

Sir David Tweedie, Chairman  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH

Dear Sir David,

**Re: Exposure Draft, Leases**

**14 December 2010**

J Sainsbury plc is pleased to respond to the Exposure Draft: Leases (the "Exposure Draft" or "ED").

J Sainsbury plc is a FTSE 100 listed food and non-food retailer in the UK with over 850 stores split between supermarkets (over 500 stores) and convenience stores (over 300 stores). A significant proportion of the properties that we operate are subject to long or short leases and the market value of our property portfolio at October 2010 was estimated at £10.2bn. We also act as a lessor in a number of properties. In our most recently published annual results to March 2010, we reported revenue of £19,964m, and profit before taxation of £733m. Our annual operating lease rental expense is around £440m of which almost 90% relates to land and buildings.

**Executive summary**

We support the efforts of the International Accounting Standards Board ("IASB") to improve the current standard on the accounting for leases. We believe that any revised leasing standard should meet the key objectives set out by the IASB in their invitation to comment, being reducing complexity, enabling increased comparability and providing relevant information for users of accounts.

However, we do not believe that the proposals meet these objectives for the following reasons:

- the asset and liability which are to be recognised on the balance sheet under the proposed standard are not consistent with the recognition of other assets, liabilities and executory contracts under IFRS;
- the measurement of the asset and liability require a significant number of judgements to be made by the entity which increases the complexity of both preparing and understanding the amounts and reduces consistency in the application of the standard and, therefore, reduces comparability for users of accounts;
- the income statement impact of leases will not be readily understood by users, nor will it reflect the underlying financial performance or position of an entity. It overlays complicated and unintuitive accounting onto a straightforward cash transaction and risks a further increase in non-GAAP measures being presented in financial statements.

We have highlighted the key areas in our letter below and have provided answers to the questions included in the Exposure Draft. On this basis, we urge the IASB to consider its proposals as to whether they meet the key objectives. We believe that the implementation of the exposure draft will only replace one imperfect model, which is widely understood, with another imperfect model.

We consider that the objectives of the IASB could be achieved through additional disclosure requirements for operating leases, an example of which we include in our response to question 15. We believe that additional disclosures for operating leases would provide appropriate, relevant, comparable and reliable information for the users of accounts without increasing the complexity of the accounting.

Should the IASB continue to believe that the on balance sheet recognition of all leases is appropriate then we urge the IASB to reconsider the inclusion of renewal options (unless there is a penalty to be paid in not exercising the option), contingent rentals, and the calculation of discount rates. In our comments below we have highlighted why we believe that these should be re-considered and in coming to our conclusions, agree with certain of the points made by Stephen Cooper.

As the impact of leases is so widespread, we also urge the IASB to develop further and test its thinking in order to:

- Ensure that any proposed new standard meets the requirements of users;
- Provide clear and concise definitions for leases, service arrangements and sale/purchase contracts; and
- More fully assess the impact on preparers of the introduction of the standard.

Further, if the IASB does decide to continue to develop the right-to-use model, we strongly believe that any revised accounting standard should be re-presented as an Exposure Draft and a further comment period permitted.

### **Key areas of the Exposure Draft**

We set out below our primary concerns regarding the Exposure Draft. We have structured these in two sections. First, we set out more detail on our fundamental objections to the Exposure Draft and, second, we expand further on specific aspects of the on balance sheet approach with which we disagree.

- (i) *Proposed on balance sheet treatment of all leases neither reduces complexity for users or preparers, nor increases comparability. In fact it may have the opposite effect to that desired.*

The proposal to include all leases on balance sheet requires significant judgements and estimates to be made in three key areas:

- Discount rate;
- Potential utilisation of renewal options; and
- Contingent rentals.

Whilst every entity will be able to make supportable judgements and estimates for their leases, it is unlikely that every entity would treat the same lease in a consistent manner due to the varying business and finance structures and risk appetite of entities. For example, the same lease cashflows could be discounted with very different rates or contingent rentals based on inflation could be based on different forward curves.

Currently, operating lease information is provided by way of disclosures, which enable users of the accounts to make their own uniform adjustments to companies' accounts should they wish to add these to the presented balance sheet. The Exposure Draft would either remove this consistency and therefore hinder comparability or, worse, see the adjustments being reversed out and standard capitalisation approaches being applied. Indeed, it is questionable whether the proposed approach will change the way users of the accounts view an entity; with a risk that any such change in perception will likely be dysfunctional.

