

International Accounting Standards
Board
30 Cannon Street
London EC4M 6XH
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Stockholm 21st January 2011

Exposure Draft ED 2010/9 – Leases

Far, the Institute for the Accountancy Profession in Sweden is responding to your invitation to comment on the exposure draft *ED 2010/9 – Leases*.

Please refer to appendix 1 of this comment letter for detailed comments to your questions raised in the exposure draft.

Leases are a very important class of transactions and source of financing for entities. However, accounting for leases has been criticised over the years. Far therefore supports the decision to develop an accounting model to replace the existing IAS 17, provided that the proposals offer an effective improvement over the existing requirements. While there are conceptual merits in some of the proposals included in the exposure draft, Far is not persuaded that the proposals offer an effective improvement for a number of reasons, summarised below and explained in detail in Appendix 1 to this letter:

- The boundary between leases and service contracts is difficult to determine. Far is not convinced that the proposed criteria carried over from IFRIC 4 provide the necessary robust and operational distinction required to determine which accounting treatment is appropriate and most meaningful for the specific transaction;
- The hybrid model for lessors replicates in substance the existing model in IAS 17; the justification for the performance obligation model contradicts the rationale for having lessees apply the right-of-use approach to all leases. Far supports the right-of-use approach for lessees and a single partial derecognition model for lessors;
- Amounts due under options and contingent rentals should not be included in the measurement of the lease assets and liabilities. Far believes that these components are distinct from the contractually unavoidable rental payments and does not meet the definition of a liability.

As a result, Far does not believe that the proposals are effective in addressing the concerns about the complexity of lease accounting and comparability of information. Furthermore, Far is not convinced that the proposals result in information that is relevant to users of financial statements.

Far believes that IASB should further develop and field-test its thinking to:

- better define what information users really need;
- clearly distinguish between what should be recognised in the financial statements and what should be disclosed, the distinction being based on the definition of assets and liabilities;
- articulate supplementary criteria to support a robust distinction between leases and service contracts.

Far

A handwritten signature in black ink that reads 'Göran Arnell'.

Göran Arnell
Chairman Far Accounting Policy Group

Appendix 1

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?

Far has a number of concerns about some specific aspects of the model that are addressed in our responses to Questions 6 to 10 below. However, on balance Far believes that a right-of-use model provides useful information.

As further explored in Far's response to Question 4 below, under the proposals the accounting treatment of lease transactions and service arrangements is significantly different. Therefore, it is crucial that the definition of a lease be further improved to clearly distinguish leases from services.

Far agrees that if the right-of-use model is applied, a lessee should recognize amortization of the right-of-use asset and interest on the lease liability.

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?

First of all it should be clearly stated that Far appreciates the fact that the boards have included a model for lessor accounting thus presenting a draft standard covering both lessees and lessors in a lease transaction. The single focus on lessee accounting in the discussion paper was a major concern in Far's comment letter in response to the discussion paper on lease accounting released 2009. Far finds this to be a significant improvement both with regards to comparability and understandability from the perspective of the user, it lessens complexity in application for the preparers and also lessens the risk of the need for further changes in lessee accounting when a standard for lessor accounting should be developed separately from a standard for lessee accounting .

Far would also like IASB to further explain why the lessor approach with a hybrid model should be superior to the hybrid model used today in IAS 17. If the rationale for developing a new and improved leasing standard is that the current IAS 17 is flawed, then it is not obvious to Far why the use of a hybrid model with similar characteristics for determining the accounting treatment for lessors as in the current distinction between finance and operating lease, would be an improvement from previous standard. In Far's view the guidance in paragraphs B22 to B27 for distinguishing between the performance obligation and

derecognition approach is not particularly well-developed and the application of this guidance can actually lead to less comparability than the current use of the reasonably well-understood criteria in IAS 17 for classification purposes.

However, it should be noted that the proposals regarding lessor accounting are based on a hybrid model which seems to be based on the notion of the exposure to risks and rewards associated with the underlying asset. In Far's view, IASB should present valid arguments and a clear rationale in support of this solution, since Far is not convinced that there are conceptual underpinnings for the conclusion to use a hybrid model for the lessor, but one right-of-use asset approach for the lessee as will be further developed below.

