

# SIEMENS

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## – Siemens AG’s response to the IASB Exposure Draft “Leases”

Dear Sir/Madam,

Siemens appreciates the opportunity to respond to the proposals set out in the Exposure Draft “Leases”. We support that the IASB and FASB (“the boards”) jointly undertake a project on lease accounting facing the conceptual and practical problems of existing leasing standards and interpretations.

While we believe that a right-of-use model for lease accounting can provide useful information, in our opinion a thorough analysis for accounting of executory contracts (including leasing and service arrangements) from a conceptual point of view within the framework project is needed before such considerable change in lease accounting is implemented. We are not convinced that the proposed criteria carried over from IFRIC 4, Determining Whether an Arrangement Contains a Lease, provide the necessary robust and operational distinction to determine the (possibly very different) accounting treatment.

Please find below our other key concerns:

- We disagree with the board’s proposal to include expected payments under contingent rentals and term options in the measurement of lease assets and liabilities. In our opinion the proposed approach is not consistent with the framework, it might generate information that diminish the usefulness of financial reporting by not appropriately reflecting the flexibility of contingent rentals and term options, it often would lead to an unreliable measurement of lease assets and lease liabilities and is burdensome and costly to preparers.

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- Referring basically to the same reasons we disagree with the boards' proposal to 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.
- We disagree with the proposed two accounting model approach for lessors (the performance obligation approach and the derecognition approach). In our opinion the proposed approach relocates the actual problems and discussions about operating lease versus finance lease to lessor accounting. We do not see the proposed model's improvement on decision usefulness as compared to current accounting.
- We disagree with the high hurdle set in the Exposure Draft that allows for sale and leaseback accounting. Furthermore, lacking appropriate application guidance in the Exposure Draft, in our opinion it often remains unclear what degree of continuing involvement would prevent sale and leaseback accounting.

In our conclusion the costs that would arise at transition and while the ongoing application of the proposals outweigh its benefits. Please find our detailed comments to the questions raised in the Exposure Draft below.

Should you have any questions or wish to discuss any of the issues in more detail please do not hesitate to contact Nikolaus Starbatty ([nikolaus.starbatty@siemens.com](mailto:nikolaus.starbatty@siemens.com), phone 49 89 636 36371).

Sincerely yours,

Siemens Aktiengesellschaft

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## Comments on the specific questions raised by the boards

### Question 1: Lessees

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

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

(a)

**While we believe that a right-of-use model for lease accounting can provide useful information, in our opinion a thorough analysis for accounting of executory contracts from a conceptual point of view within the framework project is needed before such considerable change in lease accounting is implemented.**

First of all, independent of the fact that leasing needs to be regarded in the context of other arrangements we are ambivalent regarding the right-of-use model.

- On the one hand we agree with the boards' conclusion that a right-of-use asset represents an asset to be recognised under the framework and the liability to make lease payments represents a liability to be recognised under the framework in a simple lease (i.e. a lease excluding options and contingent rentals). Furthermore, we understand that the removal of the current hybrid approach of operating leases versus finance leases is desirable from a conceptual view.
- On the other hand applying the right-of-use model to all leases on the lessee side in our understanding is based on the view that each leasing arrangement primarily is a financing arrangement, assuming implicitly a lessor purchases an asset by way of a bank loan. Instead of recognising rental expense a lessor would recognise interest expense and amortisation expense in profit or loss under the right-of-use model. While we agree with this view regarding long-term leases, in our opinion in a short-term lease ("short-term lease" not necessarily in the meaning of the Exposure Draft) this view is not appropriate: The lessee in a short-term lease simply pays a charge to use the asset for a specified period. To an extreme, renting a hotel room for one night in our view primarily has not a financing feature; rather the lessee incurs an operational charge to pay the rental. We note that in our opinion this aspect is appropriately addressed in the current differentiation and terminology of *operating* leases and *finance* leases.

However, on balance we can support the right-of-use model for lessees ignoring that leases need to be regarded in the context of other transactions.

We are aware of the conceptual criticism of the current lease accounting model under IAS 17 and we note that the proposed right-of-use model constitutes a fundamental change to lease accounting. Furthermore we understand the conceptual assumption behind the right-of-use model that

views an asset as a bundle of rights that can be divided and separately transferred. However, we strongly disagree to adopt a fundamental change to lease accounting without deliberating arrangements that might be similar to leases. The impact on profit or loss, on the statement of financial position and on the statement of cash flows under the proposed lease accounting model might be fundamentally different to the accounting for sale, licensing or service arrangements. For example the boundary between leases (particularly those that are currently accounted for as operating leases) and service arrangements is difficult to determine. We are not convinced that the proposed criteria carried over from IFRIC 4 provide the necessary robust and operational distinction to determine (the possibly very different) accounting treatment.

- Before such considerable change in lease (lessee) accounting is implemented, in our opinion a thorough analysis for accounting of executory contracts from a conceptual point of view is needed. Such discussion in our opinion should be part of the conceptual framework project. We disagree in content and form with the lean discussion under BC7b of the Exposure Draft. There the boards argue that in contrast to an executory contract in a lease arrangement (lease) assets and liabilities arise because the lessor provides access to an underlying asset creating both unconditional rights and liabilities. According to the boards this rationale justifies a significant different accounting from leases to executory contracts. In our opinion the proposed approach creates an inconsistency, as IFRSs would not require the recognition of liabilities for unavoidable firm commitments to acquire services.

Furthermore in our opinion it is not acceptable to change to a fundamentally new lease accounting model that is based on *rights* to use an asset and thereby excluding intangible assets from the scope of the Exposure Draft for the moment simply by stating that accounting for intangible assets afterwards (after the leasing project) would be considered more broadly (BC36). If after decades of a generally accepted lease accounting model the boards consider to implement a lease model that views a lease as a transfer of rights of an underlying asset, in our opinion this is the time to consider accounting for intangible assets comprehensively (i.e. in the context of IAS 38) and conceptually (i.e. in the context of the framework).

(b)

**Although we have concerns with the timing of expense recognition over the lease term under the proposed lessee accounting model we acknowledge that recognition of amortisation and interest expense is consistent with the right-of-use model.**

As mentioned above we have concerns to understand leases that are currently classified as operating leases primarily as financing arrangements that generate interest expense and amortisation expense in the statement of comprehensive income, instead of rental expense. Recognising interest expense will affect the timing and pattern of expense recognition for lessees that currently classify leases as operating leases. For many leases, the total lease expense recognised (i.e. sum of interest expense and amortisation) will be higher in earlier periods of a lease and lower in later periods.

