



Sir David Tweedie  
Chairman of the  
International Accounting Standards Board  
30 Cannon Street  
  
London EC4M 6XH  
United Kingdom

Düsseldorf, 24 November 2010

540

Institut der Wirtschaftsprüfer  
in Deutschland e.V.

Wirtschaftsprüferhaus  
Tersteegenstraße 14  
40474 Düsseldorf  
Postfach 32 05 80  
40420 Düsseldorf

TELEFONZENTRALE:  
+49 (0)211 / 45 61 - 0

FAX GESCHÄFTSLEITUNG:  
+49 (0)211 / 454 10 97

INTERNET:  
[www.idw.de](http://www.idw.de)

E-MAIL:  
[info@idw.de](mailto:info@idw.de)

BANKVERBINDUNG:  
Deutsche Bank AG Düsseldorf  
BLZ 300 700 10  
Kto.-Nr. 7480 213

Dear Sir David

### **Re.: Exposure Draft 2010/9 “Leases”**

We appreciate the opportunity to comment on the exposure draft mentioned above and would like to submit our comments as follows:

#### **General Remarks**

As mentioned in our comment letter on the discussion paper “Leases – Preliminary Views”, dated 13 July 2009, we share the boards’ opinion that a fundamental review of lease accounting is needed and acknowledge that the exposure draft addresses certain problems with today’s accounting for leases under IAS 17. In particular, the proposed right-of-use model results in consistent accounting for most lease contracts by lessees, thus increasing the comparability of lessees’ financial statements whilst reducing the opportunity to structure transactions to achieve a desired accounting outcome.

However, a necessary condition of a fundamental change in accounting requirements is that the intended conceptual improvement to financial reporting can be substantiated. We do not believe that this is the case with regard to many aspects of this exposure draft. At the same time, the proposals add complexity to current lease accounting both for lessees and lessors. On balance, the

GESCHÄFTSFÜHRENDER VORSTAND:  
Prof. Dr. Klaus-Peter Naumann,  
WP StB, Sprecher des Vorstands;  
Dr. Klaus-Peter Feld, WP StB CPA;  
Manfred Hamann, RA

**Seite 2/22** IDW CL to Sir David Tweedie on ED "Leases"

benefits of the proposals would not appear to outweigh the costs and administrative burden arising from implementing and applying the new model.

Our main conceptual objections to the proposals are as follows:

- Before a considerable change in lease accounting is implemented, the accounting for executory contracts needs to be deliberated in general as part of the conceptual framework project.

In the boards' view, before the date of commencement of the lease, the lease is executory as it depends on future action by both parties. In contrast, after the date of commencement of the lease, the lease is not an executory contract: When the lessor provides access to the underlying asset, the lessee has an unconditional right to use the underlying asset and therefore an unconditional liability to make lease payments (paragraphs BC7(b) and BC173).

Obviously, the boards do not share the view that the lessee's right to use is conditional on the lessee making payments during the lease term, i.e. the contract is still executory. However, the difference between an "unconditional" right-of-use asset arising from a lease contract and similar rights arising from other executory contracts that are currently not recognised in the statement of financial position remains unclear (e.g. service contracts, employment contracts). In our view, there is a danger that contracts which exhibit similar characteristics may not be accounted for consistently. Furthermore, if the right-of-use model is implemented for lease contracts whilst other executory contracts with similar characteristics (especially service contracts) remain "off-balance sheet", the proposals offer structuring opportunities.

- Leases of intangible assets should not be excluded from the scope of the proposed IFRS without any conceptual reason (for further details we refer to our answer to question 5).
- We support the boards' proposal to scope out in-substance purchases or sales. However, the exposure draft restricts in-substance purchases or sales to automatic transfers of the title to the underlying asset and bargain purchase options. In our view, the final standard should scope out *all* contracts that are in fact purchases or sales, considering control as well as risks and benefits (for further details we refer to our answer to question 4).
- The IDW welcomes the fact that, in contrast to the discussion paper, the exposure draft proposes a comprehensive concept for lessee accounting as well as for lessor accounting. The boards state that the exposure draft pro-

**Seite 3/22** IDW CL to Sir David Tweedie on ED "Leases"

vides a consistent accounting model for all lessees and lessors. We doubt, however, that this assumption is correct, especially in respect of the two proposed approaches for lessor accounting. Introducing both approaches impairs the comparability of financial statements, offers structuring opportunities and adds undue complexity to a new accounting model for leases. Hence, we would prefer a single approach. In our view, the derecognition approach appears to be more consistent with the proposed approach for lessees in that delivery of the leased asset is seen as satisfying a performance obligation (for further details we refer to our answer to question 2).