Firstly, it is worth noting that in paragraph BC25, IASB concludes that it would not be appropriate to apply a one approach model for lessor accounting since it can be argued that there are differences in economic substance between types of transactions. However, no further explanation is given as to why this is only relevant with regard to the lessor, and Far is of the opinion that the same could be argued on account of the lessee. Given the nature of the transaction, where one party gives the other party the right to use the underlying asset, is it not clear to Far why the difference in economic substance of the transaction is only relevant with regard to one of the contract parties, but not the other. From a theoretical point of view, it seems difficult to argue otherwise that the substance of the contractual arrangement is transferred from the lessor to the lessee and thus the transfer from the lessor should in principle mirror the reception of the lessee, which merely underlines Far's view as expressed in the previous section.

Secondly, it might be prudent to look at the "accounting object" of a lease transaction. In Far's view, the right-of-use approach implies that IASB views the asset, and thus the "accounting object" as a "bundle of rights and obligations" that can be separated from the underlying asset by contractual dispositions. The separated object is thus the relevant object for the accounting treatment. Given this premise, the requirement for the lessee to recognize a right-of-use asset and a lease liability suggests that a transfer has been executed, especially when taking into account the view of BC7 p. b of the ED, where the boards explicitly state that a lease contract is not an executory contract after the commencement of the lease, thus it is still an executory contract **before** the commencement of the lease, indicating that there is a discrete point in time where "control" over the asset is transferred. Consequently, if the relevant accounting object has been transferred from the lessor to the lessee, why should the underlying asset still be recognized as an asset with the lessor under the performance obligation approach, given the fact that the leasing contract treatment implicitly seems to not be concerned with the underlying asset? In Far's view, IASB has not been fully clear if the conceptual underpinnings for lease accounting are actually the "bundle of rights and obligations" derived from the asset or the underlying asset itself.

Furthermore, if the control of the underlying asset has been transferred, it can be argued that this should lead to derecognition, as the underlying asset would then not meet the general asset recognition criteria, to the extent of the amount transferred. However, in BC 18 IASB provides additional insight into the underlying reasoning for this approach, stating that it is continuously satisfied during the leasing period, which to Far seems inconsistent with the view of BC7, where the lessee is unconditionally required to pay for all the lease term, thus the lessor should have the unconditional right to receive the payments, further stressing Far's point on diverse conceptual underpinnings. Far would encourage IASB to further develop

these areas to ensure a consistent view on the issue from the perspectives of both lessor and lessee.

Thirdly, in Far's view the performance obligation model would lead to double-counting of assets, thus stressing once again that there seem to be differences in how the asset is viewed from the perspectives of the lessor and lessee. In Far's view, if the lessee has received an unconditional right-of-use derived from the underlying asset, then the lessor respectively would have lost the same unconditional right, thus indicating that this part should be derecognized, as Far has already indicated above. A question otherwise to answer would be what the recognized underlying asset actually is. Far would strongly encourage IASB to further investigate these areas and clarify its position and conceptual underpinnings related to the use of the performance obligation model.

Based on the above stated arguments, Far's view is that the use of a single derecognition model for lessor accounting would be preferred instead of the proposed hybrid model suggested in the ED. Far believes that this would create a more theoretically consistent approach to lease accounting, address several of the issues Far has discussed above and also lead to lease accounting that ought to lead to better comparability and thus improve user information.

Question 3: Short-term leases

The exposure draft proposes that a lessee or a lessor should apply simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term 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 recognize lease payments in profit and 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 recognize assets and liabilities arising from short-term leases in the statement of financial position, nor derecognize any portion of the right to use the underlying asset. Such lessors would continue to recognize the underlying asset in accordance with other IFRSs and would recognize lease payments in profit and loss over the lease term (paragraph 65). See also paragraph 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?

Far does not agree with the proposed approach. Far does not believe that the simplified requirements to short-term leases will result in any significant cost savings as Far believes that it is much more time-consuming and thus costly to identify and keep track of all short-term lease agreements rather than discounting lease payments once identified. Consequently, Far is questioning whether the proposed approach will provide any meaningful relief in practice. Therefore, Far would suggest an approach or an exception that would allow preparers to apply the current IAS 17 guidance regarding operating leases instead.

