



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

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## Exposure Draft ED/2010/9 Leases

Representing preparers' point of view, the Swedish Enterprise Accounting Group (SEAG) welcomes the opportunity to comment on the above-mentioned Exposure Draft.

### Summary

We are not convinced that the proposals improve financial reporting for a number of reasons. In summary, our concerns relates to the following issues.

- The proposed conceptual model (right-of-use) is not consistently reflected in the ED.
- We question the new lease model on an overall basis as we see the problems in the old model being replaced by new issues on the way of distinguishing between service and lease arrangements for lessee accounting and distinguishing between a derecognition model and a performance obligation model for lessor accounting.
- A number of differences between lessee and lessor accounting leads to an asymmetrical model. It is difficult to understand how one model can cover all lease contracts from the lessee's perspective while lessors need two different models to deal with the same contract. We believe that the model can be improved if the derecognition approach is used as the main model for lessor accounting. Also, we believe that the standard should be consistent regarding estimates required by lessees and lessors.
- The proposed model for short term leases brings no real simplification for preparers.
- We are concerned that the criteria in the proposal will not provide enough information to determine the difference between leases and service contracts.
- The distinction between sale/purchase contracts and leases is vague and too dependent on legal issues.
- Options to prolong the lease are included in the lease term. We neither believe this liability would be in line with the present definition of a liability in the Framework and nor within the working draft definition of a liability in the new draft Framework. For most contingent rents we have the same concerns, i.e. if they really are within

the definition of a liability. We also doubt if the information presented will be faithful and reliable if an entity has to estimate if a lease will be prolonged or not in 10, 15 or 20 years? Such an estimate will be very subjective and in our view not reliable.

- The guidance for sale and leaseback transactions is vague and difficult to apply.
- We foresee an immense work load and increased costs for preparers if the proposals are adopted.
- We do not agree with the assessment that the benefits of the proposals would outweigh the costs. The Board should evaluate how financial reporting of leases can be improved in a less costly way for preparers, i.e. through disclosure.

In the Appendix, we further develop our comments under the questions asked by the Board.

We are pleased to be at your service in case further clarification to our comments will be needed.

Yours sincerely,

CONFEDERATION OF SWEDISH ENTERPRISE

Dr Claes Norberg  
Professor, Director Accountancy  
Secretary of the Swedish Enterprise Accounting Group

*The Swedish Enterprise Accounting Group (SEAG) represents around 40 international industrial and commercial groups, most of them listed. The largest SEAG companies are active through sales or production in more than 100 countries.*

*Total net turnover of SEAG companies: 245 billion EUR*

*Total assets of SEAG companies: 335 billion EUR*

*Total number of employees in SEAG companies: 950 000*

## Appendix

### The accounting model

*The exposure draft proposes a new accounting model for leases in which:*

*(a) a lessee would recognise an asset (the right-of-use asset) representing its right to use an underlying asset during the lease term, and a liability to make lease payments (paragraphs 10 and BC5–BC12). The lessee would amortise the right-of-use asset over the expected lease term or the useful life of the underlying asset if shorter. The lessee would incur interest expense on the liability to make lease payments.*

*(b) a lessor would apply either a performance obligation approach or a derecognition approach to account for the assets and liabilities arising from a lease depending on whether the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected term of the lease (paragraphs 28, 29 and BC23–BC27).*

### 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?*

As communicated in our response to the questions posed in the Discussion Paper, we question the new lease model on an overall basis as we see the problems in the old model being replaced by new issues on the way of distinguishing between service and lease arrangements for lessee accounting and distinguishing between a derecognition model and a performance obligation model for lessor accounting. The proposed new model also raises concerns regarding the reliability of measurement since management forecasts covering many years are required.

However, from the ED we have understood that the Board continues the work towards a new lease standard based on the proposals, despite critical views in comment letters to the DP. Users that have requested the change should be aware of the fact that there will still be flaws in the comparability between entities that choose to invest by purchasing the asset and entities that decide to lease the asset. The reason for choosing the lease alternative compared to investing is not only a finance issue but also a choice of what risk the company is willing to take on. A lessee may be willing to pay a high lease fee in order to avoid significant risks. For such cases the asset values derived from minimum lease fees including options to extend the lease term are not comparable to the asset value of investment.