- In sale and leaseback transactions the seller/lessee should not recognise any difference between the sales proceeds and the carrying amount in profit or loss immediately (for further details we refer to our answer to question 11).

In respect of the practicability of the proposals, we believe that the proposed new accounting model is, in total, too sophisticated and too complex for both lessees and lessors, i.e. further simplifications are necessary. For instance, measuring each liability to make lease payments on the basis of an expected outcome, including contingent rentals, and regularly reassessing the liability seems unduly burdensome, especially for entities that have a large volume of small leases with different terms.

Despite our general concerns, we would like to comment on the specific proposals as follows:

### ***The accounting model***

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

- (a) a lessee would recognise an asset (the right-of-use asset) representing its right to use an underlying asset during the lease term, and a liability to make lease payments (paragraphs 10 and BC5–BC12). The lessee would amortise the right-of-use asset over the expected lease term or the useful life of the underlying asset if shorter. The lessee would incur interest expense on the liability to make lease payments.*
- (b) a lessor would apply either a performance obligation approach or a derecognition approach to account for the assets and liabilities arising from a lease depending on whether the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected term of the lease (paragraphs 28, 29 and BC23–BC27).*

### **Question 1: Lessees**

- (a) Do you agree that a lessee should recognise a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?*
- (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): Provided that the outstanding conceptual deliberations support the boards' assumption that, after the date of commencement of the lease, a lease is not an executory contract, we agree that a lessee should recognise a right-of-use asset and a liability to make lease payments.

(b): Subject to the conceptual concerns mentioned above, we support the proposed amortised cost-based approach to subsequent measurement of both the liability to make lease payments and the right-of-use asset. Consequently, a lessee would recognise amortisation of the right-of-use asset and interest on the liability to make lease payments.

Nevertheless, further simplifications should be developed to provide relief, in particular, for short-term leases (see our answer to question 3).

Seite 5/22 IDW CL to Sir David Tweedie on ED "Leases"

**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) and (b): The boards state that the exposure draft provides a consistent accounting model for lessees and lessors. In addition, the boards argue that they have proposed a single model for lessor accounting and that the performance obligation approach and the derecognition approach are only different approaches to application. We doubt whether these assumptions are correct. In particular, the two proposed approaches for lessor accounting are significantly different in terms of concept. While the boards hold the view that leases have different characteristics and lessors have different business models, thus making two approaches for lessor accounting necessary, we would prefer a single model for the following reasons:

I. In the boards' view, the existing guidance in IAS 17 is fundamentally flawed since the existence of two different accounting models for leases (the finance lease model and the operating lease model) would lead to similar transactions being accounted for differently and would introduce significant structuring opportunities (paragraph BC7(c)). We believe that the same concerns can be expressed in relation to the two proposed approaches for lessor accounting.

II. Two approaches for lessor accounting add undue complexity to a new accounting model for leases.

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

- If a lessor retains exposure to significant risks or benefits it would be inappropriate to apply an approach that derecognises all or part of the underlying asset. Such a lessor should apply the performance obligation approach.

**Seite 6/22** IDW CL to Sir David Tweedie on ED "Leases"

- If a lessor does not retain exposure to significant risks or benefits it would be inappropriate to continue to recognise the whole of the underlying asset. Such a lessor should apply the derecognition approach.

Hence, retention of risks and benefits is the crucial factor in determining whether to derecognise all or part of the underlying asset. We wonder whether this proposal is consistent with previous decisions the boards have reached in other current projects. Such projects give the impression that, in similar cases, the boards rely on the concept of control only. For instance, the exposure draft "Revenue from Contracts with Customers" draws solely on the transfer of control in order to determine the point in time at which an entity satisfies a performance obligation, i.e. when it recognises revenue. The basis for conclusions of this exposure draft (paragraph 60) states that "... the boards decided that an entity should assess whether a transfer of an asset has occurred by considering whether the customer obtains control, for the following reasons: ... The boards' existing definitions of an asset use control to determine when an entity should recognise or derecognise an asset. Because the proposed requirements can be viewed as an asset derecognition model, the boards decided to rely on the existing definitions of an asset ... A focus on control rather than on risks and rewards should result in more consistent decisions about when goods or services are transferred... ." We believe that the boards' decisions in these projects are contradictory.