Question 4: Definition of a lease

(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?

As a starting point for the analysis, it would be prudent to conclude that in Far's view, the conceptual unclarity as to the actual "accounting object" discussed in more detail under question 2, manifests itself in the definition of a lease. It focuses rather heavily on the underlying asset rather than the benefits of the right-of-use asset; that in Far's view is the actual transferred object that constitutes the lease contract.

Is the lease defined appropriately?

With regard to the definition of a lease contract, it should be noted that for the lessees it solves the classification distinction between finance and operating leases, which is considered to be a major flaw with the current IAS 17, but the hybrid model proposed for lessors does not remove this. Far would consider the creation of symmetrical treatment between lessor and lessee in this regard to be preferred.

Furthermore, it is important to note that the ED highlights the highly complex boundary between lease contracts and service contracts to be handled. As stated in ED BC 7 p. b, IASB would consider a lease to be an executory contract up to the commencement of the lease, whereas a service contract continues to be an executory contract up to the point when the service is actually delivered. With reference to Far's observation on the definition of a lease contract made above, application issues might arise as to the distinction between a lease and a service contract, since no consideration is given to the actual underlying business logic for the transaction. Far does not consider it to improve comparability or promote consistent accounting treatment and it may lead to transactions similar in economic substance being treated in a fundamentally different way, since the key indicator for the transformation of an executory contract is an actual transfer of an underlying asset, not the transfer of the "bundle of rights and obligations".

On the issue of merely incorporating the requirements of IFRIC 4 into the proposed leasing standard, Far has the following concerns. Firstly, Far is not convinced that the criteria as indicated in IFRIC 4 necessarily provided the robust and operational definition of the distinction needed to distinguish between service contracts and a lease, which in Far's view is a highly critical exercise given the fundamental differences in accounting treatment between a service contract and a lease contract. Secondly, in Far's view it should be noted that IFRIC 4 may be considered to be an anti-abuse standard, prohibiting the use of a middleman to evade the criteria for recognition of a finance lease under IAS 17. To merely incorporate such an anti-abuse rule into a principles based standard without any revision to it, may not be desirable and may lead to unintended consequences when the preparers apply it.

It should also be noted, in connection with the issue of incorporating IFRIC 4 directly into the standard, that Far would like to direct the IASB's attention to the following matter. It is not clear from the application guidance in B1-B4 whether the classification of the underlying contract should be done only at inception, or whether there should be reassessments due to facts and circumstances. Given the approach with reassessment if fact and circumstances would indicate a significant change to the amounts related to the liability to make lease payments or the right to receive lease payments, it would in Far's view be consistent to clearly state that a similar change in facts and circumstances related to the classification of the contractual relationship would be subject to reassessment. It would be beneficial if IASB considered clarifying whether such reassessment should be carried out. In addition, Far would also encourage IASB to revisit the guidance in paragraphs B1 to B4 to clarify the application issues, since this is a crucial definition and also to adjust the criteria to a principles based approach.

Far would also like to point out the issue with the specificity criteria in the definition of a lease. Far notes that many contracts that may be considered to be a lease depend on the support of non-specialized assets. For example, assume that a company actually outsources its IT-operations structure to another company. The outsourcing company can use a number of easily interchangeable assets to deliver the contractual requirements to the company, i.e. a generic server park. The question would then be if this would actually constitute a lease given the specificity criteria, since it is delivered by non-specific assets? Far also notes that this may give incentive to structuring of transactions, where several parties may contractually agree to switch assets with regular intervals, and thus in theory may evade the specificity criteria. Please note that such arrangements as described here may constitute significant amounts in future payments. Far would prefer that IASB further discussed this matter in the application guidance in order to provide better guidance on the real world application.

Finally, given the fact that the definition of a lease contract actually forms the base of the standard itself, together with the scope of the standard, Far would prefer to have the definition of a lease within the standard itself rather than as part of the definitions.