As a consequence of the proposed model in ED Leases, the market value of a leased asset can in some situations be less than the right-to-use asset recognized, depending on e.g. renewal options. Apart from the risk of providing a skewed basis for comparison between entities of different investing strategies, a standard for leases needs to be clear on the fact that a present value of future lease payments including extension periods presented in the financial reports should never exceed the market value of a certain asset. To more or less force an entity to test for impairment of a leased asset is not a conceptually acceptable way to handle a problem that in reality is created by a flawed accounting model.

*(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?*

When entering a new lease the rent actually paid will be replaced by amortization and an interest charge according to the proposed model. The profit and loss charge will be higher in the early years and lower in the later years of the lease. The longer the lease term is the greater the charge is on the first day. Costs for leased assets will not be equal to cash flows thus creating a problem for users to predict future cash flows. Therefore, we suggest using a straight-line method instead.

## **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?*

We appreciate that the Board has taken on the task to provide a model for lessor accounting. A general question is if and how a two-model-solution can improve financial reporting. Even though it may be theoretically appealing and we understand the ambition to tie the proposal to the model proposed in the ED Revenue from Contracts with Customers, it is difficult to see what enhancement it may result in compared to the model used today. It is also very difficult to understand how one model can cover all lease contracts from the lessee's perspective but that lessors need two different models to deal with the same contract.

The derecognition model is perhaps the easiest one to grasp and also the model which may result in the most user-friendly information. It is quite straight forward. The ED states that a derecognition model should be used if the lessor has transferred exposure to significant risks or benefits. Even though we are generally not fond of more detailed guidance, we suggest some additional discussion regarding the term significant in this case. This is needed especially regarding manufacturer's leases where many entities would prefer to apply the derecognition model as much as possible.

The performance obligation model is more challenging, both theoretically and practically. The liability arising from the obligation to perform in the sense of having the lessee use the lease asset, as well as the resulting "double asset" accounting for the lessor, is a step into a different theoretical direction of accounting and one might wonder in what other areas such performance obligations may exist.

Furthermore, we have noted that the concept "risk and rewards" has been replaced with the concept "control" in the ED Revenue, but in the ED Leases both concepts are used. It would make sense that the ED Leases proposal is consistent with the ED Revenue and consequently, if "risk and rewards" is replaced also in the ED Leases proposal there is no

need for the performance obligation approach for leases. But if the control concept will be used for leases, the concept needs to be developed, since the proposed model is too legally oriented. Please refer to our answer to question 4 regarding this issue.

We prefer the derecognition approach for all lease contracts, in order to have a consistent accounting model for lessee and lessor. We believe that for lease contracts containing some kind of residual value, the derecognition approach gives a better view of the economic substance in the transaction compared to the performance obligation approach. The different economic substance in different contracts is reflected in the residual asset in the books which represents the risk the lessor is exposed to. It could of course be situations where a derecognition model is not appropriate. We suggest that a simplified method is applied for such contracts, e.g. short-term leases and premises lease contracts. We suggest that current model under IAS 17 for operating leases is kept for these types of contracts.

However, even if we prefer a derecognition model we urge that the percentage yield is not skewed during the lease term, which we believe users would agree upon.

The ED describes, in paragraph 50, how to calculate the amount to derecognise according to the derecognition approach. By using the word fair value undue complexity is added to the Leases proposal and would require further explanation. Would the fair value of the right to receive payments include the credit rating of the lessee? Does the fair value of the underlying asset represent the underlying price in the contract if the lessor is a manufacturer providing financing or should the value be determined based on the price that the asset could be sold at in a current transaction between willing parties? Also, regarding real estate, it is important to clarify how the fair value should be established since different methods might be applied. Further clarification is needed.

### **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?*

We appreciate some kind of simplified requirement, but in practice the proposal in the ED will not have any material impact on the companies. As an alternative solution, we instead suggest that the Board should keep the existing model under IAS 17 for operating lease contracts for short-term leases. The number of leases with a maximum lease period of one year is generally few, when considering potential implicit options. The determination of if a lease is a short-term lease should therefore be done without considering implicit options. Such a model would be a real relief for preparers.