We also consider that the proposed model will result in an increase in the number of non-GAAP adjustments made by entities in order to provide information to users on the operations of an entity that is useful and reflects the actual financial performance and position of an entity.

*(ii) Assumption that leasing activity is driven by financing requirements*

The proposed standard assumes that leases are entered into as financing transactions, which is not necessarily the case. Many leases are entered into for operational and strategic reasons, such as upon entering a new market. Indeed, on certain occasions, a non-leasehold option is simply not available to companies. The treatment of all leases as financing transactions will, therefore, not necessarily reflect the business models of entities.

The effect of this assumption that all leases are financing transactions (and thus included on the balance sheet) could be such as to increase the risk exposure of an entity as perceived by external users of the financial statements. This is in direct contrast to the fact that the entering into of leases by the entity may actually limit the entity's exposure to risk, by increasing operational flexibility. An increased risk perception by investors may lead to a requirement to deliver higher returns, increasing an entity's weighted average cost of capital, resulting in ongoing investments at either greater cost or lower levels.

We agree with Stephen Cooper in that options to extend and cancel leases provide lessees with flexibility to react to changing business circumstances and hence reduce risk. To include such items on the balance sheet would result in measures of financial leverage being overstated.

*(iii) Recognition of leases on balance sheet*

The IASB has not provided a sufficiently compelling reason why operating leases are different to other executory contracts, such as employee contracts, and therefore require recognition on the balance sheet at inception.

This conflict is also evident in the relief provided for short term contracts, which is provided without explicitly addressing whether such leases for 12 months or less are actually service contracts.

We believe that the IASB should consider why it believes that all leases are fundamentally different to other types of executory contracts and thus why they should be recognised at initiation on the balance sheet. It should provide additional clarification and guidance to ensure that the accounting for leases is consistent with the rest of IFRS.

*(iv) Cost benefit analysis*

One significant impact of the Exposure Draft would be the amount of additional time and cost that entities will suffer in complying with the requirements. In particular:

- In order to meet the requirements to review every lease or contract that may contain a lease will result in significant management time and cost. Further, this cost will continue throughout the term of the leases due to the requirement to revisit assumptions on lease payments, term and contingent rentals. The inclusion of non-core and short-term assets will increase the administrative burden considerably, especially when the difference between leases and service contracts is unclear.
- J Sainsbury plc Group is party to in excess of one thousand operating leases. We estimate that to gather and review the information set out by the Exposure Draft would take approximately six months and require a significant amount of time annually thereafter to maintain the information required.
- The increased judgement will also require additional time and effort from auditors and is likely to increase audit fees. In the current economic climate, additional regulation which increases costs to entities does not feel appropriate, especially if it does not provide relevant and required information, and may, in the worst case, serve to reduce transparency and consistency.

We note that the IASB has considered this in part by providing relief for short-term leases. However, no real relief is provided, since many of these leases will be low value but high volume and the only concession to calculating the asset and liability being provided is on the requirement to discount the expected lease payments. It is the underlying calculations which will require the significant time and effort by management and hence this relief will be neither of significant time nor cost benefit.

In this section, we expand further on specific aspects of the on balance sheet approach with which we disagree.

(i) *Measurement is inconsistent with other accounting standards*

The inclusion of amounts due under options and contingent rentals should not be incorporated into the measurement of a lease. The inclusion will result in significant judgements about future events which may or may not be within the control of management. Consequently, it will incorporate a forward-looking position into the statement of financial position and the statement of comprehensive income. The inclusion of costs/obligations in the liability, which the entity has not yet incurred and can avoid through its own actions, is different to the measurement of other liabilities. As an example, it would also appear to be inconsistent with IAS 36 'Impairment of assets', which requires the impairment review of assets to consider a future term of only five years.

(ii) *Sale and leasebacks*

We believe that the guidance on sale and leasebacks is not sufficient to define clearly when a sale occurs and could result in inconsistency with the new Revenue Recognition standard. In paragraph 25 of the Revenue Recognition Exposure draft, revenue can be recognised when;

*'it satisfies a performance obligation identified ...by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service.'*

However, the guidance set out in the Leases Exposure paragraph B9 draft states that a sale and leaseback can only occur 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.'*

This seems, therefore, to apply a higher hurdle for the sale of assets, which are subsequently leased, than other assets being sold. We believe that the definition for a sale should be consistent across the accounting standards.