Do you agree with the criteria for distinguishing leases and sales/purchases?

IASB distinguishes leases and sales/purchases by defining to the transactions that transfer the control of the underlying asset and all but a trivial amount of the risks and benefits associated with the underlying asset. Apart from the above discussed issues on the wording of the definition itself, which in Far's way may cause problems here as well, Far would like to mention the following.

Far notes that in ED BC9 the distinction is based on two conditions, and as far as can be ascertained, the wording indicates that both conditions need to be met in order to constitute a sale. Should that not be the case, Far would encourage IASB to clarify this issue. However, in ED BC10, the two criteria specified are in Far's view limited to the transfer of control and not the risks and benefits derived from the underlying asset. This further reinforces Far's view that IASB needs to clarify the distinction between a sale and a lease.

Far would also like to point out that the current definition of a sale in ED Leases does not seem to be consistent with the definition in ED Revenue recognition. In the latter ED, only transfer of control is required. This might in some circumstances lead to a situation where the transaction does not qualify as a sale under ED Leases but would do so under ED Revenue

recognition. IASB should revise this section and ensure that the definitions used here are aligned between the two standards to avoid situations of standards colliding or not covering a specific transaction type.

Is the guidance for distinguishing lease contracts from service contract in B1-B4 sufficient?

Given the high complexity of the distinction between a service contract and a lease contract, as Far has indicated above, together with the mere inclusion of IFRIC 4, Far is not convinced that the guidance in B1 to B4 provides a proper base of information for determining the classification of a contract as either a lease contract or a service contract. For example, in Far's view in contracts where the provider has the possibility to switch the underlying asset, the specificity criteria might not be met. This may also lead to asymmetrical treatment between the provider and recipient and one party may conclude that the arrangement is a lease whilst the other concludes that it is not. In Far's opinion, that is no improvement to the current standard, since it will not lead to faithful representation of the substance of the transactions. In B2 and B3, IASB indeed itself indicates the problem, while noting that a contract with a possibility for substitution of asset may or may not be a lease, given the other conditions. Far also finds the example with the aircraft not particularly well-suited, since Far does not agree that it will always be impractical for a supplier to use another aircraft to deliver services, and there might be structuring possibilities here, which are highly tempting given the value of an aircraft. The examples also indicate that there may be possibilities to avoid application of the standard by simply creating a rotation of asset between providers and thus may such a contract from a lessee perspective not constitute a lease contract but a service contract.

Question 5: Scope and scope exclusions

The ED proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use of minerals, oil, natural gas and similar non-generative resources.

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?

No, Far does not see the rationale justifying this scope exclusion. Far's main concern is with regards to intangible assets and it is Far's view that they should be within the scope of the ED and thus the final standard. Consequently, Far argues that the guidance on revenues from licenses currently included in the ED Revenue from Contract with Customers should be removed and instead be treated as all other lease agreements by lessors. With this in mind, it is Far's view that regardless of where the guidance is placed it should result in the same accounting outcome when revenue is earned/recognised.

Far believes that the suggested scope exclusion could also result in practical implications for preparers and adding what Far believes would be unintended complexity in the standard. For instance, it is not uncommon that lease agreements include both intangible items and items of PPE. In such contracts, Far understands that an entity needs to segment the contract into two different components and account for them separately under different standards. Far can see a risk that the complexity added may result in different accounting treatment for similar agreements, which would not benefit the users of financial statements.



Based on the above, Far strongly recommends the IASB to reconsider the scope and to perform an in-depth investigation of issues related to leases of intangible assets.

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?

Far is concerned about the proposals for the treatment of arrangements that have both service and lease components. Far disagrees with the rule to apply lease accounting to the whole contract if it includes both service and non-distinct service components. Far believes that lessees in accordance with the current treatment under IFRIC 4 should separate payments for the lease from other payments using an estimation technique (see paragraph 14 of IFRIC 4). Far believes that lessees should be able to achieve this in most cases. When lessors apply the derecognition approach, the receivable will not include the amounts for undelivered non-distinct services. Accordingly, separation of payments for the lease and non-distinct service components is required for lessors using the derecognition approach, and Far supports symmetry of treatment between lessors and lessees. As a result, Far believes that lessees should always be required to separate lease and service components, whether they are distinct or not.