We expect the materiality guidance provided in IAS 1 to be valid for these cases. Furthermore, the basis for recognising a lease asset should not be made for any smaller amounts than should be the minimum for recognising an asset under any other standard (e.g. IAS 16).

### **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).*

### **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 agree with the definition. However, we believe that the definition of a lease is the starting point and the base of the standard. The definition should therefore be placed in the standard and not in the Appendix.

b) We do not agree with the proposal. In this context we first want to point out that the proposal, from our perspective, adds undue complexity and creates new borderline issues between sale/purchase contracts and lease contracts and further between the derecognition and the performance obligation approach. This is not in line with the objective of the project. Also, our view is that the criteria to identify a lease focus more on the legal control of the asset rather than the benefit or the right-of-use that is transferred through the lease.

As we have said in our comment to question 2, we believe that it is unfortunate to use a control concept in ED Leases that is heavily focused on legal control. It would lead to that the same type of contract could be treated differently in different countries depending on the jurisdiction. Our experience is that regulations about retention of titles varies a lot around the

world and affect the content of the contracts. The substance from a business point of view could be the same, but differently expressed in the contract due to proprietary rights regulations. We strongly believe that financial reporting should reflect the business, not how the lawyers draft contracts. Please refer also to our Comment Letter on the ED Revenue from Contracts with Customers.

Furthermore, it is very difficult to understand the difference between the concepts "risk and rewards" and "control" as they are used in ED Leases to distinguish between sale/purchase, derecognition and performance obligation leases. From our perspective we have difficulties to see in what case you from a lessor perspective can have the control over the asset, but have transferred all the risk and rewards; particularly since bargain purchase options are included in the concept of control. Thus, we presume that a derecognition approach would rarely be applied. If this is a correct assumption then we urge the Board to further evaluate its proposal in order to clarify under what circumstances a derecognition approach can be applied.

Lastly, we would like the board to clarify which standard that is applicable for contracts that meet the criteria for classification as sale/purchase for lessees (IAS 16?).

c) We are concerned that the criteria in the proposal will not provide enough information to determine the difference between leases and service contracts. It would be good if the new standard includes a more illustrative example or a decision-tree, providing guidance on how to assess whether the contract contains a lease or not.

Some contracts that permit the supplier to substitute the asset with another similar asset could in the context of the proposal be defined as service contracts for the supplier, but could from the lessee's perspective be considered to be lease contracts, e.g. contracts regarding trucks, forklifts etc. We can also see that the opposite could occur. Could it be possible to switch assets between companies on a regular basis and thereby avoid the standard about leases? It is also apparent (Appendix B paragraph 3) that even if the supplier has the permission to substitute assets that are not working properly the transaction could be classified as a lease. Our conclusion is that the possibility to substitute the asset may not be a proper indicator when distinguishing a lease from a service contract. From our perspective the business purpose of the transaction is a better indicator of the type of a contract rather than the specific asset. Please refer also to our comment on question 6.

## **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?*

In general we agree with proposed scope of the proposed IFRS. The exclusion of intangible assets could be questioned, as already discussed in the proposal (BC36), since intangible assets would in most cases qualify for recognition as an asset in the books of a company in the same way as tangible assets would do. The value of intangible assets can also represent a significant amount. However, our opinion is that lease contracts containing intangible assets could be rather complex and we appreciate that those assets are excluded.

**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 have concerns about the proposals for the treatment of arrangements that have both service and lease components. We recommend an approach that means that for lessee accounting purposes the predominant component should decide if a service contract should be treated in full, either as a service contract or a lease contract. Otherwise the efficient business models, with the main component being true service, could not be offered to customers in the way service providers do today. For example, a service company may have in certain regions cars that either are used to serve one customer or are used to serve two or more customers. If the customer would have detailed requirements under IFRS on the distinction between the leasing component and the service part, that would cause a lot of analysis, discussions and administration. In our example, the customer would need to know which cars are "leased items" and which are not and that will change over time.