Assume at the end of a lease term the lessee decides to renew the existing lease. At this point, the expense will jump dramatically as the lessee moves from the last year of the old lease (i.e. the lowest expense period) to the first year of a new lease (i.e. the highest expense period). Thus, the lessee would experience significant fluctuations in expense based solely on the timing of lease terms, even though the asset being utilised remains basically unchanged.

As the lessee's benefit arising from the lease is his right to use the leased asset, the lessee often receives the benefits on a straight line basis over the lease term. According to the IFRS framework (F95) expenses shall be recognised in the income statement on the basis of a direct association between the costs incurred and the earnings/benefits received ("matching principle"). We note that the expense recognition under the proposed right-of-use model may conflict with the matching principle.

## 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?

(a)

**Summarized Siemens does not completely agree with the proposed accounting model for Lessors. This assessment is based on several significant concerns we set out below. We would propose to define one model as obligatory.**

One of the main intentions of the boards to redesign lease accounting was the elimination of the existing two model approach of operating lease vs. finance lease. From our perspective the proposed approach relocate the actual problems and discussions about operating lease vs. finance lease to lessors accounting. To satisfy the proposed lessor accounting the entities need to solve the same problems and questions compared to the existing world. This should be avoided as this does not lead to a well-defined and explicit accounting.

In relation to the proposed two concept approach we would recommend a single lessor accounting model. Based on the existing comments we noticed, that it seems to be difficult to identify a favourable concept, both models have pros and cons. Based on the Exposure Draft Siemens would prefer the derecognition approach.

We believe that the derecognition model should be the only model available for the lessor as this would significantly reduce the complexity and subjectivity in distinguishing between two approaches. The derecognition approach requires to recognise a lease receivable and a residual asset which is similar to a finance lease under IAS 17 and better reports the economics of the transaction than the performance obligation approach.

In our opinion, reporting both the asset and the lease receivable as required in the performance obligation approach does not make sense as it results in two assets being recorded for one economic resource. Another issue we notice in relation to the performance obligation approach is of conceptual kind. We understand that the phrase of “risks and benefits” is equivalent in meaning to “risks and rewards”. Using this model for lessor accounting seems to be inconsistent with the paradigm shift from a “risks and rewards” to a “control” model that the board have recently proposed in ED/2010/6 Revenue from Contracts with Customers. From our view the main concept of lessor accounting and revenue recognition cannot be considered separately. In particular in the point of distinguishing between lease and purchase or sale the leasing concept should be in line with the idea as presented in Exposure Draft on revenue recognition. Consequently the used model of “risks and benefits” should be reassessed.

Nevertheless we are in doubt if the derecognition approach is conceptually consistent with the framework. From our perspective the “residual asset” approach is not in line with the framework, in particular with the principle of “historical cost”. Under historical cost accounting a non-monetary asset is no more than a deferred cost; a cost which has been incurred before the balance sheet date and, in terms of the accruals concept, relates to future periods beyond the balance sheet date, thereby justifying it being carried forward as an asset. Based on this a split of an asset as described in the proposed approach is highly questionable and should be reassessed from a conceptual point of view.

Assuming the two-model-approach it is not clear to us, why there is no subsequent reassessment of the applicable lessor model allowed when terms change. This seems to be insufficient for contract amendments or changes of some important details which would lead to the other accounting model.

Another question is, why the factor of the effective IAS 17.10 (d) (present value of the minimum lease payments compared to the fair value of the leased asset) is not included in paragraph B22.

And again assuming the two-model-approach Siemens would recommend to include for example BC27 in the standard. In particular BC27 comprises information or regulations respectively which should be included in the standard.

(b)

**With regard to the proposed model the recognition of assets, liabilities, income and expenses is conclusive as this seems to be consistent with the proposed model. Neverthe-**

**less we believe that the proposed model will impose excessive one-time and ongoing costs on preparers of financial statements.**

In contrast to the costs related to implementing the proposed model, we do not see the proposed model's improvement on decision usefulness. The boards have not yet sufficiently demonstrated any improvements that justify such immense costs.

To reflect the impact on the cost side we would like to have a detailed view on one particular regulation. As according to the Exposure Draft the lessor should remeasure the right to receive lease payments (the lease receivable) when changes in facts or circumstances indicate that there is a significant change 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 period. The accounting treatment depends on whether

- the lease is accounted for under derecognition approach or the performance obligation approach;
- the change arises from a change in the lease term or from changes in the contingent payments (including expected payments under term option penalties and residual value guarantees); and
- the change relates to a past for future period (in some cases).

Those requirements need to be reflected in the existing IT-systems. Significant changes would need to be made to systems and procedures to capture information needed to continuously reassess the lease receivable. The reassessments would be just as subjective as the original estimates of expected lease term and expected lease payments at the inception. Siemens would like to point out, that those reassessments are based on management judgement and are subjective and difficult to verify. Allocating changes in contingent rentals, term option penalties, and residual value guarantees to prior and future periods may not be as straightforward forward in actual practice as it may seem in theory.

We cannot see any benefit for users of financial statements as the financial statements of several entities might not be comparable. Given the volume of contracts, the costs of ongoing compliance would be significant. We urge the board to reconsider if any perceived benefit justifies the cost.

Under the derecognition approach, the lessor would not remeasure the residual asset except for impairment. Similar to the lessee impact, the right-of-use model would affect the timing of income recognition for lessors. For the performance obligation approach, interest income under the effective interest method would be higher in a lease's early years compared to the current straight-line recognition of an operating lease's rental income.

### 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?

**Siemens welcomes the proposal on the lessor side; however, Siemens does not believe that the proposal on the lessee side provides an appropriate relief.**

Generally, we are ambivalent about the concept to explicitly define and specify how to account for so called “short-term leases”: From a conceptual perspective the issue about short-term leases appears to be a materiality matter and a (principle-based) standard only should be applied to material transactions anyway. Therefore accounting for minor leases would be subject to the general materiality considerations without specifying bright lines (here twelve month), which might lead to structuring leasing arrangements. From a preparer perspective, however, we welcome application guidance in some circumstances. If the boards wish to continue with a definition of minor leases we question whether referring to the term of a lease (“short-term leases”) instead of the financial impact of a lease (e.g. unavoidable minimum lease payments) is the appropriate criteria. BC41 of the Exposure Draft states that the definition of short term in the Exposure Draft Leases is consistent with the distinction between long-term and short-term in IFRSs. We are not aware that in other IFRSs simplified recognition, measurement or presentation provisions exist for short-term items.