Question 7: Purchase options

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 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 purchase options and why?

Far agrees with the proposed treatment, i.e. when the option is exercised.



Question 8: Lease term

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

Far believes that the proposal to include amounts due under renewal options in the measurement of lease payable and receivable is inconsistent with the Conceptual Framework and does not provide relevant information to users of the financial statements. Far instead suggests that only unconditional contractual obligations are reflected in the measurement of the right-of-use asset and lease liability.

Far shares the concern expressed by Stephen Cooper in paragraphs AV2-AV4 of the exposure draft (ED). Far agrees that options to extend a lease provide the lessee with the flexibility to react to changing business circumstances and consequently these features reduce risks. If all lease payments in optional lease periods are included in the recognition and measurement of the right-of-use asset then the resulting liability and related measures of financial leverage are overstated. In Far's view, this fails to provide useful information about the economic position of the lessee. Furthermore, Far considers that rentals payable in an extension period do not meet the definition of a liability based on the Conceptual Framework, until the renewal option is exercised. The lessee does not have an unconditional obligation to pay as long as it does not exercise the option. In addition, Far considers that rentals receivable in an extension period do not meet the definition of an asset based on the Conceptual Framework, until the renewal option is exercised. The lessor has neither an unconditional right to receive nor control over these amounts as long as the lessee does not exercise the option.

In addition to that rentals payable and rentals receivable in extension periods do not meet the definition of a liability and asset, respectively, the proposed model would require unreasonable levels of effort and it is questionable whether the proposed model would give reliable information.

The suggested approach would give rise to significant extra costs for companies to assess and reassess the likelihood of the exercise of options for a large number of lease contracts that in many cases will run into the thousands. This is burdensome, complex and judgemental for both parties because the lessee may not have reliable information at every reporting date about future market rentals for the asset and therefore be unable to assess if the option is favourable or not and the lessor may not be aware of the lessee's decision that may impact the likelihood of the renewals (e.g., a decision to relocate). Including these amounts increases volatility because they are likely to be reassessed and may reduce comparability because entities in similar situations with similar leases may end up accounting for them quite differently.

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?

Far notes that there are different categories of contingent rentals. Contingent rentals that are linked to the use of an asset or the performance of the asset are under the control of the lessee and similar to an extension option. Far believes that contingent rentals linked to the use of an asset or the performance of the asset do not meet the definition of current obligation because the obligation results from a future decision of the lessee. Rentals that are contingent on a future price index meet the definition of an unconditional obligation where the uncertainty only relates to the measurement of the amount to be paid. Far supports the alternative view, expressed by Stephen Cooper, that contingent rental arrangements which vary upon usage or performance of the asset provide the lessee with additional flexibility and reflecting them in the measure of the lessee's liability does not provide relevant information about the underlying economics of the agreement.

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?

Please note that Far is not in agreement with the proposal for estimation of lease term as discussed in more detail in question 8 above. Far has raised some serious concerns about this approach. However, the following is based on the assumption that IASB were to proceed with the proposed model for estimation of lease payments and thus the valuation of the liabilities and assets as indicated in the ED. Under this assumption, Far does in principle agree with the suggested treatment, since it is in general consistent with the proposals related to initial measurement. However, Far also wishes to raise the following issues.

The requirement to perform regular remeasurements of lease contracts, as Far understands it, would be on a contract to contract basis and not using a portfolio approach will be a resource intense and very costly exercise. It is not uncommon for large companies to have leasing portfolios amounting to several hundred of thousands of contracts and in practice this will be an extremely burdensome task. Furthermore, it should be noted that it might also require significant investments in ERP-systems, to Far's knowledge the current available system does not have full application capabilities for the suggestions as stated in the ED. Given these real world application issues, Far would like to state that IASB should further investigate if this type of information is actually required by the users, since this has not been fully demonstrated, and based on this perform a cost/benefit analysis of the remeasurement proposal. Far does not consider the arguments and analysis put forth in BC200 to BC205 to be either convincing or well-supported by empirical data or other evidence. Far would also welcome if IASB would consider the use of a portfolio approach for the remeasurement, subject to conditions that the entity using it should manage its leasing operations on a portfolio basis.