We understand from the IASB Update that servicing equipment shall always be classified as property, plant and equipment. If that would include replacement components owned by the service provider under a service contract that would significantly complicate the service providers accounting treatment, especially if such replacement components would fall under leasing accounting principles.

Exceptions to this could be if the lessee signs a significant service agreement where, for example leased assets represent 40% of contract value. For such a contract a split would be reasonable, preferably based on requirements as defined in IFRIC 4, not the detailed proposals in the ED.

We disagree with the rule to apply lease accounting to the whole contract if it includes both a lease and a non-distinct service component. We believe that lessees in accordance with the current treatment under IFRIC 4 should separate payments for the lease from other payments using an estimation technique (see paragraph 14 of IFRIC 4). We believe that lessees should be able to achieve this in most cases. When lessors apply the derecognition approach, the receivable will not include the amounts for undelivered non-distinct services. Accordingly, separation of payments for the lease and non-distinct service components is required for lessors using the derecognition approach, and we support symmetry of treatment between lessors and lessees. As a result, we believe that lessees should always be required to separate lease and service components, whether they are distinct or not, and that lessees should be able to make their own assessment of the components.

#### **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 agree that a lessee or a lessor should account for purchase options only when they are exercised. First of all the purchase option is just an option and not a binding commitment for the lessee. The option could therefore not fulfil the definition of a liability.

Further on, the calculation of the present value of the exercise price would require assessing the likelihood for exercising the purchase option and that would in most cases be just a guess. The lessee would also be required to assess the future market value of the leased asset. For long-term contracts, uncertainty will significant and in many cases it would be more or less impossible to determine the future market value. Including the present value of the exercise price of a purchase option in the lessee's obligation to pay a lease liability would therefore lead to a misleading accounting.

#### **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?*

In summary, we do not support to include optional periods in the lease term. We strongly support to only recognize contractual obligations and to disclose information of optional lease periods. We think it is very important that there is a common definition of a liability among different standards and that a liability under e.g. IAS 37 is conceptually the same as a liability for a lease. If liabilities would be differently defined we think this will diminish comparability between companies and creates new adjustments of the financial statements by analysts. We are also very concerned of the costs that will arise if optional lease periods should be assessed and included in the measurement. To assess if options to prolong the lease will be exercised in the future, this will demand a totally new planning process in the companies, and there have to be judgments for years far beyond the normal planning process, which seldom is for a period of more than five years. We explain our view further in detail below.

We do not support to include optional lease periods that are dependent on management's future decisions regarding the lease term. We do not think such a liability is within the definition of a liability in the Framework. According to paragraph 60 in the Framework "an essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way". And further from paragraph 61 in the Framework which states that "A distinction needs to be drawn between a present obligation and a future commitment".

Assume a lease contract for a retail location with a lease term of 10 years with three optional periods of 5+5+5 years (a common contract in practice). The agreement must be terminated by the latest 12 months before the end of each lease period. Otherwise the contract will prolonged for an additional 5 year period.

Our opinion is that the entity has a present obligation only for the first 10 years, not for the optional periods, as there is no obligation to pay anything if these options are not called. If there is no notice to terminate the lease after 9 years there is a new present obligation to pay for the lease until year 15. Even if the location would be a first class location we do not think the entity has an obligation, duty or responsibility to act in a certain way. If the location

would be closed down after 10 years this would only affect the entity itself (i.e. lower sales etc), but no other external parties. A decision to prolong the lease is in our opinion a future commitment and could be compared with an agreement to acquire an asset. Not until there is an irrevocable agreement to acquire the asset is there a present obligation. A lease contract, giving the lessee a right to run a business on this location, creates a liability (and an asset) only when there is a present and unconditional obligation to pay to the counterparty under the lease contract.

We are also very doubtful if the information presented will be faithful if the entity has to estimate; (1) if optional lease periods will be exercised in the future, and (2) the conditional rent under these optional lease periods. For a lease agreement in accordance with the example above the management must assume both the total lease term including options, and contingent rents under the lease term. This could result in estimates for 10, 15 years or even longer periods in the future. By nature such estimates will be very arbitrary and will be more or less a theoretical exercise. We believe the output of such an exercise will be of a very low value for a user of the financial reports.