A sale of an asset should be recognised as part of a sale and leaseback transaction when control of the asset passes, assuming the sale and subsequent rentals are at market value.

The guidance could also result in the potential double recognition of some assets on sale and leasebacks with associates and joint ventures, on which we expand further in our response to question 11.

(iii) *Transitional provisions*

We believe that insufficient thought and definition has been given to transitional provisions. This is evident across a number of areas, in particular:

- We agree with Stephen Cooper in that the transitional provisions will result in a higher impact to the income statement in the early years of adoption than would be the case with retrospective application, which could mislead users of the financial statements.

- There are no transitional provisions for sale and leasebacks and hence it is unclear whether assets currently leased and previously owned would be treated simply as leased assets, or whether consideration will be required as to whether the original sale and leaseback would meet the definition provided by the exposure draft.
- It is also unclear what treatment will occur to current onerous lease provisions held by an entity and the treatment of the right-to-use assets relating to leases considered onerous.

We believe that the current transitional provisions will increase the burden on entities as we believe that users of the accounts will require further explanation of the income statement and balance sheet position in order to make investment decisions. We would welcome further consideration of and guidance in this area.

*(iv) Lack of consistent approach between lessee and lessors*

The proposed standard does not provide a consistent approach between lessee and lessor accounting. The lessee approach is based on control of the assets whereas the lessor approach is based on risks and rewards. This could result in two entities recognising the same asset in their individual financial statements. Further the use of the risks and rewards model is potentially inconsistent with the control based recognition principles of the draft Revenue Recognition standard.

We believe that the IASB need to spend additional time considering the consistency between both lessee and lessor accounting and the accounting proposed by the Revenue Recognition standard.

*(v) Tax*

The proposal has wide-reaching consequences for tax legislation. In the UK, the tax legislation is based on the current accounting treatments for leases and the Exposure Draft makes no reference to this issue. It is not clear whether an entity will be required to maintain two sets of accounting records for leases in order to meet tax legislation or whether tax legislation will be changed. If entities are required to maintain two sets of accounting records, this will impose further additional cost on entities, plus additional tax reporting burdens.

## **Concluding Remarks**

Whilst this project has been ongoing for a number of years, we believe that the standard has not gone through the necessary process to ensure that it provides a faithful representation of an entity's financial position and performance.

We reiterate our disagreement with the proposals. If the IASB does decide to continue to develop the right-to-use model, we strongly believe that any revised accounting standard should be re-presented as an Exposure Draft and a further comment period permitted.

Our detailed responses to the Exposure Draft questions are included in the Appendix to this letter.

Yours Sincerely,

**John Rogers**  
**Chief Financial Officer**

## Appendix:

### Question 1

- (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?*

We do not believe that a lessee should recognise a right-of-use asset and a liability to make lease payments.

We do not believe the recognition of an asset and a liability is consistent with other standards currently published. We also believe that the current measurement proposals are also inconsistent with other standards. Please see answers to questions 7 and 8.

However, we acknowledge that the current disclosures in financial statements in regard of leases can be improved to assist users of the financial statements. Hence, we would propose that the current model remains with additional disclosure to provide comparable and clear financial information to users of the financial statements such as discounted minimum lease term obligations, additional detail on timing of payments and options to extend, purchase and contingent rentals. Further detail on the disclosures is included in the response to Question 15.

### Question 2

- (a) *Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associate 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?*

As both lessor and a lessee, we believe that the proposed accounting model would increase complexity in the financial statements due to the proposed presentation and recognition model.

The retention of a 'risks and rewards' model is in conflict with the proposed accounting treatment for lessees which is based on the 'control' model. A key example being that the lessor retains a 'performance obligation' despite the lessee recognising an asset for the expected cost of the asset. We do not believe, therefore, that the performance obligation approach is workable.

We therefore ask the Board to spend additional time considering the proposed models for lessee and lessor accounting to ensure that they reflect the obligations and commitments made by both parties.

