

15 December 2010

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

## **Comment Letter on Exposure Draft (ED) – Leases**

Dear Sir / Madam,

SwissHoldings, the Swiss Federation of Industrial and Services Groups in Switzerland represents 50 Swiss groups, including most of the country's major industrial and commercial enterprises. We thank you for the opportunity to comment on the above mentioned exposure draft (the ED). Our response below has been prepared in conjunction with our member companies. We outline some general comments below and answer the specific questions of the ED in the annexe.

### **General comments**

SwissHoldings agrees that the accounting for leases requires revision as the current standard allows too many financial structuring opportunities which reduces the comparability and decision usefulness of financial statement information. Several users of financial statements already make adjustments to capitalize operating leases to improve comparability between companies. However, there is no common approach among users of financial statements. The Boards' efforts to review the accounting in this area should increase comparability.

SwissHoldings supports the following proposals made in the ED:

- a) The identification of assets and liabilities that arise under a lease contract by applying consistent principles;
- b) The discontinuation of different types of leases for lessees, which required subjective judgments to be made for their determination; and
- c) The presentation of leasing activities in the financial statements.

However, we have several concerns regarding the proposals of the ED. The most important relates to the measurement of lease assets and liabilities. We are not convinced that the inclusion of options and contingent rentals to determine the measurement of lease assets and liabilities is appropriate and aligned with the Conceptual Framework. This change increases judgemental input for measurement purposes and as a consequence increases uncertainty of measurement, decreases comparability among preparers and will be difficult to explain. We concur with Mr. Cooper's alternative view in paragraphs AV2-AV4. We believe that such contingent elements of leasing arrangements should be subject to separate recognition and measurement criteria.

We further suggest that the two EDs 'Leases' and 'Revenue from Contracts with Customers' should be better aligned in respect of:

- a) The identification of a purchase or a sale; and
- b) The inclusion or exclusion from scope of intangible assets in the respective standards and their accounting treatment.

We welcome the simplification of the accounting treatment for short-term leases. But our member companies expect that it will have a minor impact for the application and implementation of the standard within a group. We would rather propose to the Boards that they consider the notion of cancellable and non-cancellable leases. While we accept that non-cancellable leases should be recognised on an entity's balance sheet we would propose that cancellable leases should be treated as executory contracts without requiring their capitalisation.

Moreover, we accept the proposal to incorporate the criteria of IFRIC 4 to determine whether an arrangement or a contract contains a lease in the new standard. It might be worthwhile to further assess whether these allow for the differentiation of arrangements in all circumstances.

Finally our member companies expect significant operational issues with the implementation of the standard, especially in respect of data preparation.

Below we further develop our views in our answers to your specific questions on the ED.

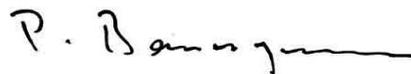
Yours sincerely,

**SwissHoldings**

Federation of Industrial and Service Groups in Switzerland



Dr. Gottlieb A. Keller  
Current Chair of SwissHoldings,  
(General Counsel Roche Holding AG)



Dr. Peter Baumgartner  
Chair Executive Committee

**cc** SH Board

## ANNEXE

### QUESTIONS FOR RESPONDENTS – INVITATION TO COMMENT

#### The accounting model

##### 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?*

In principle, we support the objective to represent more faithfully the assets in use and related commitments of an entity in its statement of financial position. We agree with the boards view in its Basis of Conclusion (BC) that a lease provides to an entity the rights and obligations that meets the boards' definitions of assets and liabilities. The recognition of a 'leasing asset' and 'leasing liability' is appropriate.

We are particularly concerned about the determination of the assets and liabilities and we have significant reservations on the proposals to consider lease period renewal or extension options and contingent rental payments. We believe that such contingencies do not meet the Conceptual Framework's definition of assets and liabilities as we further explain in our answer to your question 8. We also acknowledge that the ED proposes to adopt the criteria of IFRIC 4 to distinguish between leasing and service contracts. The conditions for the distinction are fundamental to the whole standard as we further cover in the answers to questions 4 and 6.

- 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 agree that the right-of-use model implies amortisation of the right-of-use asset and interest on the liability to make lease payments in respect of the unavoidable obligations of the lease contract.