In addition we do not think the flexibility under such an agreement will be presented fairly in the financial statements. There is a reason why the agreement is 10+5+5+5 and not 25 years as a total. The economic substance of the agreement is that the entity likes to have, and actually has, the flexibility to leave the location after 10 years. This flexibility should be reflected in the financial statements, not as if the agreement would be for a total of 25 years or similar.

Another important aspect is that the requirement in the ED to include optional periods will affect the planning processes in companies. Often budgets and plans in companies are for a period of three to a maximum of five years. As decisions for locations of stores and plants are strategic decisions, these decisions are a natural part of a planning process and the decisions are taken by top management or the board of directors. To be of any value at all judgments of optional periods must be included in these planning processes. But if the optional periods are outside the range of the planning process new processes have to be developed and performed in the company for a longer period of time. This would be very costly as there usually are a lot of people involved in these processes. And the reason for why a planning process seldom is for more than five years is obvious; predictions for more than five years are very difficult to perform and have a low reliability.

Regarding the factors presented in B18 to consider in assessing the probability of each possible lease term we think that only contractual factors should normally be considered. Our opinion is that factors presented in (b), (c) and (d) should only be considered if there is a situation where the factor could be seen as within the definition of a liability. We think that factors under (b) sometimes might be considered, but it would be very rarely to consider factors under (c) and (d). We suggest that the Board reconsiders which factors should be taken into account and our proposal is that only factors which are relevant to fulfil the definition of a liability should be included.

We are also very concerned about IASB's conclusions in BC7(a) of the ED. Firstly; we are not convinced that the proposals are consistent with the existing Conceptual Framework (see above). Secondly; in the context of the tentatively adopted working definition of a liability, presented on the IASB website, there is stated that "a present economic obligation conceptually exists when an entity is committed to a particular action(s) that is capable of resulting in cash flows and there is a mechanism to enforce that economic obligation against the entity". In our view this is not at all in line with the view in the ED that optional periods be included in the lease term as long as these periods are just "optional", and could not be enforced against the entity.

We believe it is very important that a liability under one standard (leases) is conceptually equal with a liability under another standard (for example IAS 37 or IAS 39). The possibility to compare companies will diminish if liabilities are defined differently between standards. It is even more important to follow the present and future Framework definition of a liability as the lease liability and asset (already without including optional periods) will be significant in many companies compared with other assets and liabilities. There would also be a problem, both from an accounting perspective and from a business perspective, if a liability from a supplier of an asset is treated differently compared with a loan for the same asset from an external party such as a bank or similar. In substance would these loans be the same, i.e. financing of an asset, and they should therefore be presented and treated in the same way as long as they have the same features. If not, there are difficulties to explain, internally and to users of the financial statements, the logic ground for the financial reports.

We think that the concept of a liability, as proposed in the ED Leases, is different from the concept used in other standards. This difference could lead to adjustments of the lease liability by banks and other creditors, to reach a liability comparable with other liabilities. Then the present common adjustment of operational leases has been transferred to a new adjustment of the liability. We question if this will be an improvement for users. According to our understanding, many users would prefer an accounting model where the minimum lease term is reported as a liability supported by disclosure in the notes. This is due to the fact that estimates that have to be performed by the lessees according to the ED Leases are not increasing decision usefulness.

We therefore support the disclosure approach presented in BC120(b). We are not in agreement with the IASB that this approach would potentially misrepresent the assets and liabilities arising from a lease. We are of the opposite opinion that there is a misrepresentation to present a liability which in part could be avoided by future actions by the entity. We believe the assets and liabilities under the disclosure approach will be in line with the Framework and that disclosures provide enough additional information to give the users of the financial reports the ability to evaluate the effects of optional periods and contingent rents. We believe this would be the best presentation of the amount, timing and uncertainty of the cash flows arising from a lease in accordance with the objective in paragraph 4 of the ED.