In our view, a single lessor approach is preferable because it would increase the comparability of financial statements, reduce the opportunity to structure transactions and avoid undue complexity. We support the (partial) derecognition approach as opposed to the performance obligation approach, in particular on the following grounds (see IASB/FASB agenda paper 3D/108, dated 14 June 2010):

- The performance obligation approach is inconsistent with the proposed approach to lessee accounting. Under the lessee accounting model proposed by the boards, the lessee is viewed as having an unconditional obligation to pay rentals. The obligation is viewed as unconditional because the lessor has performed under the lease contract at lease commencement. If the lessor has performed, it is unclear why the lessor should recognise a performance obligation.

In contrast, the derecognition approach is consistent with the proposed approach to lessee accounting. The lessor is viewed as having delivered a right-of-use asset to the lessee at lease commencement. Consequently, the lessor has no performance obligation and the lessee has an unconditional obligation to pay rentals.

**Seite 7/22** IDW CL to Sir David Tweedie on ED "Leases"

- Despite the proposed (linked) presentation of a net lease asset or net lease liability, the performance obligation approach double counts assets: The lessor recognises separately a receivable in respect of amounts due under the lease and continues to recognise the whole of the underlying asset. Thus, the assets recognised by the lessor will exceed the cash inflows expected from those assets.

In contrast, under the derecognition approach the lessor derecognises (a portion of) the underlying asset, thus avoiding the double-counting of assets.

- According to the performance obligation approach, manufacturer/dealer lessors do not recognise revenue, cost of sales and gains/losses at the start of the lease.

In contrast, the derecognition approach results in manufacturers/dealers recognising revenue, cost of sales and gains/losses at the start of the lease.

Some raised concerns about profit/loss recognition at lease commencement. However, such gains correctly reflect the fact that the lessor has "sold" part of the underlying asset in return for a receivable.

- The performance obligation approach results in banks/finance organisations recognising the underlying asset on their books, even if the main risk exposure is to credit risk associated with the receivable.

In contrast, under the derecognition approach the assets recognised by a bank/finance organisation will reflect the risks to which it is exposed. If the entity has very little exposure to the risks associated with the underlying asset, the residual asset it recognises will be correspondingly small.

The IASB/FASB staff have indicated that the complexity of the derecognition approach would not worry the leasing industry and also that practical problems can be dealt with by providing additional guidance.

The IASB/FASB agenda paper gives the impression that the majority of constituents, the leasing industry and the staff prefer the derecognition approach for lessor accounting. Obviously, it is only the fact that the FASB does not support the derecognition approach which has led to the proposal of a hybrid model as an unsatisfactory compromise. In our view, achieving convergence with US GAAP should not be the overriding argument for developing new common standards which will not improve accounting under IFRS. If striving for convergence mainly results in seeking the lowest common denominator then it is not desirable.

### **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 select 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?*

As mentioned in our comment letter on the discussion paper, we do not support exemptions from the scope of the new standard for short-term leases. Such leases could give rise to material assets and liabilities. Instead, we welcome some simplifications for short-term leases in order to mitigate concerns about tracking and recording a large number of such leases.

The proposed simplified accounting would allow lessees to ignore the effects of interest on the recorded assets and liabilities, and allow lessors to use accrual accounting. We acknowledge that this proposal attempts to address cost-benefit concerns, but it has a low impact for lessees, since the main difference compared to the general provisions is the effect of discounting, which normally would not be expected to be significant over a period of less than 12 months. The boards should develop further simplifications.

We support the proposed simplifications for short-term leases of lessors.

### **Definition of a lease**

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

### **Question 4**

- (a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?*
- (b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?*
- (c) Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?*

(a): In general, we agree with the proposed definition of a lease. A new standard on lease accounting should include robust guidance on the definition of a lease and the scope of the standard. If the right-of-use model is adopted for lease contracts whilst (other) executory contracts with similar characteristics remain “off-balance sheet”, the new standard will offer structuring opportunities. For instance, requiring lessees to recognise assets and liabilities arising in lease contracts may lead to arrangements being structured such that the contract would qualify as another contract rather than as a contract conveying a right of use. Hence, guidance on distinguishing leases from service contracts is crucial.