##### 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?*

The ED proposes alternative accounting models. From an application point of view, alternative models increase complexity and decrease comparability. Our first reaction is therefore not to introduce options for lessor accounting, however we understand the boards' reasoning as stated in paragraph BC25 and BC26. If a lessor does not retain significant risk with the leased asset during or after the committed lease term, this could also be interpreted to mean that the lease term covers a significant part of the life cycle of the leased item and that the asset is used up during the leasing period. Consequently, it appears consistent that both the lessor and the lessee amortize the leased asset over time. This would also hold true for non-durable assets which are leased for a significant part of their useful life. As a result, the accounting of leases for lessees and lessors would be harmonized.

However, the same interpretation is flawed conceptually in respect of durable assets for a limited leasing period, e.g. a power plant or other infrastructure facilities of the energy or telecom industry which are leased to business partners, such as communities, or competitors. On balance therefore SwissHoldings would suggest to the Boards to consider the partial derecognition model

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as one single model for lessor accounting, but allow and make the application of the performance obligation approach available for lessors, if this model in accordance with the entity's business model will produce a more comprehensive presentation of its business activities.

- 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 commented above, we prefer one single model for lessor accounting. But lessors should be able to apply the performance obligation approach in cases where the derecognition model would inappropriately represent their business activities. We also recommend that the Boards should undertake extensive field testings on the application of the two approaches, especially with preparers within the above mentioned industry sectors.

### **Question 3: Short-term leases**

*The exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is twelve months or less:*

- a) *At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognise lease payments in profit or loss over the lease term (paragraph 64).*
- b) *At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognise assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRS and would recognise lease, payments 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?*

Although, we believe that the relief from discounting for short-term leases will be minor when compared to the total of the entity's lease contracts, we certainly do not oppose this simplification. In addition, we would like to propose that the boards should retain the notion of cancellable and non-cancellable leases. We believe that short-term leases with short-term cancellable periods should be treated as executory contracts. These contracts can be cancelled on short notice and do not represent eminent assets of an entity. We also are of the opinion that the argument about structuring opportunities for requiring the capitalisation of cancellable leases does not hold. No lessor would accept to lease out an important asset such as administrative building or a warehouse for a 12 month period if he has to undertake significant investments to offer and enter into the lease contract. Moreover, the lessee of a cancellable lease has no future obligation beyond the period of the lease. Therefore we believe that cancellable leases, especially short-term leases cancellable in the short term, should be excluded from recognition on the balance sheet as they will not be decision useful for most users.

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## Definition of a lease

### Question 4

a) *Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?*

We are not absolutely convinced that the line between a lease and service contract can be easily drawn given the proposed definition of a lease. In principle, the ED carries forward the criteria of IFRIC 4 to determine whether an arrangement or contract contains a lease. These criteria are very much focused on the use of a specified asset(s) as well as the access or location of the asset. In our opinion, the criteria should also comprise the business purpose underlying the arrangement such as whether it supports an entity's production, value performance, general operational needs or services. If the main purpose of the arrangement is to receive support and service, the transaction should be treated as a service arrangement. We also believe that for such arrangements, the assets involved are usually exchangeable in nature, easily obtainable and replaceable. Although, a service provider might not exchange them frequently, it will not change the characteristics of these underlying assets. Therefore we doubt, whether the proposal to define the specialised characteristics of an asset by requiring the feature that it would be infeasible or impractical for a lessor to provide alternative assets, is appropriate. In our view, the existence and availability of similar goods to render the service or fulfil the contract should be sufficient to confine non-specialised assets.

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?*

The proposal for the distinction between a lease from a contract that represents a purchase or sale encompasses two conditions, the transfer of control as well as risk and rewards of the underlying asset, whereas the ED on 'Revenue from Contracts with Customers' proposes the transfer of control as a sole condition. We do not understand the reason for this difference and suggest the alignment of the two EDs in this respect. We note that if a lessor provides a warranty or guarantee to the lessee, or has a profit-sharing relationship with the lessee on the future sale of the asset, the transaction could be considered as a lease under the ED 'Leases' but also as a sale according to the ED 'Revenue from Contracts with Customers'.

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?*

We address this question together with your subquestion 4 a) above.