The boards’ rationale for defining short-term leases and providing specific accounting guidance is to provide “simplified accounting requirements” (BC45) to “mitigate concerns about the costs” (BC44). We welcome this objective. In our opinion for lessor accounting in short-term leases this goal is met by the proposals in the Exposure Draft. For lessee accounting in short-term leases this goal, however, is not achieved in our opinion: The main burden for lessees of applying the pro-

posed model to short-term leases in practise is the cost of identifying and tracking a large number of expected lease payments that may be contingent. In comparison discounting the lease payments is less complex. Furthermore, ignoring discounting for short-term assets and liabilities is a general measurement consideration based on materiality (explicit IAS 37.46 in the context of provisions) anyway. Therefore, if the boards may continue with a specific approach for short-term leases, we suggest lessees to account for basically as operating leases under today's IAS 17.

Furthermore we note that the Exposure Draft is unclear about the presentation of lease payments of the lessee in short-term leases in the statement of comprehensive income. The boards should specify whether the lessee should present amortisation expense or lease expense.

#### 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)

**From our perspective the lease definition shows some major weaknesses which should be addressed in further deliberations.**

The proposed guidance would apply to all leases, except for:

- Leases of intangible assets
- Leases to explore for or use natural resources (such as minerals, oil and natural gas)
- Leases of biological assets

Subleases are included within the scope of the Exposure Draft. The definition of a lease is generally the same as current US-GAAP. Based on the exclusions specified in the proposed guidance and the boards' deliberations, we believe that this standard will essentially apply to leases of property, plant and equipment. However, as current US-GAAP specifies that only leases of property, plant and equipment are subject to lease accounting standards and the proposed standard uses a scope that includes all leases with specific exclusions, certain scope changes could occur. For example, it would appear that, based on the definition and exclusions included in the Exposure Draft, inventory could be the subject of a lease for accounting purposes. Existing lease accounting

guidance does not currently apply to inventory. While we do not believe it was the boards' intent to expand the contracts considered leases beyond those considered leases under current accounting, companies should assess their arrangements to determine if the change in description of the scope of lease accounting could result in arrangements that were not previously considered leases to be within the scope of the Exposure Draft.

Please note that the scope of the new leases standard is of heightened importance as the accounting for leases will be dramatically different from non-lease executory contracts.

(b)

**In addition to the conceptual issues addressed in our answer to question 2a) we think, that the Exposure Draft does not provide sufficient guidance for making a determination if both control and all but a trivial amount of the risks and benefits associated with the underlying asset are transferred.**

The existing guidance that leases which automatically transfer title to the underlying asset or contain a bargain purchase option would normally meet the criteria (paragraphs B9 and B10) for distinguishing a lease does not cover critical cases as presented in practise. However, in our opinion some parts of the proposed standard are not self-evident and we recommend working out robust definitions instead of clarifying the standard in the application guidance.

In addition, the Exposure Draft describes a bargain purchase option as an option to purchase the asset at a price that is expected to be significantly lower than the fair value of the asset at the date that the option becomes exercisable. Current accounting practice also considers if an economic penalty creates a bargain purchase option. For example under current practice a lease of a specialised asset with no suitable alternative that contains a purchase option may be deemed to be a bargain purchase option even if the option is at a price that approximates fair value. As proposed in the Exposure Draft, it would not appear that similar consideration of economic factors would be appropriate.

(c)

**Determination of whether an arrangement contains a lease will have significant accounting implications under the proposed model.**

Using the proposed guidance in paragraph B1-B4 in fact the criteria for determining what is or is not a lease is not changing. Considering the fact, that the treatment of leasing contracts and service contract differs from actual regulations, that determination for many arrangements will take on increased importance. As the current accounting for operating leases and service contracts is often similar, determining that a service arrangement contains a lease classified as an operating lease generally does not result in significantly different accounting for the arrangement. That is, a service arrangement with an embedded operating lease is often accounted for similarly to a service arrangement that does not contain a lease. The differentiation needs to be presented in the

disclosures under IAS 17. Under the proposed guidance, any embedded lease in an arrangement will result in the recognition of lease assets and liabilities. As such, the determination of whether an arrangement contains a lease will have significant accounting implications under the proposed model.

Further, certain contracts were grandfathered under EITF 01-8 and therefore current US-GAAP guidance is not applied in determining whether a contract is or contains a lease. Under the proposed model, these contracts will need to be assessed upon transition.

### **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?

**Without including the important case of lease of intangible assets a comprehensive concept could not be designed reasonably.**

The Exposure Draft excludes among others leases for intangible assets. IAS 17 includes scope exclusion covering similar types of assets. However, the IAS 17 scope exclusions list individual assets whereas the Exposure Draft proposes scope exclusions for classes of assets, as noted in our response to question 4.

From our understanding the leases for intangible assets should be considered when developing a fundamentally new concept for leases.

### **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?

**Summarized Siemens agrees with FASB's proposal, that the lessee and lessor should apply the lease accounting requirements to the combined contract.**

To identify all separately accounted for service components within a lease, entities will perform the following three-step process at inception of the contract:

Step 1: Identify performance obligations

Step 2: Determine if the service is distinct

Step 3: Allocate the payments between the lease and service components

In relation to step 1 we refer to our comment letter to the Exposure Draft revenue recognition (comment letter no. 210). We do not completely agree with the proposed principle of performance obligation. In our opinion the distinction between the principles for the segmentation of contracts and the identification of separate performance obligations is not clear, because both contain the criterion "the entity, or another entity, sells an identical or similar good or service separately". Further, there is no guidance how a distinct bundle of goods or services should be accounted for adequately, if the goods or services in the bundle have different patterns of performance.

Assuming a contract that contain service and lease components (not distinct) and assuming the options given we support the idea to apply lease accounting to the whole contract for lessee and lessor. In particular in cases of sublease arrangements when the same entity is a lessee in a head lease and a lessor in a sub-lease of the same asset this will lead to symmetrical treatment. Although we support the view to picture the economic substance of the transaction; we do not see a reasonable way to split a contract which includes components which are not distinct.