### **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?*

We are concerned if contingent rentals could be seen as a liability in accordance with the definition of a liability in the Framework. For example; if the contingent rent is based on the sales in a store the obligating event would be the sales, not the agreement of contingent rents itself. First when the obligating past event has occurred (i.e. the sales) there is a present obligation. It is difficult to motivate and explain, both internally and to external parties, why future events that could be avoided by future actions (for example closing down the store which would result in sales of zero), should be a liability in this context, when they are not a liability when estimating a liability under IAS37. Therefore we do not think that contingent rents should be included in the estimate and the liability.

If the Board, despite our concerns, decides to include contingent rents in the estimate, our opinion is that contingent rentals and expected payments under term option penalties and residual value guarantees should only be included if they can be estimated reliably. We think this should be valid both for lessors and lessees. If the contingent rents are based on an index or similar we think they might be estimated reliably. But for contingent rents based on assets usage or performance, and where the estimates have to be based on management forecast over many years, we do not think such forecast usually could be seen as reliable enough to be included in the measurement. By nature will such a forecast over many years be very subjective. If such rents would be included the information presented will not faithfully represent the flexibility of such an arrangement.

If only contingent rentals based on an index or similar are included in the measurement we do not think there is a need for an expected outcome technique. We are aware that also with contingent rentals based on an index or similar there could be different scenarios. As the spread between the scenarios would be less than if all contingent rentals would be included, we think the most probable outcome should be used. The information may in theory be somewhat less reliable, but in practice and with substantially lower costs to produce the information by the preparers, we think the information would be reliable enough.

### **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?*

As we do not support to include lease options and contingent rents in the measurement the need for reassessments should be limited. But if Board, despite our concerns, believes that lease options and contingent rents should be included in the measurement reassessments, we would like point out that such reassessments will take a lot of effort and be very costly to perform. For some companies there are thousands of contracts. To reassess these regularly (each quarter) will be very burdensome. Our opinion is that a reassessment should only be required if there is a “significant” change on an aggregated level for all contracts. Only in that situation the liability and the asset in the balance sheet would be substantially affected and only in that situation would the change be of interest for the users of the financial reports. We therefore suggest that IASB clarifies that “significant” should be evaluated on a total level for the entity, not per agreement.

If reassessments should be performed regularly for optional lease periods and contingent rents we are very doubtful how reliable such reassessments would be when there are contracts with both contingent rents and optional periods. The reassessments could be for 10 or 15 years in the future (or even longer) and we think such a reassessment often would be technical exercise with low value for users of the financial reports. By nature it is almost impossible to assess with any degree of reliability if an option to prolong will be used in the long future and contingent rents for the optional period(s). The assessment would be even more complex if contingent rents are based on a floating interest rate or similar as the yield curve in the future has to be assessed.

### **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 see it as important that the criteria for when a sale has taken place is synchronized with the criteria applied in the revenue recognition project, as we have said in our comment to question 4.

Regarding sale and leaseback transactions, we also have difficulties to see the interaction between B9/B10 and B31. What is the status for B31? Should an entity always consider B31 or only when the sale and leaseback criteria in paragraph 66 are fulfilled? If there is no sale and leaseback (only a sale) should B31 be considered anyway?

If there is no sale in accordance with paragraph 67(b), the ED introduces a new concept which is “financing”, without further explaining how the asset under the “financing” transaction should be treated. In reality the transferor has not full information of the asset after the transaction has taken place, as the property in fact is owned by another party. There are questions how to account for this asset in at least the following aspects.

The asset is not accounted as sold. Which standard covers this asset after the transaction? Should it be depreciated? Over which useful life? The same useful life as just before the transaction took place? Should the useful life be reassessed? If yes, on which ground? If the asset is modified, increased in area, modernized etc, how will that be reflected in the recognized asset? Or should it be reflected by the transferor at all, or should it be reflected by the transferee?

How about costs for the asset for repairs and maintenance and other ongoing costs; should they be included in the accounting of the transferor? As the asset is not treated as sold they should be included, but the transferor does not have any information of the costs. If not, why only account for an asset partially? Would that be a faithful presentation? How about cash flows for this asset? As the asset is not sold the rent payments could not be accounted for as rent payments, instead payments of interest and amortization of the loan? If yes, then it would not be any cash outflows for the asset. Should the asset be tested for impairment? If yes, with which cash flows?