The exposure draft defines a lease as a contract in which the right to use a specified asset (the underlying asset) is conveyed, for a period of time, in exchange for consideration. In addition, the proposals use existing guidance by incorporating the principles of IFRIC 4. Regrettably, the exposure draft does not specify what constitutes the underlying asset in the contract. In some cases, the underlying asset that is the subject of the lease is a portion of a larger asset (irrespective of whether such portion is a physically distinguishable portion of an asset, or defined by reference to the output of the asset or the time the asset is made available). Similarly to IFRIC 4, the proposals do not address how to determine when a portion of a larger asset is itself the underlying asset that is the subject of the lease. While paragraph 3 of IFRIC 4 at least clarifies that ar-

**Seite 10/22** IDW CL to Sir David Tweedie on ED "Leases"

rangements in which the underlying asset would represent a unit of account in either IAS 16 or IAS 38 (e.g. for the purpose of depreciation) are within the scope of IFRIC 4, the exposure draft remains silent on this issue. Since we believe that the issue of portions is important and has a wide application, we suggest the boards clarify this issue in the final document.

(b): According to the proposed paragraph 8(a), an entity shall not apply the (draft) IFRS to a contract that results in an entity transferring control of the underlying asset and all but a trivial amount of the risks and benefits associated with the underlying asset to another entity; such a contract represents in fact a purchase or sale of an underlying asset. In general, we support the boards' proposal because in-substance purchases or sales on the one hand and leases on the other hand have different economic features and the accounting treatment should reflect the economic differences, regardless of the way the transaction is described in the contract. However, paragraph B10 restricts in-substance purchases or sales to

- automatic transfers of the title to the underlying asset and
- bargain purchase options.

In our view, the final standard should scope out *all* contracts that are in-substance purchases or sales, considering control as well as risks and benefits. This includes contracts that refer to assets which are of such a specialised nature that only the lessee can use them without major modifications. In this case, it is reasonably certain that the lessor and lessee will ensure that there are adequate contractual provisions to protect their positions, thus reflecting an in-substance purchase or sale. Another example of an in-substance purchase or sale is a contract that covers the whole of the expected useful life of the asset.

The proposals require an entity to consider, inter alia, its exposure to risks and benefits associated with the underlying asset when the entity assesses whether the contract is a lease or an in-substance purchase or sale of the underlying item. Again, we are surprised that the boards refer to the concepts of "control" and "risks and benefits/rewards" in this case. Current projects of the IASB and the FASB have given the impression that the boards' focus is solely on the transfer of control. In our view, the concept of control is primarily related to the legal structure of the transactions. Therefore, we believe there is a danger that economic aspects might not be considered adequately if the concept of control were applied exclusively, i.e. without considering risks and benefits/rewards. Consequently, we welcome the reference to risks and benefits.

(c): We refer to our answer to question (a).

## Scope

### **Question 5: Scope exclusions**

*The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33–BC46).*

*Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and why?*

Leases of intangible assets (for example: software, patents and licences) are excluded from the scope of the proposed IFRS until the boards have considered the accounting for intangible assets more broadly. The decision to exclude leases of intangible assets appears to be for reasons of expediency in completing the project within the proposed timeline. We do not support this scope exclusion since we see no conceptual reason as to why a lease accounting standard should exclude intangible assets. Furthermore, the scope exclusion raises several questions. For instance, it is unclear whether and to what extent the accounting requirements of the future standard "Leases" could be applied by analogy to licensing agreements (which would be within the scope of IAS 38) when a right-of-use asset is transferred. In our view, the boards should not publish a final standard that excludes intangible assets from its scope.

### **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.*

Seite 12/22 IDW CL to Sir David Tweedie on ED "Leases"

*(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 agree with the proposal of the FASB. The provisions for identifying lease and service components in the future leases standard should be consistent with those for identifying performance obligations in the future revenue standard. Therefore, if the service component in a contract that contains service components and lease components is not distinct, the lessee and the lessor should apply the lease accounting requirements to the combined contract. We share the view of the IASB staff that it would be extremely rare for a lessor to be unable to separate the leases element from the service element of a contract (see IASB/FASB agenda paper 3D/108, dated 14 June 2010, page 9, and paragraph BC53 of the exposure draft). Thus, we believe that it is neither necessary nor appropriate to include inconsistent guidance in the standard to ensure that income from a service component is not recognised before the lessor provides that service.