For practical purposes we would appreciate to apply accounting of service contracts on combined contracts and recommend a detailed description in the disclosures.

In addition we disagree with the idea of applying different rules depending on which accounting approach is used for services that are not "distinct". This appears illogical and treats the same economic event differently. The combining or separating should be the same regardless of which accounting method is applied

## 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 disagree with the board's assessment that purchase options should be accounted for different from options to extend a lease. Based on our suggestion not to include options to extend in the measurement we propose keeping current guidance for purchase options: Payments under purchase options should only be included in the measurement if it is reasonably certain that the purchase option will be exercised.**

We disagree with the Exposure Draft's assessment of the economics of purchase options and agree with the boards' prior view it had on purchase option in the preceding March 2009 discussion paper:

*"The boards noted that purchase options can be viewed as the ultimate renewal option. Providing a purchase option is no different from providing renewals that extend over the entire economic life of the leased item. Consequently, the boards tentatively concluded that the accounting requirements for purchase options should be the same as for options to extend or terminate the lease." (Discussion Paper Leases, Preliminary Views, March 2009, paragraph 6.56)*

We share the boards' prior view that from an economical perspective a purchase option is the ultimate renewal option to obtain/transfer the remaining rights of use and that a purchase option is integral to its underlying lease arrangement.

The Exposure Draft proposes

- to include options to extend the lease term in the measurement of the lease asset and lease liability,
- to ignore purchase options until exercised and

- refer to bargain purchase options as an indicator that an arrangement qualifies as a sale/purchase.

Proposing substantial different accounting concepts for renewal options and purchase options that in our view are economically similar raises some questions: Assume for example a 20 year lease provides a purchase option after four years (that is not considered a bargain purchase option) that is considered more likely than not to be exercised by the lessee after four years. According to the Exposure Draft purchase options should only be accounted for when exercised. Therefore in our view it is unclear whether the most likely term (four years) is relevant though this term can only be realised by exercising the purchase option.

The proposed concept to exclude purchase options until they are exercised might also lead to a different presentation of similar arrangements. A lessee that wants to use an asset either for three years or over its entire useful life of five years might structure an arrangement as following: The lessee might conclude a non-cancellable lease contract with a term of three years with either (a) an option to extend for another two years or (b) alternatively with a purchase option after three years. Economically the substance of both arrangements is similar as the lessee in both scenarios has the option to use the asset over its total useful life of five years. According to the proposals in the Exposure Draft in the case of the option to extend the lessee initially measures the right-of-use asset and the liability to make lease payments based on five years; in the case of the purchase option only based on three years. Therefore the lessee that will exercise the purchase option initially recognises a lower asset and liability, although the payments under the purchase option might be higher than the rentals for the option to extend. In our view this would provide information that is not decision useful and relevant.

Based on our suggestion not to include options to extend in the measurement (see our comments to question 8 below regarding the lease term) we propose to keep current guidance for purchase options: Payments under purchase options should only be included in the measurement if it is reasonably certain that the purchase option will be exercised.

#### **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 a lessee or 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. In our opinion the proposed approach (a) is not consistent with the framework, (b) it might generate information that diminish the usefulness of financial reporting by not appropriately reflecting the flexibility offered by term**

**options, (c) it often would lead to an unreliable measurement of lease assets and lease liabilities and (d) is burdensome and costly to preparers.**

(a) In our view the proposed approach is not consistent with the framework. For instance a lessee enters into a lease with an option to extend. If the lessee would consider it more likely than not to exercise the option to extend he would recognise a liability to make lease payments at an amount that is not due to an unconditional present obligation as it is at the lessee's discretion to extend or not in a future period. Also a lessor in a lease with an option to extend at the lessee's discretion (that the lessor considers that it is more likely than not that it will be exercised) would recognise a lease receivable at an amount for which the lessor neither has an unconditional right to receive lease payments nor control.

Other current IASB/FASB projects in our opinion are dominated and directed by conceptual considerations (e.g. projects on financial statement presentation and on revenue recognition) rather than by practical needs. We note that in the context of the proposed lease term definition the boards identify the conflict with the framework. However, we are surprised, that the boards decided to propose a so called "practical solution" (BC117) and simply state (but do not reason) that excluding optional periods would lead to right-of-use assets and lease liabilities that are misstated (BC117). While we welcome the boards' intention to provide a practical solution its basis for conclusion should be explained in appropriate detail.

(b) Term options provide a lessee with flexibility to react to business opportunities or unfavourable developments and consequently term options reduce risks compared to fixed lease terms as stated by Stephen Cooper in his dissenting opinion on the Exposure Draft (AV2-4 of the Exposure Draft). The proposed accounting for term options in our opinion does not appropriately reflect the flexibility and therefore would diminish the usefulness of financial reporting. We think that including all lease payments in more likely than not optional lease terms overstates the right-of-use asset, the lease liability and related measures of financial leverage. Contrarily, on the lessor side, including optional lease periods in the measurement of the lessor's lease receivable under both the performance obligation and the derecognition model would underestimate the business risk of the lessor.

(c) We question that in many leases a reliable measurement of the lease term as proposed in the Exposure Draft is possible. Particularly lease contracts of real estate often have terms of 10 years, 15 years or even longer and include multiple and diverse kind of options to extend. The economic rationale for entering into a lease as a lessee instead of buying an asset is to obtain flexibility. Therefore Siemens as a lessee in real estate leases often decides shortly prior to the end of the term whether to extend or not based on the specific business needs at this time. According to the proposals of the Exposure Draft lessees would be required to forecast activities in periods beyond their normal planning and budgeting cycle. Therefore the level of judgement and subjectivity inherent in the measurement of the lease liability and right-of-use asset would increase immensely. This refers to the identification of each possible term and even more to allocating probabilities to these scenarios. Exposure Draft B18 demands to include lessee's intentions and past practice in

the assessments. A lessor often is not aware of the lessee's anticipated decisions that may impact the likelihood of the renewals. We are concerned that "more likely than not" could result in a frequent reassessment which increases volatility in lease assets and liabilities, reduces comparability between entities and therefore would diminish the usefulness of financial reporting.

(d) According to (c) it would be burdensome and costly to generate and review for potential periodical reassessment these unreliable measures of lease terms.

Instead we suggest keeping current guidance: The lease term should be the non-cancellable period plus any options to extend or terminate if at the inception of the lease it is reasonably certain that the option will be exercised. Substantial qualitative and quantitative information regarding term options should be disclosed in the notes.