If there is no purchase, the transferee shall not recognize the transferred asset. Instead, the amount paid is recognized as a loan. Received lease payments could not be seen as lease payments as no property is recognized in the books. Instead would they be seen as interest and amortization of the loan? The transferee has in reality costs and payments for the asset (i.e. repairs and maintenance). How should the transferee account and present these costs and cash flows in the financial reports? They could not be seen as costs and cash flows for the asset as there is no asset in the books. Should they be presented as costs and cash flows for the receivable?

If the sale and leaseback transaction is to a partially owned company (for example a joint venture) could one part of the asset be treated as sold and one part as financing? We are not sure if the statement in BC161 regarding bifurcation of an asset should be applied or not to such a transaction. We believe it would be possible to bifurcate an asset into two parts and to see one part as sold and another part as a financing. We think this would be the best presentation in accordance with economic substance of the transaction as the risks and rewards of the asset in reality are shared with another party.

To not create diversified treatment among companies for transactions involving a “financing” we recommend the Board to clarify how the questions mentioned should be solved in the Leases standard or in other appropriate standards.

## **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).*

As a general comment, we would like to point out that questions of presentation are also dealt with in the IASB project on Financial Statement Presentation (FSP). Therefore, we find it very unfortunate if the IASB now would make decisions on presentation in the Leases project, which might later be changed due to the development of the FSP project.

### **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?*

We think it is preferably that the lessee discloses the information in the notes. Presenting the information in the statement of financial position would make that statement too extensive and result in reduced clarity. If the IASB, despite our views, wants the information on the face of the financial reports, we support that the right-of-use assets and the liabilities should be presented separately.

*(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?*

In our opinion, the lessor should disclose the information in the notes; otherwise the information would be too extensive and less understandable.

*(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?*

We think it is sufficient that the lessor discloses the information in the notes. The reason is the same as in 12 (a) and (b).

*(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?*

Assuming that intermediate lessors should recognise leased assets in the balance sheet, our view is that an intermediate lessor should disclose all information related to leases in the notes. Presenting all lease-related items in the statement of financial presentation would make that statement too extensive and it would result in reduced clarity. But we also question if an intermediate lessor should recognize leased assets in the balance sheet. Please refer to our comments under question 18.

### **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?*

According to paragraph 26 lessees shall present amortization of the right-of-use asset and interest expense on the liability to make lease payments separately from other amortization and interest, either in profit or loss or in the notes. In our view disclosures in the notes would be sufficient.

In our opinion a lessor under the performance obligation approach shall present interest income, lease income and depreciation expense in the notes. Presenting the information in the statement of comprehensive income would make that statement too detailed and less clear. Also, according to IAS 1 it is not a requirement to present depreciation/amortization on a separate line in the statement of comprehensive income.

According to the ED, a lessor under the derecognition approach shall present lease income and lease expense in profit or loss either in separate line items or net in a single line item so that the lessor provides information that reflects the lessor's business model. We think that this sometimes may cause difficulties. If, for example, a lessor's business model uses leases both as means of realizing value from the goods it would otherwise sell and also for the purpose of providing finance, how should this be presented in the statement of comprehensive income? We also think that there sometimes may be difficulties to assess whether lease income and lease expenses should be presented gross or net.

Regarding the requirement to present interest income from rights to receive lease payments separately in profit or loss, we do not agree as other types of interest income are not presented separately.

**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?*

In general we are very hesitant to disclose this information separately in the cash flow statement due to the following reasons.

Separating the leases in the cash flow statement would force companies to disclose this information on a quarterly basis. The information, depending on the business, would also include information about leases from customers/contracts which might put companies in an unfavorable position towards other companies.

There might be certain problems extracting the information, i.e. will the information be available on such detailed level? There will be more pressure to look over the lease contracts and split services and leases etc. which in turn will create more work effort and consequently will be very costly.