### Question 3

*The exposure draft proposes that a lessee or a lessor may apply the following simplified requirement 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 profit or loss, nor derecognise any portion of the underlying asset. Such lessor would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payment in profit or loss over the lease term (paragraph 65).*

*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?*

The benefit provided by the exemption is negligible in terms of cost benefit as the full calculations would still need to be performed.

Many leases with a duration of 12 months or less are by their very nature for low-value, high-volume items. We would consider that in these cases as normally the lessor is obliged to replace when the life of the asset is exhausted, that these contracts are more representative of service arrangements and hence should be accounted for as such.

### 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 any 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 alternative guidance do you think is necessary and why?*

Whilst the definition of a lease has been taken from the existing standard, there is insufficient guidance on the definitions of a service contract and a sale/purchase contract for the treatment to be consistent across the large number of entities that apply IFRS.

In particular, we do not think that the guidance for distinguishing between a lease and a service contract is clear. The criteria relate very much to the physical delivery of the asset rather than the benefits gained through the right-to-use a specific asset and hence, where the asset used by an entity is non-specific, it is unclear whether this would be a lease or a service contract. The use of a non-specific asset is generally through necessity i.e. the need to purchase a service such as photocopying.

### Question 5

*The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-to-use assets in a sublease, except leases of intangible assets, lessees of biological asset and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraph 5 and BC 33-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?*

We consider that there is no reason to exclude intangible assets from the scope of the ED as some leases may contain both equipment and software for example. In addition, it is likely to result in similar contracts being treated very differently depending on whether the assets are property, plant and equipment or intangibles.

We support the exemption for investment properties being carried at fair value.

### Question 6

*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, B6-B8 and BC47-BC54). If the service component in a contract that contains service components and lease components is not distinct:*

*The FASB proposes that the lessee and lessor should apply the lease accounting requirements to the combined contract.*

*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 appropriate? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?*

We believe that it can be difficult to unbundle the service element from a contract where the services cannot be purchased separately and hence it would be difficult to allocate payments reliably.

On this basis, therefore, where the service and lease components are not distinct, the lessee should determine what the lease predominantly relates to and account for the whole contract on this basis.

Lessors are generable able to separate service and component elements of a lease and hence could account for the items separately.

However, these two different treatments will give rise to a situation where an entity is both a lessee and a lessor of the same asset. In this case, the entity will have access to the information in order to measure the service components and component from the lessee perspective and hence should account for both sides accordingly.

**Question 7**

*The exposure draft proposes that a contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus a contract is accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraph 8 and BC63 and BC64).*

*Do you agree that a lessee or a lessor should account for purchase options when they are exercised? Why or why not? If not, when do you think that a lessee or a lessor should account for a purchase option and why?*

As noted above, we do not agree with the proposed presentation of assets and liability.

We would, however, consider that such purchase options would be required to be disclosed under our alternative proposal.

**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?*

As noted above, we do not agree with the proposed presentation of an asset and a liability in relation to all leases.

The current proposal in respect of lease term requires management to consider their future actions long beyond the requirements of any other standard. In addition, management of different entities will consider the longest possible term differently based on the same underlying lease and hence there is unlikely to be consistency between different entities which will significantly hinder effective comparison of financial statements by external users.

Furthermore, the inclusion of an obligation which the entity is not required to pay unless it exercises an option is inconsistent with the Conceptual Framework and hence is inconsistent with other liabilities recognised in the balance sheet.

We therefore agree with Stephen Cooper's view that options to cancel and extend leases provide a lessee with flexibility to react to changing business circumstances and consequently these reduce risk. If all lease payments in optional lease periods are included in the recognition and measurement of the right-to-use asset, then the resulting liability and related measures of financial leverage are overstated.

**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 contract should be included in the measurement of lease assets and lease liabilities 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 can only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the lease receivable if they can be measured reliably? Why or why not?*

As noted above, we do not agree with the proposed presentation of an asset and a liability in relation to all leases.

The inclusion of contingent rentals, term option penalties and residual value guarantees is inconsistent with other current accounting standards as it requires the entity to measure an obligation which it has not yet incurred and can avoid through its own actions. We, therefore, agree with Stephen Cooper in that including all expected contingent rentals does not provide relevant information about the economics of such leasing arrangements.