### **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 disagree with the proposal to include expected payments under contingent rentals and term option penalties in the measurement of lease assets and liabilities. Basically our view and argumentation is similar to our comments on the boards' proposals regarding the lease term (question 8).**

Regarding a possible conflict with the framework in our opinion it is necessary to distinguish contingencies about future rental payments

- which are based on the future use (e.g. number of hours a leased asset is used) or future performance (e.g. percentage of sales made from leased property) made of the asset from those
- that depend on the development of an index (e.g. LIBOR).

As usage of a leased asset is under control of the lessee and performance of a leased asset partly might be under control of the lessee, in our opinion such contingent rentals do not meet the definition of an unavoidable current obligation; rather the obligation results from a future decision of the lessee. Regarding the boards' proposal regarding contingent rentals that are based on an index we agree to include them in the measurement of lease assets and liabilities.

Furthermore we doubt that a reliable measurement of future contingent rentals is often possible as it requires forecasting activities in periods beyond the normal planning and budgeting cycle. On the lessor side estimating future expected contingent rentals leads to recognising revenue that might be reversed in a later period if there is a subsequent reassessment. In our opinion such a “currently expected” meaning of revenue would diminish the usefulness of financial reporting.

Including contingent payments in the measurement of the lease asset and lease liability also would be burdensome and costly to preparers. Based on the nature of contingent payments, contractual features and a number of possible scenarios would need to be considered in an expected outcome calculation. To perform this analysis for each lease could be a very time consuming and costly process. We note that the boards explicitly consider the alternative to exclude avoidable contingent payments (as under IAS 37) as more complex (BC125 of the Exposure Draft). We disagree with this statement. In our opinion, contrarily, the proposed approach to include expected lease payments in the measurement is by far more complex.

In summary we suggest keeping the current approach to account for contingent rentals: Contingent rental payments based on usage or performance of leased asset and unguaranteed residual value guarantee should be accounted for when incurred. Index-based lease payments should be included at the prevailing rate in the measurement of lease asset and lease liability as the rate at inception is in our opinion not contingent; rather the future changes are contingent and should be accounted for accordingly.

## 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?

**Since we disagree to measure lease assets and lease liability based on expected contingent lease payments (see our comments to question 9) in expected lease terms (see our comments to question 8) the issue of a periodical reassessment generally would not arise. Therefore our concerns about subjectivity, reliability, complexity and costs of a periodical reassessment would be circumvented.**

However, if the boards’ are going to proceed with an approach to include expected contingent lease payments in expected lease terms in the measurement of lease assets and lease liabilities we have the following comments:

We welcome the “trigger approach” in the Exposure Draft to reassess lease assets and lease liabilities only if facts or circumstances indicate that there would be a significant change in the liability since the previous reporting period.

The Exposure Draft proposes that a lessor in the derecognition model should reassess the carrying amount of the right to receive lease payments due to a change in expected contingent rentals after the date of commencement of the lease if facts and circumstances indicate that there would be a significant change in the right to receive lease payments. Furthermore, the boards propose to recognise any resulting changes in profit or loss. In our opinion an assumed increase in the expected future use of the leased asset might lead to a reduction of the carrying amount of the residual value asset.

The wording in paragraph 17, 39 and 56 of the Exposure Draft (“shall reassess the carrying amount... from *each* lease if...”) in our opinion is subject to interpretation what (features of) leases to reassess when facts or circumstances indicate a significant change. For instance, an entity is lessor of medical equipment. The expected future contingent rentals are based on the lessee’s usage of the equipment. Based on economic, social and political developments usage of the medical equipment may vary rapidly. Two interpretations might be possible regarding which leases to reassess:

- a) Each lease of the entity shall be reassessed. This includes reassessment of the lease terms, residual values and of all kind of contingent rentals of all leases.
- b) This leads to a reassessment of the contingent rentals of those leases of medical equipment that are affected by changes of these circumstances (e.g. outbreak of an epidemic, reorganisation of a governmental health system).

In our opinion interpretation (b) is appropriate; however, interpretation (a) is closer to the wording of the Exposure Draft. We ask the boards to make clear that the understanding under (a) is intended.

#### **Question 11: Sale and leaseback**

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 disagree with the high hurdle set in the Exposure Draft that allows for sale and leaseback accounting. Furthermore, lacking appropriate application guidance in the Exposure Draft, it often remains unclear what degree of continuing involvement would prevent sale and leaseback accounting.**

We note that the proposed changes to sale and leaseback constitute a fundamental change to current sale and leaseback accounting under IFRS.

Generally, under current IFRS the seller-lessee in a sale and leaseback transaction immediately recognises any profit or loss if the leaseback qualifies as in an operating lease; respectively any excess of sales proceeds over the carrying amount is deferred and amortised over the lease term if the leaseback qualifies as a finance lease. In the Exposure Draft the boards propose that if the transfer meets the definition of a sale the seller-lessee derecognises the asset, recognises gain of loss and accounts for the lease based on the general lessee proposals. If the transfer does not meet the condition for a sale, the seller-lessee shall account for the contract as a financing. According to the Exposure Draft a contract represents a sale of an underlying asset if an entity transfers to another entity control of the entire underlying asset and all but a trivial amount of the risks and benefits associated with the entire underlying asset. In paragraph B31 of the Exposure Draft the boards mention some conditions that normally preclude a sale.

We note that the Board intends to propose in the sale and leaseback context the same criteria for a sale as those to distinguish between sales and leases (BC162). However, we note that the boards added conditions in paragraph B31 of the Exposure Draft that a reporting entity should assess whether a transfer qualifies as a sale in the context of a sale and leaseback transaction. In our opinion this implies that the additional conditions in paragraph B31 set a higher hurdle to qualify as a sale in a sale and leaseback transaction compared to separate lease transactions subject to the provisions of B9 and B10.

While the conditions in paragraph B31 tend to set a hurdle that we generally consider too high, we question how to deal with them in practice. The Exposure Draft only lists factors to consider, however, there is no application guidance what extent or degree regarding these criteria hinders to assess a transfer as a sale.