In determining whether a service component is distinct, paragraph B7 applies the conditions of the exposure draft "Revenue from Contracts with Customers". However, in our view, these conditions are ambiguous and should be modified. In this context, we also refer to our comment letter, dated 13 October 2010.

#### **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?*

Seite 13/22 IDW CL to Sir David Tweedie on ED "Leases"

As mentioned in our comment letter on the discussion paper "Leases – Preliminary Views", we believe that a purchase option has the same economic substance as a renewal option extending over the entire economic life of the leased item and, therefore, should be accounted for in the same way as options to extend the lease. Different accounting approaches to renewal options and purchase options, which are economically similar in practice, create structuring opportunities.

### **Measurement**

*The exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that:*

- (a) assumes the longest possible term that is more likely than not to occur, taking into account the effect of any options to extend or terminate the lease (paragraphs 13, 34, 51, B16–B20 and BC114–BC120).*
- (b) includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21 and BC121–BC131). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be measured reliably.*
- (c) is updated when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments, including expected payments under term option penalties and residual value guarantees, since the previous reporting period (paragraphs 17, 39, 56 and BC132–BC135).*

### **Question 8: Lease term**

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

Despite the fact that the proposed determination of the lease term requires a significant amount of judgement, we support the boards' decision 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 ex-

**Seite 14/22** IDW CL to Sir David Tweedie on ED "Leases"

tend or terminate the lease. If optional periods are not included in the lease term, the measurement of the right-of-use asset and the lease liability might be inappropriate.

The proposed approach is superior to the probability-weighted measurement approach, as it includes the entity's expectations but avoids the complexity of the probability-weighted measurement approach and reflects a possible outcome, i.e. it does not produce counter-intuitive effects.

We concur with the boards' decision not to adopt a components approach to lease contracts, because, from a conceptual point of view, the adoption of a components approach would only be appropriate if all (possibly interdependent) components of the lease were measured at fair value. This would be overly complex and burdensome. Moreover, it seems impossible to determine the fair values of the options with sufficient reliability.

#### **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?*

The boards' proposal that, in general, contingent rentals and expected payments under term option penalties and residual value guarantees should be included in the measurement of assets and liabilities will probably be burdensome for preparers. Nevertheless, we support this approach, because it avoids the inappropriate measurement of assets and liabilities, e.g. an understatement of the right-of-use asset that might occur if rentals were completely contingent on sales from a leased property. In addition, not reflecting contingent rentals in the measurement of a liability to make lease payments would allow lessees to structure lease payments as contingent in order to avoid recognising a liability.

**Seite 15/22** IDW CL to Sir David Tweedie on ED "Leases"

However, we do not 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. The need to develop scenarios and probabilities based on information that could differ from lease to lease coupled with the need to reassess the estimate regularly would make this requirement too costly and time-consuming for most entities. Rather, we would prefer a provision to measure such assets and liabilities based on the most likely lease payments, as it is simpler to apply, limits the risk of earnings management and will not result in a measurement that reflects an impossible outcome. Furthermore, this is more consistent with the decisions on the lease term when there are options to extend or terminate the lease.

We appreciate the proposal 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. This is consistent with the exposure draft "Revenue from Contracts with Customers", but the proposal may result in an economically identical head lease and sublease being measured differently: In considering contingent rentals, the lessor can only include contingent rentals that are reliably measurable, while the lessee uses an expected outcome technique without being restricted by reliability. The boards propose this approach on the basis that the head lease and the sublease are separate transactions, and that subleases would be measured on the same basis as other leases. Nevertheless, it might be appropriate to provide a measurement exception for intermediate lessors in case of contingent rentals.

The exposure draft "Leases" proposes that a lessor recognise contingent rentals only if the lessor can measure them reliably, whilst the exposure draft "Revenue from Contracts with Customers" provides that a seller include variable consideration in the transaction price only if it can be estimated reasonably. It is unclear whether "measure reliably" and "estimate reasonably" are intended to have (slightly) different meanings. We recommend that the boards use the same wording if they do not intend that "measure reliably" and "estimate reasonably" should result in different recognition thresholds.