## 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?*

Our member companies welcome the scope exclusion for intangible assets, especially as intangible assets for most of them to certain degrees form an essential part of their operations. However we note that there are several differences between the proposed accounting for assets under the leasing standard and under the proposed treatment in the ED on revenue recognition. As intangible assets are excluded from the scope of lease accounting, but lessors should apply

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the proposals of the ED on 'Revenue from Contracts with Customers' different accounting treatments could be observed if intangible assets would be within the scope of either of the standards. These could also be observed as a 'general difference' between the two EDs. We expect the following impacts if the ED 'Revenue from Contracts with Customers' will apply for intangible assets contrary to the application of the proposals of the ED 'Leases':

- More sales of intangible assets, particularly licences, will occur as the retention of risk and rewards would not have to be considered for determining whether a transaction is a sale;
- Earlier and higher recognition of revenues from licences on exclusive rights, as the timing of the recognition would differ significantly;
- Revenue streams from licences with options to extend the term will be longer, as the notions 'material' and 'more likely than not' in order to determine the probability of occurrence would be interpreted differently;
- Receivables from licences with options to purchase will be higher, as the proposals for the measurement include the above mentioned notions for the determination of the likelihood of occurrence.

**Question 6: Contracts that contain service components and lease components**

*The exposure draft proposes that lessees and lessors should apply the proposals in Revenue from Contracts with Customers to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B5-B8 and BC47-BC54). If the service component in a contract that contains service components and lease components is not distinct:*

- a) *the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.*
- b) *the IASB proposes that:*
  - i. *a lessee should apply the lease accounting requirements to the combined contract.*
  - ii. *a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.*
  - iii. *a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements, and the service component in accordance with the proposals in Revenue from Contracts with Customers.*

*Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?*

If the meaning of the word 'distinct' is to have the service and lease components in a contract separated, SwissHoldings agrees with the proposed application for lessees of the lease accounting requirements to combine lease and service components of the contract for arrangements that contain both services and lease components, if the service component is not distinct, for practical reasons. The separation of the different components would increase complexity significantly for lessees. In addition, we assume that lessees often would not have access to the required information when service components are included. On the other hand, this information should be available to lessors. We believe that the proposed requirements to treat contracts with service components under the performance obligation and derecognition approach differently will add unnecessary complexity. Thus, we would like to propose that lessors should segregate separately, the services and lease components irrespective of the lessor approach to be applied.

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### **Question 7: Purchase options**

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

We do not understand why the measurement of options to purchase and options to extend the term are considered for the measurement of a lease contract differently. It is proposed to account for purchase options only upon exercise. However, the proposals in the ED require that the effect of options to extend or terminate the lease be taken into account. We do not understand this separation. A purchase option is part of an agreement just as an option to extend is. We also believe that the payment for the execution of the purchase is part of the cash flows of the lease contract and as such an element to be included. We are of the opinion that purchase options should be accounted for not only when they are exercised. We therefore propose that the Boards should reconsider whether to recognise and to measure both purchase options and options to extend. However we believe that they should not be reflected in the measurement of lease assets or liabilities and that it would be sufficient just to disclose the terms and conditions of these options.

### **Measurement**

#### **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?*

SwissHoldings disagrees with the proposal to determine the lease term as the longest possible term that is more likely than not to occur. Lease extensions which are not exercised do not represent an unconditional and present legal obligation and as a result, do not meet the Conceptual Framework's definition of a liability because they are avoidable by the lessee. We therefore also agree with the alternative view of Mr Stephen Cooper disclosed in paragraphs AV1-AV4.

In particular, AV2 states that if the exercise of options to extend merely depends on future business conditions it is inappropriate to reflect this in the measurement at contract inception, even if extension or renewal of the lease is likely. We understand that some users disagree with this on the basis that some estimate is better than nothing and a user would be aware that this is a judgemental area. However, we disagree with this reasoning and illustrate through a simple example. Two different entities have exactly the same machine and are in the same type of business. Based on business forecasts both entities are expected to need this type of machine for the next 10 years. One machine is leased for 5 years with an option to renew each year thereafter. The other machine is leased for 5 years with no renewal options (instead the entity will just renegotiate at the end of the lease term). The proposals would require the entity with the renewal option to book an asset based on a lease term of 10 years whereas the other entity would only have a lease term of 5 years. Therefore, to argue that a renewal option should be considered in measuring the lease term based on business needs does not hold and would result in inconsistencies between entities.

But the existence of options should not be disregarded to support the preparation of decision useful financial statements information. As mentioned above in our answer to question 7, the renewal, termination or purchase options should be disclosed separately in the notes.

We believe that the measurement of the leasing asset and liability should be based on the time period that has the highest probability to occur our view is that this is best reflected by the period that an entity has committed to, because it would most likely relate to the fixed term of an arrangement without taking any probabilities into consideration and as such provide the highest degree of accuracy to users of financial statements.