The current treatment could continue in that contingent rentals are only recognised when incurred. Additional disclosure in the notes to the financial statements around the amounts of contingent rentals paid should ensure that it is clear what part of any lease costs are fixed and which are flexible.

Term option penalties and residual value guarantees should be provided for when it is probable that they will be incurred and their value can be measured reliably similar to the proposed recognition criteria for lessor.

#### **Question 10: Reassessment**

*Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the obligation or receivable arising from changes in the lease term or contingent payments since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?*

As noted above, we do not agree with the proposed presentation of an asset and a liability in relation to all leases.

Under the current standard, entities are required to remeasure whether a lease is an operating or finance lease when there is a significant change in the contract.

As the original measurement of lease term and contingent payments are estimates, it is likely that remeasurements will need to occur as the contract progresses through the lease. However, it is not clear what a significant change is considered to be and hence this will cause difficulties for both preparers and auditors.

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

*Do you agree with the criteria for classification as a sale and leaseback transaction? Why or not? If not, what alternative criteria would you propose and why?*

The current exposure draft does not provide clarity over the recognition of sale and leaseback transactions. We consider that the entity should be able to consider the substance of the transaction to determine whether the transaction is linked or not.

Furthermore, the conditions that normally preclude the recognition of a sale/purchase set out in Paragraph B31 include the following:

*“Any other provision of circumstance exist that allow the seller/lessee to participate in any future profits of the buyer/lessor or the appreciation of the transferred asset, eg a situation in which the seller/lessee owns or has an options to acquire a significant interest in the buyer/lessor”.*

This seems to, therefore, include any transactions between an entity and its subsidiary, joint venture or associate of the company selling the asset including any indirectly held investments and preclude them from being recognised as a sale and leaseback even if there is no element of financing to the transaction.

**Question 12: Statement of financial position**

- (a) *Do you agree that a lessee should present its liability to make lease payments separately from other financial liabilities and present right-of-use assets as if they were tangible assets within property, plant and equipment, or investment property as appropriate, but separately from other assets that the lessee does not lease (paragraphs 25-27, 42-45, 60-63 and BC142-159)? Why or why not? What alternative presentation do you propose and why?*
- (b) *Do you agree that a lessor applying the performance obligation approach should present its 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? 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 residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? What alternative presentation do you propose and why?*
- (d) *Do you agree that lessors should distinguish assets and liabilities that arise under a sublease separately (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?*

The liability to make lease payments is, based on the IASB's assumption that all leases are financing arrangements, inherently the same as any other financial liability and hence should be classified in the same manner. The liabilities would, therefore, require separate presentation if necessary to provide an understanding of the entity's financial position. However, separate presentation would not be required if the grouping of the liabilities with other financial liabilities did not prevent an understanding of the entity's financial position.

The right-of-use asset does not constitute a physical asset owned outright by the entity and hence should be presented separately on the face of the balance sheet.

We do not agree with the presentation proposed for the performance obligation approach as it does not address the underlying difficulty in applying this approach and the linked presentation in the balance sheet does not clarify the issue.

If the performance obligation approach is continued, it may be more appropriate to consider net presentation on the balance sheet with additional detail provided in the notes to the accounts. The net presentation could include solely the underlying asset and the liability as the receivable is subject to different risks to the underlying asset and the requirement to provide access to that asset inherent in the liability.

The lessor applying the derecognition approach should classify its right to receive lease payments similarly to the current treatment of loans and receivables as it is an equivalent financial asset. The residual assets should be included with the main PP&E note and a separate disclosure of the value of residual assets (cost, accumulated depreciation and impairment) included below the main table.

The presentation of sub-leases should be based on the underlying operations of the entity and reduce the presentation of the entity's liabilities under the initial lease if the sub-leasing is designed to mitigate the financial impact of the sub-lease.

**Question 13: Statement of comprehensive income**

*Do you think that lessees and lessors should present lease income and expense separately from other income and expenses in the statement of comprehensive income (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? 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 do not agree that for lessees the amortisation of the right-to-use asset and interest expense should be disclosed separately in the statement of comprehensive income as they are not distinct from other types of amortisation and interest at that level.

The information should be presented in the notes to the accounts.

