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IASB

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To whom it may concern,

The Institute of Certified Public Accountants in Ireland welcomes the opportunity to comment on:

‘ED/2010/9 Leases’

Introduction

We are of the view that the present IFRS 17 should be retained as the proposed ED raises new problems whilst trying to resolve old ones. The judgment issues in determining whether to use the “performance obligation approach” or “de-recognition approach” replaces the judgment issues in determining whether a lease is an operating lease or finance lease.

Secondly until there is universal agreement on the precise definition of assets and liabilities it is likely that this standard will be revisited again.

Thirdly it has not in our view been demonstrated as to how additional clarity is achieved under the performance obligation by including a corresponding credit amount that may or may not satisfy the test of liability under IAS 37 except by coincidence.

If it is proposed to mandate the ED in its current form as a standard then we would prefer the de-recognition model only to be applied to lessors. The option to use both models may lead to different presentation for the essentially the same set of circumstances because differing judgements have arisen as to what constitutes retention of substantial risks or benefits.

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?

We are of the view that the distinction should continue to be made between Financial Leases and Operating leases. To avoid companies circumventing the substance over form in relation to the acquisition/use of such asset it might require the present standard to restore the old criteria of 90% of the benefits consumed by the lessee. Additionally such a standard might include a range of say 75% to 89% requiring an explanation of why the lease is not treated as a finance lease.

(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?

We believe it should be determined in accordance with the present IAS 17.

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?

We believe that the problem of having two approaches for the lessor may lead to similar transactions by different companies engaged in the same activity arriving at different treatments based on differing judgments. If the present ED is to be mandated then the de-recognition approach only should be permitted for the lessor.

(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 don't agree with the liabilities computed under the performance obligation as issue of the liability should be determined by IAS 37 not a derived "balancing credit" amount for lease receivable debit amount. The liability and probability of its occurrence may be different from the probability of the discounted future streams of income that comprise the lease receivable.

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?

What if the lease is one year and one day? or some short post cut off period. Perhaps a short term lease should be defined as period where the discounted and undiscounted amounts are not materially different. For example there could an 11 month lease involving hundreds of millions of Currency Units where the difference between discounted and undiscounted amounts are material. On the other hand there could be lease for say 15 months where given the amounts involved result in the discounted and undiscounted amounts not being materially different.

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?

We agree with the definition having regard to B1 and B 22 to B 24

(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?

We agree with the definition.

(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?

Yes

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?

Pending production of a finalised draft of the standard we have no comment at this point.

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 are of the view that the service component should be accounted for separate to the lease component and therefore proposal 3 from the IASB should be applied in all cases by both the lessee and the lessor. We are of the view that the methodology set out in exposure draft Revenue from Contracts with Customers can be used to estimate a standalone selling price.

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 only account for purchase options when they are exercised. The mere existence of a purchase option in an agreement is not sufficient to recognize a purchase/sale as there is no guarantee that the option will in fact be exercised. Once a purchase option is exercised and legal ownership of the asset passes from the seller to the purchaser the lease contract should be considered terminated. Further clarification is required regarding options to extend a lease term in particular criteria prohibiting the use of indefinite extensions. But the existence and terms of options should be disclosed in the notes to the accounts.

Question 8: Lease term

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

We disagree with the proposal that the lease term should be 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. We are of the view that it is inappropriate to account for lease extensions as if they were exercised. The proposal in the exposure draft could result in entities recognizing assets and liabilities associated with lease extension options that are never exercised. Instead we propose that lease term extension periods should only be included in the lease term where the exercise of the extension option is virtually certain. We consider that it is more appropriate to disclose lease options rather than recognize them in the statement of financial position.

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 agree with the proposals regarding contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease provided they can be measured. However we are of the view that such contingent rentals and expected payments should only be recognized if they meet the definition of a liability for the lessee and an asset for the lessor.

Question 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

We agree that lessees and lessors should remeasure assets and liabilities arising under a lease when there are significant changes to estimates of lease terms and contingent payments. However it is our view that guidance be included on what is regarded as a 'significant change'.

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?

Yes we agree. The proposed arrangements and the definition of "transfer" provide for a much clearer definition of what is a Financing Arrangement and makes it more difficult to classify what are effectively financing arrangements classified currently as Sale and Leaseback Arrangements.

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?

Yes we agree

(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?

Yes we agree

(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 believe that the right to receive lease payments should be disclosed separately from other financial assets because of the differences in nature that can exist between leases and other financial assets. If the management are of the opinion that there is little difference between the right to receive lease payments and the other financial assets then they need not be disclosed separately in the balance sheet but should be disclosed in the notes to the accounts.

(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

We do not see any reason to disclose sub-leases separately.

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?

If the item is part of normal activities we see no need for separate disclosure.

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?

If the lease income or expense is part of the normal business activities, for example a leasing co, we do not see the need to disclose it separately apart from disclosing financing items under the appropriate item in the cash flow statement. For providers of finance the amount of financing income or expense will be required to be disclosed under the requirements of other IFRSs.

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?

Yes we agree. This improves the usefulness for users, particularly any information that will assist or provide more information to clarify uncertainties in future cash flows or assumptions made in the preparation of financial statements.

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?

On balance we think the proposals for lessees and lessors to use a simplified retrospective approach to recognise and measure all outstanding leases at the date of initial application is appropriate.

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

We are of the view that full retrospective application on lease accounting requirements should not be permitted in order for users of financial statements to more readily understand the transitional arrangements.

(c) Are there any additional transitional issues the boards need to consider?

If yes, which ones and why?

There are no additional transitional issues the boards need to consider.

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?

Although the evaluation of the benefits and costs of the proposals is subjective we are not convinced that the benefits of the proposals would outweigh the costs. In particular we are of the opinion that the new lease model would not change the way a business operates or that it would achieve benefits to the business but it could result in significant costs because of the requirement for a fundamental change to management and financial reporting.

Question 18

Do you have any other comments on the proposals?

We do not have any other comments on the proposals except we would again direct your attention to the introduction as set out on the first page of this response.

The Institute of Certified Public Accountants would be happy to discuss the above with you.

Yours sincerely,

Declan Nestor
Chairperson, Financial Reporting Sub - Committee