The notes would only be visible in the annual report which does not reveal as much confidential information as it would do on a quarterly basis. However, it would somehow be the same situation as for the cash flow statement, i.e. more information would be needed in the notes which companies might not want to disclose or the information might not be available. Also, more detailed information in both cases (notes and statement) might raise more questions from analysts and auditors.

Also, we also want to draw the Board's attention to the question how to present cash flows related to sale and leaseback transactions. It is not clear from the ED how cash flows related to such transactions classified as "financing" should be presented. Please also refer to our comments under question 11.

In the project for Financial Statement Presentation major changes have been proposed for particularly the statement of cash flows. We anticipate even more difficulties to present the suggested information according to the Staff draft of Financial Statement Presentation, than according to the proposal in ED Leases.

**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?*

This might put companies, depending on the business, in a position where they would have to disclose information about their contracts which will not be favorable from a competitive point of view.

Both from a lessor and a lessee perspective it might be a problem as it would reveal information about the business that, as mentioned above, would not be favorable from a competitive point of view, i.e. customer and business confidentiality. Also, there might be problems with regard to companies' IT systems supporting this, i.e. the information might not be available.

## **Transition**

### **Question 16**

*(a) The exposure draft proposes that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186–BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?*

We would appreciate a fully prospective approach. If the simplified retrospective approach is used it will be very time-consuming to go through all outstanding lease agreements at transition. However, as we are aware of the purpose of these suggested new accounting rules for leases, to enhance comparability between entities, we understand such an approach would not be favorable for comparability. We agree with the proposal based on the discussion held in the Basis for Conclusions, not taking outstanding lease requirements at the transition date into consideration would reduce the usefulness of information provided to users of financial statements.

*(b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?*

We believe that a full retrospective approach should be permitted, if a simplified retrospective approach will be the transition rule.

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

We believe that it is essential that the transition period is long enough to give preparers time to implement the amendments.

## **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?*

We do not agree with the assessment that the benefits of the proposals would outweigh the costs. Our assessment is among other things based on the following observations.

The proposal would lead to less financing alternatives for entities indicating higher financing costs on an overall basis. This will probably lead to a changed business model for many entities and we believe changes in financial reporting rules should not be the driver for changes in the business model.

The Board should be aware that we as preparers foresee an immense work load in analyzing all operating lease contracts including non-core assets as, for e.g. office buildings and large number of contracts of immaterial amounts. In our view this cannot be defended from a cost-benefit perspective. Even though we expect the materiality guidance of IAS 1 to be valid, this will be of little help for the preparers.

Furthermore, requiring optional lease periods and contingent rentals to be included in the recognition and measurement of leases will add significant complexity since management decisions on whether to extend the leases would be required on a very detailed level. The costs for such estimates will be high and as we have stated previously in this letter, we do not believe that this will improve decision usefulness. Assessments of optional periods in the long future creates new planning processes in the companies as normal planning processes seldom covers more than three to five years. As these decisions often are of strategic nature the processes must involve both top management and planning departments. The processes could be very complex and will be very costly both to develop and to continuously run.

Extensive investments in information systems will also be required to meet the suggested new disclosure requirements etc., especially the need to distinct the service part. The extensive investments will only be an initial cost, the cost of maintaining the systems and keeping the contracts up to date will add to the yearly cost.

Short-term leases measured at the undiscounted amount of the lease payments described in paragraphs 64 and 65 will not be a simplification as an asset or a liability with a maturity within one year would never be discounted anyway. This proposal would therefore not be of any real help to the preparers.

## **Other comments**

### **Question 18**

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

Our answers to the questions related to presentation are based on the current version of IAS 1 Presentation of Financial Statements. We believe that presentation of leases in accordance with the staff draft to Replacement of IAS 1 and IAS 7 would result in even more reduced clarity of the financial statements.

In addition, we also would like to make a comment regarding intermediate lessors. The ED is not specific about the treatment of intermediate leasing. What we understand is that the

income only (not revenue or costs) should be recognized in the income statement but gross amounts in the balance sheet. This is inconsistent. Also, the term “Right to Use” indicates that it is an asset used by the company which never is the case of assets where the company is only the intermediate. Such leases should not be recognized in the balance sheet of the intermediate lessor.