- One of the conditions is “the seller-lessee guarantees the buyer-lessor’s investment or return on that investment” (paragraph B31b). The issue is unclear in our opinion: Does each leaseback that has a non-cancellable term constitute a buyer-lessor’s return that prevents a transaction being sale? If yes, does also a lease term that is minor relative to the remaining useful life of the transferred asset prevent the transaction from being sale?
- Another condition is “the seller-lessee’s rental payment is contingent on some predetermined or determinable level of future operations of the buyer-lessor” (paragraph B31g). Assuming a leaseback term that is quite short relative to the remaining useful life to the asset and furthermore the contingent rent portion is quite low relative to the total lease payments, in our opinion no useful information is provided if in such a transaction sale and leaseback accounting would be prevented.

Also regarding most other conditions in paragraph B31 it remains unclear at which degree of the seller-lessee’s continuing involvement a transfer is not considered a sale. Nevertheless the conditions in paragraph B31 imply a threshold that in our opinion is inappropriately high. As we clearly welcome principle-based standards, in our opinion paragraph B31 in fact does not constitute application guidance. If a final standard remained that vague in this context we would expect accounting literature to establish the relevant interpretation for sale and leaseback accounting rather than IFRSs, followed by a potential request to IFRIC.

In the basis for conclusion the boards state that deferring gains and losses arising from sale and leaseback transactions is inconsistent with the framework and would increase the complexity of the proposed requirements (BC164) without giving further explanation. In our opinion in certain sale and leaseback transactions deferring and amortising gains and losses provides useful information. We refer to the following rationale previously expressed by the FASB:

*“The Board noted ... the terms of the sale and the terms of the leaseback are usually negotiated as a package. Because of this interdependence of terms, no means could be identified for separating the sale and the leaseback that would be both practicable and objective. For that reason, the Board concluded that the present general requirement that gains and losses on sale-leaseback transactions be deferred and amortized should be retained.” (SFAS 13.107)*

Apparently, under the proposals in the Exposure Draft many sale and leaseback transactions would not qualify as a sale and therefore should be accounted for as a financing. Here, the seller-lessee would not derecognise the transferred asset and any amounts received should be recognised as a financial liability while in our opinion the recognition of a sale often would reflect the economic substance. We ask the boards to clarify how to account subsequently for the financial liability as the Exposure Draft does not include any guidance.

The Exposure Draft stipulates the purchaser/lessee to apply the performance obligation approach provided the transfer qualifies as a sale/purchase. While we understand the basic rationale we question whether situations may arise where alternatively the derecognition approach may be appropriate conversely. For instance, a buyer-lessor in a sale and leaseback transaction may obtain a third-party residual value guarantee such that the buyer-lessor does not retain exposure to significant risks or benefits associated with the underlying asset.

The Exposure Draft does not provide transition guidance regarding sale and leaseback transactions. Therefore it remains unclear how to account for transfers that previously qualified for derecognition of the underlying asset and recognition of profit and loss under current IFRS of the seller-lessee; however, under the proposed model it would not qualify for as a sale.

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

(a) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment or investment property as appropriate, but separately from assets that the lessee does not lease (paragraphs 25 and BC143–BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?

(b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of

financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

(c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

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

(a)

**We disagree to require separate presentation of right-of-use assets and liabilities to make lease payments in the statement of financial position; alternative disclosure in the notes may be appropriate. We agree with the proposal to present right-of-use assets as if they were tangible assets within property, plant and equipment.**

We agree with the boards' basis for conclusion that there are important differences between a right-of-use asset and an owned asset. For example, there may be greater financial flexibility for the payments associated with a right-of-use asset than for an owned asset or there may be greater risks because the lessee may need to replace the right-of-use asset at the end of the lease term (BC144). We note that also for owned assets there might be future cash outflows if the asset has not been paid yet. However, instead of requiring the lessee to present the right-of-use asset separately and the liability to make lease payments separately from other financial liabilities, in our opinion it is appropriate to disclose right-of-use assets and liabilities to make lease payments in the notes alternatively. According to IAS 1.55 an entity shall present line items in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position. Therefore, in order not to create an inconsistency with IAS 1.55, the boards should stipulate that based on the relevance to an understanding of the entity's financial position (e.g. relative importance of leasing as a lessee) right-of-use assets and liabilities to make lease payments should be presented in the statement of financial position or disclosed in the notes otherwise.

We ultimately agree regarding the proposal to present right-of-use assets as if they were tangible assets within property, plant and equipment. While we support the view that a *right-of-use* asset conceptually represents an intangible asset and accordingly the boards reference to IAS 38 (e.g. paragraph 11c, 20, and 23 of the Exposure Draft) and refer the term "amortisation" (e.g. paragraph 11b, 20, and 26 of the Exposure Draft) we agree that a lessee should present a right-of-use asset with property, plant and equipment. Thus, we agree that such classification pro-

vides useful information about the productive capacity of a business as expressed by the boards in BC143 of the Exposure Draft.

(b) and (c)

**Overall we support the proposed recognition of assets, liabilities, income and expenses as this seems to be consistent with the proposed model.**

We are not convinced by the presentation requirements for lessors applying a performance obligation approach. We think that the proposals reflect the ambiguity of the approach. BC148 of the Exposure Draft explains that the linked presentation is required because of the interdependency of the assets and liabilities originated by the lease transaction and because it alleviates the concern that under the approach both assets and liabilities are overstated in the statement of financial position. We agree with these points, but we think that they are a consequence of the approach.

Assuming the performance obligation approach we would suggest requiring a net presentation of the underlying asset and performance obligation. The lease receivable should not be included in the net total, because it is subject to a different type of risk (e.g. the lessor could transfer the receivable without terminating the lease arrangement). On the other hand, the underlying asset is strictly linked to the obligation to provide access. Siemens believes that presenting a net balance on the face of the statement of financial position (and providing a breakdown in the notes) would be a more effective way to mitigate the concerns about the “grossing up” effect of the performance approach rather than inserting an additional sub total line.

With reference to the presentation requirements for lessors applying derecognition approach, we note that IAS 16.6 defines property, plant and equipment as tangible items that:

- (1) Are held for use in the production or supply of goods or services, for rental to others or for administrative purposes; and
- (2) Are expected to be used during more than one period.

IAS 2.6 Inventories defines inventories as assets:

- (1) Held for sale in the ordinary course for business;
- (2) In the process of production for such sale.

The proposals for lessors applying the derecognition approach require a different presentation in the statement of comprehensive income based on the business model applied. Siemens believes that a similar distinction should be also made in the statement of financial position. If the lessor has to separate the lease income and expenses, in our view this implies the underlying assets are more associated to inventories than to items of property, plant and equipment and should be classified as such.