Seite 16/22 IDW CL to Sir David Tweedie on ED "Leases"

### **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 support the proposed requirement to remeasure assets and liabilities in order to reflect current economic conditions. Retaining the initial measurement would result in amounts that are not decision useful, especially in the case of long-term leases. As such reassessments increase complexity and, thus, cost for preparers, we welcome the proposal according to which detailed examination of every lease is not required unless there has been a change in facts or circumstances that would indicate that there is a significant change in the lease asset or lease liability.

Paragraph 56(b) of the exposure draft proposes that entities should recognise changes in contingent rentals, residual value guarantees and term option penalties in profit or loss under the derecognition approach. The boards rejected adjusting the lessor's residual asset for changes in the right to receive lease payments arising from performance-based or index-based contingent rentals because such changes do not necessarily represent changes in the lessor's remaining rights relating to the underlying asset (paragraph BC109). However, we believe that (at least) a change in contingent rentals based on the usage of the underlying asset could result in a change to the residual asset.

### **Sale and leaseback**

*The exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents the sale of the underlying asset, the leaseback would also meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66–67, B31 and BC160–BC167).*

Seite 17/22 IDW CL to Sir David Tweedie on ED "Leases"

### **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?*

In general, we acknowledge the conceptual consistency of the boards' proposals and agree with the criteria for classification as a sale and leaseback transaction. However, the sales price and the (fixed) lease payments in a sale and leaseback transaction are usually interdependent and negotiated as a package, even if sales price and lease payments are at fair value. The sale and leaseback transaction is a means whereby the lessor provides finance to the lessee in a combined transfer and lease contract that should be accounted for as a single transaction. Hence, the seller/lessee should not recognise any difference between the sales proceeds and the carrying amount in profit or loss immediately. Such recognition would result in an inappropriate reflection of the economic circumstances and would introduce the potential for earnings management.

The assessment as to whether the transfer meets the conditions for a sale of the underlying asset is, inter alia, based on risks and benefits. In this context, we refer to our answers to question 2 and question 4(b).

### **Presentation**

*The exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25–27, 42–45, 60–63 and BC142–BC159).*

### **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*

Seite 18/22 IDW CL to Sir David Tweedie on ED "Leases"

*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)-(d): We agree with the separate presentation of assets and liabilities arising from leases in the statement of financial position as proposed. However, in our view, the performance obligation approach should be abolished (see our answer to question 2).

**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?*

In general, we agree with the separate presentation of lease income and lease expense in the statement of comprehensive income as proposed.

However, in respect of the performance obligation approach, we prefer the FASB's view whereby interest income, lease income and depreciation expense should total to a net lease income or net lease expense. Such a net presentation of income and expense is consistent with the presentation of a net lease asset or net lease liability in the statement of financial position. Nevertheless, we believe that the performance obligation approach should not be implemented (see our answer to question 2).

Seite 19/22 IDW CL to Sir David Tweedie on ED "Leases"

**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 agree with the separate presentation of cash flows arising from leases in the statement of cash flows as proposed.

**Disclosure**

**Question 15**

*Do you agree that lessees and lessors should disclose quantitative and qualitative information that:*

- (a) identifies and explains the amounts recognised in the financial statements arising from leases; and*
- (b) describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows*

*(paragraphs 70–86 and BC168–BC183)? Why or why not? If not, how would you amend the objectives and why?*

One point of general concern to us is that most recent projects have led to additional disclosure requirements. It appears that the Board proposes new disclosures almost as a matter of routine, even if only a small group of users has expressed a desire to receive a particular piece of information. The resulting information overload makes financial statements increasingly confusing. We recommend a comprehensive review of the current disclosure requirements in order to focus on the disclosures that are truly necessary.

In respect of the exposure draft "Leases" we believe that some proposed disclosure requirements might result either in overly extensive and detailed information or in boilerplate statements, at least in case of entities with a multitude of leases. Paragraphs 73, 78 and 82 constitute such examples.