Far would also like IASB to further operationalize the concept of significant change, since in Far's view this might be beneficial to comparability between financial statements. Given the above-mentioned view of the burdensome and high cost task of remeasurement, in the absence of a more detailed operationalization, the application may differ between preparers and thus reduce comparability and information usefulness.

Question 11: Sale and leaseback

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

Far believes that the answer to the above-stated question is best presented under different subheadings, since the questions raise several different issues for discussion.

Identification of a sale?

As already noted in Far's answer to question 4, there seems to be a difference between the general definition of sales in ED Leases and ED Revenue Recognition, which is equally applicable on an SLB transaction. As Far understands it, the IASB intends to use the same criteria for SLB transactions as for ordinary sales, as indicated in paragraph BC162. Having said that, it should be noted that B31 actually states that SLB transactions may have conditions that are not applicable in usual sales and adds a list of such conditions. The intention is not clear, but the obvious interpretation is that these additional conditions must also be evaluated in order to conclude whether there is a sale in an SLB transaction. This would lead to the situation where there are actually three different definitions of what constitutes a sale. Far believes that this is not the IASB's intention. It would therefore be prudent to realign the definitions of what constitutes a sale between sales/leases and SLB transactions first, preferably by moving the description of conditions to paragraph B9, which forms the basis for the distinction in ED Leases. The next step would then be realigning the definitions between ED Leases and ED Revenue Recognition in order to get coherence between standards.

The concept of financing

It should be noted that the ED in paragraph 67 b introduces the concept of financing, indicating that if the criteria for a sale are not met, then the asset should not be derecognized and the proceeds should be accounted for as a financial liability from the perspective of the transferor. Far believes that there is insufficient guidance as to the treatment for this type of asset. A few examples of real world application issues would be the following.

Should it be considered to be a lease asset or continue to be treated under IAS 16? There will be issues relating to depreciable value and thus depreciation and the useful life of the asset. It could, in Far's opinion, be argued that the SLB transaction would most likely lead to a change in the useful life, but there is no guidance as to the basis or the procedure to be used if such remeasurements to be made. From the perspective of the transferee, there would be similar issues. The transferee would in many cases have costs for repair and maintenance or even subsequent costs that may meet the threshold for recognition, but will have no asset to which to allocate them. Far believes that IASB should provide guidance on these matters. There might also be issues related to presentation of cash flows and expenses related to this

transaction, such as classification of cash flows in the cash flow statement or classification of expenses in the statement of comprehensive income.

From Far's perspective, this proposed change of the accounting treatment for these types of transaction does not seem well thought through by IASB. It is not clear to Far why the proposed changes would provide a better and more useful treatment than the accounting of today, where in principle a "quasi sale", meaning a sale that does not transfer the significant risks and rewards from seller to buyer in an SLB transaction will not lead to derecognition of the asset. Given this and the above discussed issues, Far would strongly recommend IASB to revisit the accounting treatment of SLB as part of the ED to further develop the conceptual underpinnings and to clarify the actual application issues.

Accounting treatment of SLB transactions?

It should also be noted that Far is not convinced that the proposed accounting treatment could be seen as coherent with the underlying concept of "bundle of rights and obligations" as would be the conceptual premise adopted by IASB. As already stated, the performance obligation approach, in Far's view, would not be consistent with this underlying concept.

Far would argue that this conceptual premise should lead to the conclusion that the "bundle of rights and obligations" could be separately negotiated and transferred, thus implying that it could be transferred between the contract parties. With regards to SLB transactions, Far would consider the solution chosen with a sharp distinction between sales and non-sales together with the performance obligation approach to be inappropriate, since it may be interpreted as to be linked to the underlying asset rather than the "concept of bundle of rights and obligations". Given this view, Far would prefer the following treatment as this would be congruent with a partial derecognition model for lessors.