(d)

**We disagree to require distinguishing assets and liabilities that arise under a sublease in the statement of financial position; alternative disclosure in the notes may be appropriate. Depending on the transfer of risks and benefits from the head lessor to the sub-lessee in our opinion in certain situations a net presentation of head lease and sublease assets/liabilities in the statement of financial position would provide useful information.**

The boards underline that a head lease and a sublease are separate transactions. Therefore, the Exposure Draft proposes that an intermediate lessor in its capacity as a lessee would account for the assets and liabilities arising from the head lease in accordance with the lessee model proposed in the Exposure Draft. Similarly, the intermediate lessor, as a lessor in a sublease, would account for the assets and liabilities arising from the sublease in accordance with the lessor model proposed in the Exposure Draft. This could result in different measurements of assets and liabilities arising under a head lease and a sublease (reliability threshold only on the lessor side regarding lease payments, possible use of different discount rates). In our opinion it is appropriate to account net in certain sublease transaction. If a lessor in a sublease transfers all risks and benefits of a head lease to his sub-lessee a net presentation of head lease and sublease assets/liabilities in the statement of financial position would provide useful information if in the notes qualitative and quantitative information about nature and risk transfer of the transaction would be disclosed.

Regarding an intermediate lessor accounting for under the performance obligation approach in our opinion it remains unclear in paragraph 43 of the Exposure Draft if the liability to make lease payments under a head lease should be presented separately in the statement of financial position from liabilities to make lease payments in leases outside head lease/sublease arrangements. In our opinion it should not.

Regarding an intermediate lessor accounting for under the derecognition approach in our opinion it should not be required to present rights to receive lease payments and residual assets from subleases distinguished from those in a lease that is not a sublease. Analogue to IAS 1.55 the boards should stipulate that based on the relevance to an understanding of an entity's financial position such intermediate lessor's assets should be presented in the statement of financial position or disclosed in the notes otherwise. While we find the illustrative presentation of an intermediate lessor accounting for under the performance obligation approach helpful in paragraph B29 we would welcome such illustration under the derecognition approach as well.

### **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?

**We disagree to require presentation of lease income and lease expense separately from other income and expense in profit or loss.**

In our opinion according to IAS 1.85 lessees and lessor should present lease income and lease expense separately from other income and expense only when it is relevant to an understanding of the entity's financial performance. Otherwise separate disclosure in the notes is appropriate in our opinion.

We note that the Exposure Draft is silent regarding the presentation of additional expense associated with the current period adjustment of contingent rentals. Therefore it is unclear whether such expense would be presented as additional interest expense, additional amortisation expense or any other items of expense. We ask the boards to clarify this presentation issue to avoid diversity in practise.

According to the Exposure Draft a lessee should present amortisation of the right-of-use asset separately in profit or loss. The boards should explain separate presentation of amortisation if an entity generally chooses to present expenses by function according to IAS 1.103. We wonder whether lease expense that for example is part of administrative expenses should be excluded from the presentation of administrative expense.

We note that the Exposure Draft is unclear about the presentation of lease payments of the lessee in short-term leases in the statement of comprehensive income. The boards should specify whether the lessee should present amortisation expense or lease expense.

**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?

**We disagree to require separate presentation of cash flows arising from leases in the statement of cash flows.**

In our opinion, separate presentation of cash flows arising from leases in the statement of cash flows should only be required if it is relevant to an understanding of the entity's cash flows. Otherwise separate disclosure of such cash flows in the notes is appropriate in our opinion.

As mentioned above we have concerns generally to regard leases that are currently classified as operating leases as financing arrangements and thus to present such payments as cash flows

from financing activities. In our opinion paying rentals particularly on short-term leases (“short-term leases” not in the meaning of the Exposure Draft) rather represent charges that qualify as cash flows from operating activities to ensure a faithful representation.

Assume an intermediate lessor that fully transfers risks and benefits (including lease term and payment scheme) from the head lease to the sublease. In our opinion no relevant information is provided by presenting the rentals received under the head lease as cash flows from operating activities and rentals paid as cash flows from financing activities. Therefore in certain sublease arrangements netting should be considered.

## 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?

(a)

**Siemens does not agree with the disclosure requirements proposed by the boards for mainly two reasons:**

(1) ambiguity and insufficient improvement in comparability of information

The Exposure Draft requires a significantly increased volume of disclosures compared to the actual regulations; however, the proposal allows for the use of judgment in the level of detail and extent necessary to satisfy the disclosure requirements.

The disclosures should:

- Identify and explain the amounts recognized in the financial statements arising from leases
- Describe how leases may affect the amount, timing and uncertainty of the entity’s cash flows

Entities should aggregate or disaggregate disclosures so that useful information is not obscured by either too much detail or by summarizing items that have different characteristics.

(2) cost-benefit-aspects

Certain requirements, including disclosing significant judgments and estimates and balance sheet roll forward information, will necessitate that information on leases not previously needed for dis-

closure purposes be tracked and compiled. We believe that the proposed disclosure requirements will impose excessive additional costs on the preparers of financial statements. In contrast to these costs, we do not see the proposed model's and disclosure requirements' improvement on decision-usefulness.

In our opinion, the accounting model itself should provide decision-useful information to users of financial statements so that such excessive disclosure requirements are dispensable.

(b)

**In relation to information, reflecting the how leases may affect the amount, timing and uncertainty of the entity's future cash flows we basically agree with the boards' proposal.**

We would like to point out, that the disclosed information could be reduced. The requirements on disclosures in relation to subjective decisions and management's judgement should not be excessive.

#### **Question 16**

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

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

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

(a)

**In principle we agree that a simplified approach should apply.**

The Exposure Draft proposes a simplified retrospective approach to transition, with different transition requirements for leases accounted for under the performance obligation and derecognition approach.

Given our large number of contracts even a simplified retrospective application of the proposals would result in very high costs for Siemens. The highly individualized conditions of many of our contracts would require a contract by contract assessment in order to apply the new model and to

measure the correct amount of lease assets and liabilities which is a very complex and extensive procedure.

To this adds that Siemens and other entities filing a Form 20-F-2 with the Securities and Exchange Commission in the United States must present comparative figures for two years. Hence, Siemens would need to keep up and support both models of accounting for a minimum two years. Assuming Siemens applies the new standard as of fiscal 2013/2014, Siemens would be forced to implement the new accounting model as early as 1 October 2011. On the other hand, a prospective application comes with other disadvantages. A prospective application would lead to applying two accounting models for of up to, and sometimes exceeding, 10 years.