The boards propose that lessees should disclose a maturity analysis of their liabilities to make lease payments (paragraph 85). Consistent with the maturity analyses required by US GAAP for leases and other financial liabilities, entities would be obliged to disclose the amounts due on an annual basis for the next

Seite 20/22 IDW CL to Sir David Tweedie on ED "Leases"

five years, plus a lump sum for the remaining years. In contrast, paragraph B11 of IFRS 7 states that entities use their judgement to determine the appropriate number of time bands when preparing the maturity analyses required by IFRS 7, i.e. entities determine the appropriate maturity categories. Hence, lessees applying IFRS would disclose their lease obligations differently from other financial liabilities. In the IASB's view, comparability between leases in different jurisdictions is more important than comparability between liabilities within IFRSs (paragraph BC182). We strongly disagree with the IASB and believe that accounting provisions in a single jurisdiction should not lead to internal inconsistencies within IFRSs. Maturity analyses under IFRS should be based on similar principles in order to assist users of financial statements in understanding and evaluating the nature and extent of liquidity risks.

### **Transition**

#### **Question 16**

- (a) *The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186–BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?*
- (b) *Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?*
- (c) *Are there any additional transitional issues the boards need to consider? If yes, which ones and why?*

(a): In general, we agree with the simplified retrospective approach as proposed.

(b): We acknowledge the concern that, if all leases are effectively reset to “year 1” on transition (as proposed), then the impact on profit or loss could be significant and misleading (paragraph AV9). In our view, entities should be allowed to avoid such consequences. Hence, we suggest fully retrospective application also be permitted in addition to the proposed approach.

(c): The proposed transition provisions focus on contracts that are within the scope of the (draft) IFRS, i.e. contracts that are classified as leases. They are silent on other contracts that may also be affected (e.g. in-substance purchases and sales). In the absence of specific transition relief, full retrospective applica-

**Seite 21/22** IDW CL to Sir David Tweedie on ED "Leases"

tion would be required under IAS 8. We doubt whether this would be appropriate.

Similarly, no specific transition relief is proposed for sale and leaseback transactions, and it is unclear, for example, whether an entity that is a party to a sale and leaseback transaction should adopt a full retrospective approach to the sale leg and then apply the simplified retrospective approach to the leaseback.

Because of the considerable accounting and systems changes many entities would be faced with, an adequate lead time will be crucial once the standard has been finalised.

### **Benefits and costs**

#### **Question 17**

*Paragraphs BC200–BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?*

We refer to our general remarks.

### **Other comments**

#### **Question 18**

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

At present, paragraph 2(b) of IAS 39 provides guidance on derecognition and impairment of lease receivables and payables. The exposure draft "Leases" includes proposals on impairment issues only. Hence, we are not sure whether paragraph 2(b) of IAS 39 is intended to remain applicable to the derecognition of lease receivables and payables. The boards should clarify this point.

The exposure draft "Leases" proposes that all lessors apply IAS 39 to determine whether the right to receive lease payments is impaired. In addition, under the derecognition approach, the lessor should apply IAS 36 to determine whether the residual asset is impaired. (Further) impairment testing issues under the performance obligation approach are not addressed. In this case, the lessor would continue to recognise the underlying asset which appears to remain subject to impairment testing under IAS 36. The boards do not discuss how a lessor should avoid the "double-counting" of certain impairment losses. Moreover, the

**Seite 22/22** IDW CL to Sir David Tweedie on ED "Leases"

exposure draft is silent on the interdependencies between asset impairment and subsequent measurement of the lease liability. We believe that these complex issues could be avoided by eliminating the entire performance obligation approach.

The exposure draft proposes that a lease contract be recognised once the lessor has performed by delivering the underlying asset to the lessee. In contrast to the exposure draft "Revenue from Contracts with Customers", the exposure draft "Leases" does not require the lessee and the lessor recognise a lease contract if the lessee performs by making an advance payment to the lessor prior to commencement of the lease. In our view, there are many arrangements in which payments are made prior to the date of commencement of the lease, in particular when the underlying asset is being constructed specifically for the lessee. We suggest the final document cover the accounting for such items between the dates of inception and commencement of the lease.

In contrast to current IFRS (SIC-15), the exposure draft does not include proposals on the topic of lease incentives, i.e. incentives to encourage a lessee to enter into a lease. Such lease incentives are common in practice, and may be monetary or non-monetary. We recommend some guidance on this issue.

Moreover, the final standard should address contract modifications, i.e. lessor and lessee agree to change the provisions of the lease contract.

Finally, a more general comment: The sheer extent and the significance of the "editorial" corrections that were issued shortly after the publication of the exposure draft "Leases" demonstrate that both the boards and their staff should spend more time on each project rather than taking rash action.

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

Norbert Breker  
Technical Director  
Accounting and Auditing

Uwe Fieseler  
Director International  
Accounting