The seller/transferor would have transferred the residual asset and financed the portion of the asset that he is still entitled to use, as these separate assets would reflect transferable "bundles of rights and obligations". The buyer/transferee would then have received the residual asset and a lease payable, reflecting the right to payments for the "right-of-use asset" that the seller has kept. Consequently, the following accounting treatment would apply:

- The seller/transferor should derecognize the portion of the asset transferred (residual asset) and recognize a liability to pay lease rentals over the lease term for the "right-of-use asset" kept.
- The buyer/transferee should recognize the asset purchased and recognize a financial receivable for the "right-of-use obligation" that has been used by the lessee.

In Far's view, the argument put forth by IASB in BC161 stating that such an approach would be too complex is not valid. A similar allocation would be required when a lessor would use the derecognition approach, see ED paragraph 50, and Far fails to see why this approach would not be appropriate in an SLB situation. Far suggests that the conclusion reached by IASB in the above-mentioned paragraph may be premature, as the allocation between the sale/purchase and the financing portion in the SLB situation should in principle be no more complex than in an ordinary derecognition transaction.



Other issues

- Transactions with JV or Associates in separate financial statements? Always financing?
- Structured transactions involving SPE/SPV?
- Control vs. Risk and Rewards?

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?*

Far agrees with the proposed alternative.

- (b) *Do you agree that a lessor applying 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 or lease liability (paragraphs 42, BC148 and BC 149)? Why or why not? What alternative presentation do you propose and why?*

Far believes that presenting a net balance on the face of the statement of financial position and providing further details including a breakdown in the notes would be more appropriate. Far believes that the level of detail would be too much if presented on the face.

- (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?*

Far agrees with the proposed alternative.

- (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?*

Far believes an intermediate lessor should disclose all information in the notes instead.

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?

Far supports the informational requirements as put forth in the ED and believes that it will provide useful information for investors on a general level. However, Far has the following remarks.

In Far's opinion it would be sufficient to present this information in the notes rather than on the face of the statement of comprehensive income. Far would also like to stress that the informational requirements in some cases seem to extend the current requirements of IAS 1, when it comes to presentation on the face of the statements and IASB should consider whether some of the informational requirements could be made in the notes rather than on the face of the statements. In Far's view, a too detailed presentation and disaggregation requirement for the statements may be contra-productive and lead to informational overload rather than improved decision-usefulness. These remarks are equally valid for both lessor and lessee.

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, BC 147, BC 153 and BC 159)? 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?

Far thinks that this information should be disclosed in the notes in order to avoid information overload on the face of the statement of cash flows. If you argue that this information should be on the face of the statement of cash flows, you can also argue that pension payments, salary payments, and many other payments in the business should be reported on the face of the income statement, and Far thinks this approach is wrong.

Question 15: Disclosures

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

- (a) Identifies and explains the amounts recognized 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?*

The disclosure requirements are very extensive and would in practice result in rather time consuming and expensive implementation costs. Therefore, Far urges the IASB to even further clarify the importance of materiality when applying the requirements in practice. With this in mind Far believes it would be fair to exclude the reference to IFRS 7 and instead only apply the guidance in paragraphs 85 and 86 and that paragraph 83 only should be applied for lessors.

Question 16: Transition

(a) The exposure draft proposes that lessees and lessors should recognize 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?

Far agrees.

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

Far believes that full retrospective application should be permitted. Far does not think that there are conceptual reasons to prohibit it when entities have the relevant information.

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

IASB should clarify the transition provisions in order to clarify that the lease term to be used should be the lease term as defined in the ED, not the lease term defined as the non-cancellable contractual period as defined in IAS 17.

Question 17: Benefits and costs

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?

Far does not agree with the assessment that the benefits of the proposals would outweigh the costs. Far believes that costs for education, robust upgrades of accounting systems and implementation of new processes and controls will be very significant for many companies. In addition, companies will have costs for determining an appropriate discount rate on a contract-by-contract basis, to initially determine and thereafter reassess contingent rentals and lease terms on a contract-by-contract basis, and of gathering and compiling lease information that might be distributed all over the world and associated with leases that have different contract terms.

Question 18: Other comments

Do you have any other comments on the proposals?

No.