Where an entity is a lessor it should be a judgemental decision of the entity whether amounts should be presented on the face of the statement of comprehensive income or in the notes. For example, if an entity's principal activity is the leasing of assets, this information is clearly material to the users of the financial statements. However, if an entity's principal business is not the leasing of assets, then it would not be material information to be included in the statement of comprehensive income and should be disclosed in the notes.

**Question 14: Statement of cash flows**

*Do you think that cash flows arising from lease contracts should be presented on 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?*

Paragraph 27 states that cashflows relating from lessee obligations should be classified as financing activities and presented separately from other cashflows.

As stated above, we consider that the entering into of leases is not solely motivated by the financing requirements. Hence to include all lease cashflows as financing would mislead the reader of the accounts as to the underlying operating nature of an entity.

We believe, therefore, that it should be the decision of the entity where the cashflows from leases reside. However, they should be shown separately on the cashflow.

Further, it contradicts the approach for lessors whereby all cashflows from leases are assumed to be operating in nature. Where an entity sub-leases an asset, it is not clear if the cashflows should be presented gross or net, or within operating or financing.

### **Question 15**

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

*(a) identifies and explains the amounts recognised in the financial statements arising from lease contracts; and*

*(b) describes how lease contracts 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?*

As noted above, we do not agree with the proposed presentation of an asset and a liability in relation to all leases. Hence, we do not agree with the proposed disclosures in the exposure draft.

However, we agree that the current lease disclosures required under IAS 17 can be enhanced to provide users with additional relevant information to make informed decisions on a company's obligations under lease contracts. We believe that the current disclosures in respect of finance leases are sufficient.

We propose the following additional disclosures in relation to operating leases as defined by the current IAS 17 (with comparatives):

- Actual cashflow per annum under minimum lease payments (as currently disclosed)
- Discounted cashflows presented to be described as current or non-current
- Qualitative and quantitative information on features such as options, contingent payment and guarantees as considered relevant to an understanding of an entity's obligations

### **Question 16**

*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?*

*Do you think that full retrospective application of lease accounting should be permitted? Why or why not?*

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

The current transition requirements will result in an increased cost to the income statement over the initial years post transition. This will require communication between an entity and its users to ensure that this depression of earnings is considered by those users appropriately. This could lead to increased use of non-GAAP performance measures.

Full retrospective application, however, is likely to be difficult due to the requirement to look back over long leases and consider the assumptions that would have been made at the time.

Partial retrospective application may be appropriate in that the standard would already require the user to update all assumptions to the current date with the exception of the discount rate. The lessee could, therefore, estimate the asset and obligation at the outset of the lease based on the current knowledge of the lease and only recognise at the balance sheet date, the amortised asset and liability to date with all expense being recognised via equity at the date of transition.

The transitional arrangements also provide no guidance on the treatment of sale and leasebacks which occurred before the date of transition and hence it is unclear if these are to be treated simply as existing leases or whether the financial statements would need to be re-prepared under the new provisions.

**Question 17**

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

We do not believe that the cost and benefit of the proposed accounting has been considered in sufficient detail.

Entities have a significant number of leases which will need to be considered on a contract-by-contract basis. This will involve a significant time investment by the relevant entities on both transition and on an ongoing basis. We do not believe that the simplified requirements and the requirement for re-measurements only when material are sufficient exemptions to address the costs of the new standard, particularly as auditors will require support for any items which are not considered material for adjustment.

The board has also not considered any incremental accounting system costs and time incurred to educate preparers and users of an entity's financial statements.

We therefore urge the board to consider further cost/benefit analysis be performed and further engagement with preparers of financial statements to measure the cost of the proposals.

**Question 18**

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

We believe that the proposed treatment will give rise to additional non-GAAP measures being presented by entities to provide relevant and comparable data to users of their financial statements, as the presentation of the assets and liabilities in relation to leases will not provide sufficient clarity over an entity's absolute obligations (see earlier comments on recognition of lease terms and contingent rentals) and the true cost to the entity of those leases. We do not believe that this is the intention of the board.

Further, the proposal has wide-reaching consequence for tax legislation. In the UK, the tax legislation is based on the current accounting treatments for leases. It is not clear whether an entity will be required to maintain two sets of accounting records for leases in order to meet tax legislation or whether tax legislation will be changed. If entities are required to maintain two sets of accounting records, this will impose further additional cost on entities, plus additional tax reporting burdens.