leases

ACCA (Association of Chartered Certified Accountants) is pleased to have this opportunity to comment on the above exposure draft (ED). The ED was considered by ACCA's Financial Reporting Committee after a consultation with our members in countries around the world. I am writing to give you their views.

General comments

In line with our response in 2009 to the discussion paper issued by the IASB, we do not support the right of use (ROU) model for accounting for leases by lessees. The existing principles in IAS17 are reasonable. That is where substantially all of the risks and benefits of an asset have been transferred under a lease to the lessee then they should account for it as an in-substance purchase on deferred terms. We accept that there may need to be modifications to IAS17 to allow this principle to be better translated into practice. IAS17's treatment we consider is widely accepted by most users, even if not by all investment and credit analysts. Most users find the treatment of operating leases relevant and understandable, especially for leases involving smaller proportions of the useful life of the asset. It seems likely that the analysts' aversion to the IAS17 model may be driven by the known instances of structured deals, which as we have noted need to be addressed. The proposals for the majority of leases for less than the expected life of the asset will be very costly to implement with little prospective benefit.



The proposals in the ED contain significant problems including

- A flawed approach to lessor accounting with the so-called performance obligation model
- Departures from the definition of liabilities in the IASB's own conceptual framework for both lessees and lessors
- A need to revisit the boundary between the provision of a service and lease of an asset
- Consistency in the definition of sales within this document and the draft standard on revenue from contracts with customers
- Whether the ROU asset is a tangible or intangible asset

Given the fundamental change in the accounting model on the one hand and on the other the significant problems of complexity of accounting and costs created by the proposals, it is very important to understand IASB's intentions for extending this to incorporation at some future date into the IFRS for SMEs. We hope that fundamental differences between IFRS and IFRS for SMEs in treatment should only be created when absolutely necessary. The benefits of this accounting model are however likely to be of even less worth to private companies.

No mention is made in this ED of the issues for Islamic sharia-compliant entities in applying the proposals. These could be significant arising from both the separation of different elements in a single contract and in the measurement model. As a global standard-setter IASB needs to address issues that might affect significant numbers of entities around the world.

Answers to IASB's specific questions

Q1. Model for lessees

As noted above we would have preferred a revision to IAS17 without changing the principles and the whole basis of the accounting treatment. This would retain the distinction between capitalising leases where the significant risks and benefits of the asset are passed to the lessee, and simply accounting for other leases as the rental payments as they arise. However we recognise that the boards have decided in developing their proposals to take a different approach and use the ROU model. Our answers are therefore on the assumption that the new approach is used.



Q2. Model for lessors

We do not support a multi-model approach which envisages a performance obligation model (POM), the derecognition model and one for short term leases. We support the derecognition model as the one which should be applied by lessors in all cases (except where the lease meets the definition of a sale).

We note that the POM would restrict profit recognition on the inception of the lease to those cases where the risks and benefits are largely transferred to the lessee.

However for the following reasons we support the derecognition model

- As a single model it is more consistent with the ROU model for lessees
- The POM seems to double up the assets (both the underlying asset and the finance lease receivables)
- The leasing liability in the POM does not meet the definition of a liability in the framework as it does not involve an outflow of benefits
- The lease liability seems inconsistent with the lessee model (which assumes that delivery of the asset to the lessee at inception constitutes fulfilment of the obligations by the lessor) – it implies the lease is an executory contract

We comment on the proposals for a different model for short leases in answer to Q3 below.

Q3. Short term leases

While we are keen to reduce the burdens of compliance in cases where compliance is unimportant, we see the need to consider a simplification for short-term leases as mostly an indictment of the flaws of the ROU approach.

Our comments on the proposals are

- Any definition of short-term leases is bound to create an arbitrary bright line which we think not helpful in standards.
- Case-by-case options are inherently undesirable in standards
- It seems probable that the proposed reduction for lessees would not provide significant reductions in the burden of preparation. Discounting may not be material in any case and the main effort for preparers is in



collating the information about a company's leases, not applying a discount rate.

- We would not support the proposed treatment for lessors, as introducing further inconsistency in the accounting model.

Overall therefore the reduction in the burden for lessees needs to be achieved by extended short term lease treatments, but in additional ways – perhaps by revisiting the boundary between contracts for services and leases for example.

Q4. Definition of a lease

(a) We agree with the definition of a lease included in the ED.

(b) What is a lease and what is a sale/purchase?

We broadly agree with the proposal that where control is transferred and all but a trivial amount of the risks and benefits, the asset should be treated as sold (albeit on deferred terms).

Our further comments are

- The indicators in Paragraph B10 mostly concern the right to buy. The standard should also make clear that a lease for all of an asset's useful life would also constitute a sale.
- Transfer of control should also be clearly linked to the standard on revenue from contracts with customers.
- "Trivial" seems to introduce a new term into IFRS and that should only be done where essential because of the difficulties of application and translation that creates. To what extent is trivial different from insignificant for example?

(c) What is a lease and what is providing a service?

This is potentially a very important area for the ED. This guidance needs to be reconsidered.

Paragraphs B1 to B4 set boundaries between the supply of a service to receive the output of an asset on the one hand, and of the ROU of the asset itself on the other. This guidance seems essentially unchanged from IFRIC₄ which many find an interpretation which is obscure and hard to apply. The use of the phrase "may be a lease" in the penultimate sentence of B3 is not helpful. The opportunities seem rife for legal niceties and structures to determine very different accounting treatments.