– (b)

**Siemens opposes the permission for full retrospective application.**

Permission for full retrospective application will result in different assessments by the entities. This is counterproductive with respect to idea to improve decision-usefulness of the information provided and comparability of information.

c)

**The boards should consider the changes to the recognition of expenses on lessee's side.**

As mentioned in our comment regarding question 1b above the proposed right-of-use model often leads to a pattern of expense recognition where the total lease expense recognised (i.e. sum of interest expense and amortisation) will be higher in earlier periods of a lease and lower in later periods. While this effect might be compensated for a portfolio of many new and old leases in a steady state there would be an effect at transition to the new approach as all leases would be accounted for in their earlier periods. We ask the boards to consider this effect when deliberating the transition requirements.

#### **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 strongly disagree that the benefits of the proposal would outweigh its costs.**

We emphasise that implementation and application of the proposed model would cause enormous costs for Siemens as a lessor and lessee. Even once the new systems would be implemented it would be extremely burdensome to establish processes to ensure an ongoing reassessment as proposed in the Exposure Draft. However, information regarding today's operating leases on the

lessee side currently is already available on the notes. Furthermore the supposed benefits by including contingent features and amounts payable in optional periods leads to information that often might be unreliable. Therefore in our opinion the costs of the proposed IFRS outweigh its benefits.

## Question 18

Do you have any other comments on the proposals?

### Please refer to our specific other comments below:

a) We note that regarding lessor accounting the boards have recorded in the June 2010 “IASB update” that it had complied with the due process listed in the IASB Due Process Handbook. Nevertheless we express doubts about compliance with the due process as the IASB Due Process Handbook stipulates the IASB normally to publish a discussion paper as its first publication on any major new topic. The March 2009 discussion paper on leases, however, deals with lessor issues in only one of ten chapters and the boards have not reached any preliminary view as the boards decided in July 2008 to defer consideration of lessor accounting:

*1.20 When the boards added lease accounting to their agendas, they agreed that the project would consider both lessee accounting and lessor accounting. However, in July 2008 the boards tentatively decided to defer consideration of lessor accounting and concentrate on developing an improved lessee accounting model. Consequently, most of this discussion paper focuses on lessee accounting.*

*1.21 The boards’ reasons for deferring consideration of lessor accounting were as follows:*

*(a) Most of the problems associated with the existing accounting model relate to the treatment of operating leases in the financial statements of lessees. Users of financial statements have raised fewer concerns about the existing accounting for lessors.*

*(b) Consideration of lessor accounting at the same time as lessee accounting could delay publication of a new accounting standard for lessees. Lessee accounting affects a wide range of entities across all industries. Existing accounting standards significantly understate the extent of those entities’ assets and liabilities. Consequently, improvements to lessee accounting would benefit a large number of users.*

*(c) Lessor accounting raises issues that relate to other projects that the boards are currently considering, particularly derecognition and revenue recognition. Until conceptual models for derecognition and revenue recognition have been developed, it will be difficult and perhaps premature to build a new accounting model for lessors.*

*(d) Any lessor accounting project will need to address how to account for investment property. The existing accounting models for investment property under US generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRSs) are very different. Therefore, reconciling those differences may be difficult and time-consuming.*

*(Discussion Paper Leases, Preliminary Views, March 2009)*

We note that many fundamental issues regarding the lessor accounting addressed in this comment letter and in the public debate demonstrate that the discussion arising now on the basis of the Exposure Draft should have taken place on a prior discussion paper level.

b) We understand that under the proposed lease accounting model the lease payments shall be measured on the basis of the expected outcome using all relevant probability-weighted information. Thus, contingent rentals shall be included. Furthermore we note that the ED supersedes IFRIC 4. While the provisions of IFRIC 4 regarding the determination whether an arrangement contains a lease are incorporated in the ED leases, the provisions of IFRIC 4 regarding separating payments for the lease from payments for other contract parts are not transferred to the ED leases. In ED/2010/6 "Revenue from Contracts with Customers" we note that the boards propose allocating the "total amount of consideration" to each identified component of accounting, e.g. a lease component. We ask the boards to clarify in ED/2010/6 "Revenue from Contracts with Customers" whether amounts based on contingent prices and quantities shall be included in the total amount of consideration in this context. Furthermore we note that deletion of the provisions of IFRIC 4 regarding separating payments for the lease from payments for other contract parts might lead to a lack of guidance in a contract that includes a lease component and a financial instrument component.

c) In our opinion the boards should consider to remove some application guidance in appendix B of the Exposure Draft into the standard text. In our opinion the standard text often is highly principle-based and needs to be read together with the respective application guidance, e.g. regarding the distinction between leases versus purchases/sales (B9-B10) or the distinction between the performance obligation approach and the derecognition approach (B22-B27). Browsing between the relevant and mandatory guidance between standard text and application guidance appears laborious. However, the examples illustrating the accounting for changes in the lease term under the performance obligation approach and the derecognition approach (B28 and B30) in our opinion are appropriately labelled application guidance.

d) We would welcome some statements regarding intra-group lease accounting in the context of segment reporting. We ask the boards to clarify that a simplified approach to account for inter-segmental leases is appropriate in the context of IFRS 8, Operating Segments.

e) The Exposure Draft proposes to withdraw SIC-15, Operating Leases – Incentives. A lease contract with a new lessor may include incentives for the lessee to enter into the lease, such as an upfront cash payment to the lessee or payment of certain costs for the lessee (e.g. moving expenses or leasehold improvements). The Exposure Draft does not address accounting for lease incentives. In light of the significant scrutiny applied to lessee accounting for lease incentives, we ask the boards to issue clear guidance how to account for incentives.

f) The Exposure Draft remains silent on how to account for modifications or changes to a lease. The boards should include guidance when to consider modifications or changes as part of the original lease (and how to account for them) or when they constitute a new lease.

g) With regard to lessor accounting the Exposure Draft specifies that determining whether to apply the performance obligation approach or derecognition approach takes place at inception of the lease. Furthermore the Exposure Draft explicitly stipulates that a lessor shall not change the lessor accounting approach after the date of inception. We wonder about the boards' basis for this conclusion and doubt that a fundamental modification affecting the transfer of the significant risks or benefits should be ignored.

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