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### **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?*

For the same argumentation as deserted above, we believe that rental payments which can be influenced by the lessee such as contingent payments for usage or performance of the asset should not have an influence on the measurement of lease assets and liabilities. This concept is not applicable to residual value guarantees whose incurrence is certain and thus should be included in the measurement. The measurement should be based on the most likely outcome approach, not only an expected outcome technique in order to increase prediction of related cash flows for users.

### **Question 10: Reassessment**

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

As described in our answers to questions 8 and 9, we believe that options should not be included in the measurement of assets and liabilities arising under a lease but valued, if possible, for themselves and accounted for or disclosed separately. In addition, the proposed onerous remeasurement mechanism could be avoided as the measurement of the options will encompass these aspects.

### **Sale and leaseback**

#### **Question 11**

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

We agree with the criteria for classification as a sale in sale and leaseback transaction. However, SwissHolding believes that the derecognition approach would be applicable in a sale and leaseback transaction. The 'partial' derecognition of the asset would then be the consequence of the application of this approach. We understand that the allocation process for derecognition required in paragraph 50 would also be operational in sale and leaseback transactions. But again, we would point out that the conditions for a purchase or sale in the ED requires the transfer of control and risk and benefits associated with the underlying asset whereas the proposals of the ED 'Revenue from Contracts with Customers' focus on the transfer of control only.

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## Presentation

### 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, what alternative definition would you propose and why?*
- b) *Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?*
- c) *Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?*
- d) *Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?*

We agree with the proposal to present the right-of-use assets and the liabilities to make lease payments in the statement of financial position.

### 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 or a lessor should disclose this information in the notes instead? Why or why not?*

We expect the amounts, if separated, to be significant in the statement of comprehensive income. We agree with the proposals to present lease income and lease expense.

### Question 14: Statement of cash flows

*Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?*

We agree with the proposals to present cash flows arising from leases in the statement of cash flows.

## Disclosure

### Question 15

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

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- 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?*

We consider the proposed disclosure requirements as extensive and believe that some requirements will not be user friendly as they will be based on assumptions like the inclusion of expected contingent rentals in the analysis. This could even increase the uncertainty about financial statement information rather than provide decision useful information. However, we note that it is proposed in paragraph 71 that an entity needs to consider the level of detail necessary to satisfy the disclosure requirements. As this kind of general principle will be always subject to interpretations and discussions we would prefer that the Boards require minimal disclosures rather than introducing an 'all-inclusive' and 'nice to have' list of disclosures which could be regarded as mandatory.

## **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-BC188). 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?*

Although, we doubt whether the application of the simplified retrospective approach will present the financial statements economically correct in all material aspects, especially in the case of long-term leases entered into a long time ago, we appreciate and support the proposal of a simplified approach.

## **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?*

SwissHoldings believes that its member companies will have to invest significantly in new systems or in updates of the actual systems including changes in accounting processes in order to gather and consolidate systematically the required information. We also expect operational issues with the implementation of the standard, especially in the area of complete collection of contract specific data to support the proposed measurement model and due to the magnitude of the number of contracts in scope. The implementation will be burdensome especially for smaller and medium-sized entities and we doubt whether the costs will outweigh the benefits of the proposals for these entities.

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The proposals will significantly impact ratios for financial statement analysis. We estimate that for certain entities this will have a significant impact on their compliance with debt covenants or guarantees.

## **Other comments**

### **Question 18**

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

### **Discount rate**

We agree that – if known – the rate implicit in the contract, i.e. the rate the lessor charges the lessee, should be used to determine the present value of lease payments and as such would approximate best the cost of the right-of-use asset. But we are not convinced that the lessee's incremental borrowing rate would produce the same values for the transaction under all circumstances. We consider that the rate the lessor charges the lessee has more to do with the lessor's required return on the lease arrangement and less to do with the lessee's actual borrowing rate and its financial strength or credit risk. Specifically, if the lessor bears significant residual value risk, the return it will require from the lease will cover not just the lessee's credit risk but also the residual value risk. Therefore, we propose that the Boards consider also the application of the rate of similar transactions as many leases are priced to reflect the characteristics of the typical item, commodity or customer segment. This could be the rate of a borrowing of the same duration as the lease.

### **Paragraph 42 (d) and 43 (d)**

We would like to draw the Boards attention to the interpretation of the sign '-' in the paragraphs 42 (d) and 43 (d). This sign could also be interpreted and be read as *minus*, meaning that the total to be presented as net lease asset or liability would be the result of (a) right-of-use asset minus (c) the lease liabilities rather than being the total of (a) right-of-use assets through (c) lease liabilities including (b) the rights to receive lease payments. We would suggest to the replace the sign '-' by a narrative statement.

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