Many of the leases that are felt to be least appropriate for the ROU treatment can alternatively be viewed as service contracts involving fungible assets – e.g. cars, photocopiers etc. Though a specified asset with a serial number may be involved the particular asset is not significant to what in economic substance is wanted (for example workforce mobility, warehouse space or the ability to photocopy documents). In many of these cases these contracts should be accounted for simply as providing a service. Such an approach would help to reduce the difficulties with separating lease and service components (see Q6 below). Some of the restrictions in B3 in particular will constrain accounting for the economic substance of what is being provided.

Q5. Scope exclusions

Leases of intangibles should be scoped into this new standard. We note that no very good reason is given for their exclusion. We are content with the other exclusions as the cases are covered by other IFRS.

Q6. Contracts containing both service and lease components

Many of these dual contracts may be more in substance about the provision of a service (see Q4c above). So we do not accept that the default position for lessees should be lease accounting, but think often that the whole contract should be treated as one for services. Separate component accounting will potentially be very costly for preparers and so it should be reserved for a more restricted set of circumstances where it is truly significant.

For lessors we think that in most cases they will be able to distinguish the prices of the different elements of a contract and so support separate accounting for the two components where they are indeed separate.

Q7. Purchase options are not payments under a lease

We agree with the proposals in the ED.

Q8. Lease term

We do not agree with the proposals in the ED because

- assessing the likelihood of the take up of the renewal options adds significant complexity to the proposals
- payments in optional lease extensions would not give rise to a liability as defined in the framework as the entity would retain the discretion to avoid the outflow of resources until the option is exercised.



- In the ED a 5 year lease with an option for a further 5 years will sometimes be accounted for as a 10 year lease. This misrepresents the economics and understates the flexibility that the lessee has.

The board may be unduly concerned about “structuring opportunities” around lease terms. We would expect that the real flexibility for the lessee of break clauses after shorter terms will come at a price from the lessor which may deter many using such opportunities.

The best accounting treatment for the lessee, and that most in line with the conceptual framework, would be to have the liability recorded at the minimum unavoidable obligation to pay rentals including any related residual value guarantees (RVG), with any option to extend for further periods to be valued separately.

However the complexity and practical difficulties in valuing the option mean in our view that a simpler method should be used which would not account for the option at all but simply provide disclosure of it.

We are particularly concerned with the recognition under the ED of income by the lessor dependent on the occurrence of future events which may not be within their control. It is important that this standard and that on revenue recognition are co-ordinated in this regard.

Q9. Lease payments to include contingent rentals, optional periods and RVG

Rentals in optional extension periods and RVG – see our answer to Q8 above

On contingent rentals we broadly support the dissenting view of Stephen Cooper. The liability should be limited to those rentals where the lessee has little or no discretion to avoid them such as those where rentals are linked to an inflation index, but not to include those where the rental is dependent on the level of usage of the asset or for some retail properties on a percentage of sales.

See also our notes above on lessor profit recognition which apply in this case as well.

We note also that

- there are clearly problems with reliable estimates of these rentals which may stretch some way into the future



- the liabilities may not be as relevant for users when comparing with other forms of debt as the service cost of the leasing obligation might not be a fixed cost unlike other forms of debt.

Q10. Remeasurement

We agree with the proposals in the ED to account for any changes in the estimates of the obligation to pay future rentals changes by re-measuring the asset and the change dealt with prospectively via increased or decreased depreciation.

Q11. Sale and leaseback

We support the proposals in the ED.

We note that paragraph B31 contains indicators to consider and that these are a bit more extensive than the general ones in B9 and 10. We think on the whole that determining what is a sale or not in the two cases should be broadly similar.

Q12. Presentation in statement of financial position

(a) Lessees

We agree with disclosing the lease liability separately from other financial liabilities. We also favour the ROU asset being shown with other property plant & equipment, but with separate disclosure. We see no reason for the lease assets and liabilities to be required to be shown in the primary statements, but would be content for the analysis to be shown in the notes to the financial statements. We would expect that where the ROU lease assets were very significant then preparers should, following the general principles in IAS1, consider separate presentation in the primary statements

(b) Lessors – Performance obligation approach.

See our answer to Q2 – we do not support the POM.

(c) Lessors – derecognition approach

Separate disclosure should be required, but this could be in the primary statements or the notes.

(d) Subleases

Separate disclosure should be required, but this could be in the primary statements or the notes.



Q13. Presentation – statement of comprehensive income

Separate disclosure should be required, but this could be in the primary statements or the notes.

Q14. Presentation – cash flow statement

The presentational requirements should be aligned with the other two primary statements.

Q15. Disclosures

We are not clear that the disclosure requirement for the details of the movement on the lease liability is justified considering the other disclosures that would be in the balance sheet and the cash flow statement.

With that exception we support the disclosures proposed. The caveat in paragraph 71 discouraging excessive and immaterial detail is particularly welcome and important in our view.

Q16. Transitional arrangements

The ED proposes that lessees should not do a full retrospective restatement but a restatement which for all existing leases treats the date of adoption of the IFRS as if it was inception of the contract.

While we note that full restatement is the best answer, on grounds of comparability between companies we would not support an option for existing IFRS preparers to do so.

For similar reasons we would not favour an option for early adoption for this standard except in the case of first time adoption of IFRS as a whole

Q17 Costs and benefits

As noted in our general comments we believe requiring the ROU model with all its complications will be very costly to preparers both as a one-off conversion but also on an ongoing basis, and that these costs will not be justified by the benefits.



If there are any matters arising from the above that require further clarification, please contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read "R Martin", with a stylized flourish at the end.

Richard Martin
Head of financial reporting