POSITION PAPER
29th November 2010

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom
Sent electronically to www.iasb.org

FASB/IASB Exposure Draft ED/2010/9 – Leases

Dear Sir/Madam,

The Swedish Bankers' Association and the Association of Swedish Finance Houses and the Associations' members (the Associations/we/our) appreciate the opportunity to respond to the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) Exposure Draft ED/2010/9 – Leases (ED). The Associations are members of Leaseurope through AFINA. The Associations have played an active part in the handling of this matter by Leaseurope and by the European Banking Federation (EBF).

In summary we consider that the proposed standard should not be introduced. Our main concerns behind this view are as follows:

- The ED does not meet its purpose of improving transparency in accounting for leases and the administrative burden for lessees and lessors is increased as a result of the complexity of the proposal.
- The ED is lacking a thorough cost/benefit analysis. We consider this to be necessary as it must be possible to validate that the proposed new rules lead to substantial improvements in comparison with retaining and revising the current standard.
- The Associations consider that the current standard for accounting for leases (IAS 17) works well and is an established and accepted standard that should be retained, where the requirements for supplementary disclosures for both lessees and lessors can be developed.
- We believe that the accounting approach for both lessees and lessors should start from the contractual aspect of the contract, i.e. what has been agreed between the parties to the contract. Only contractual obligations should therefore be recorded and it should only be one accounting model for both lessees and lessors.

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1. Summary of our position and key concerns

- The Associations’ view is that the ED adds to the complexity of accounting for leases. As a result of the complexity and scope of the proposal we obtain a standard that is not adapted to entities’ business models.
- We consider a cost/benefit analysis to be necessary as it must be possible to validate that the proposed new rules lead to substantial improvements in comparison with retaining and revising the current standard.
- Several conceptual issues have been identified, such as the fact that the proposal for accounting for lessees and for lessors is not consistent. Options to extend should not be included in the valuation of liabilities for either lessees or lessors. Furthermore, the proposal leads to new problems in distinguishing between purchase and lease and also distinguishing a lease from a service contract. We introduce our “liability-to-pay model“ for lessees and we prefer the derecognition approach for lessors.
- The proposal on subsequent measurement does not reflect the linked nature of the lessee’s obligation to make payments and the right to use the asset. Costs for lessees will be dramatically increased in the earlier parts of lease contracts. The lessee’s right of use asset should be measured on an amortised cost basis using mortgage-based amortisation to appropriately reflect its pattern of consumption of economic benefits and the liability should be amortised according to the same methodology.
- The proposal signifies reduced comparability and understanding in comparison with current rules, as a greater proportion of subjective factors is introduced in the proposed standard. The proposal therefore increases complexity and does not result in a fairer presentation being obtained. Nor is the proposal consistent with the EU’s efforts to simplify the regulatory environment, tending rather in the opposite direction.
- Simplification requirements for short-term leases should be expanded.
- The proposal is not suitable for premises.
- Competition is reduced as the number of lessors can be expected to decrease.
- The supply of financing is made more difficult for companies as plant and machinery cannot be used as security for financing to the same extent as previously. This will lead to companies instead seeking other forms of financing.
- The proposal means that leasing is discriminated in relation to other forms of financing and that opportunities to finance entities are adversely affected.
- The proposal may lead to greater volatility and procyclicality in entities’ financial results and have an impact on entities’ business models.
- Knock-on effect on SMEs and other unlisted companies. If the proposal is implemented, the new standard, like IAS 17 and its principles, will be applied by a substantially wider circle than listed companies, and the proposal must therefore also be assessed on the basis of what effects it has on unlisted companies, including SMEs.
- The lack of a proposal for the entry into force of the ED leads to uncertainty.
2. Development of key concerns

Our key concerns are described in the section below.

Complexity and not adapted to entities' business models

The Associations’ view is that the ED adds to the complexity of accounting for leases. As a result of the complexity and scope of the proposal we obtain a standard that covers most types of leases and is not adapted to entities’ business models: a kind of one-size-fits-all solution. The subjective components of measurement requirement for options to extend to lease term and for contingent rentals add to the complexity of accounting for leases. Our overall judgement is that the alleged advantages of the proposals do not outweigh the drawbacks associated with the proposal.

Cost/benefit analysis

We wish to question the benefit of the ED. We do not consider that FASB/IASB have demonstrated that the benefit outweighs the costs associated with the envisaged new standard. The Associations wonder, with all the elements of subjective assessments with which the ED is associated, whether this really leads to a situation where “users would receive better information about expected cash flows”.

When new or amended rules are introduced, a reasonable requirement is that they should be accompanied by a thorough impact assessment. The reason why an impact assessment is needed is that it must be ensured that rules are not introduced or amended without there being an observed need and that the proposed rules are appropriate and proportionate to their purpose. In addition, the assessment is needed to ensure legal certainty for those who are going to apply the amended or new standardisation. This creates the necessary basis for predictability and transparency in standardisation. We consider the cost-benefit considerations in the ED Basis for Conclusions to be fragments of an impact assessment and not to provide sufficient backing for the proposal. We would therefore like to see, firstly, greater clarification of the problems FASB/IASB consider to exist with the current standard and, secondly, an analysis of the effects of the proposal principally for those who prepare and use financial statements. In addition, it must be shown that introducing a new standard offers benefits in comparison with developing and refining the current standard. We therefore consider that the underlying purpose of the ED has not been achieved, and we consider that this must be shown through a thorough impact assessment.

Several conceptual issues have been identified

We have noted several conceptual issues through the proposals in the ED. The more key conceptual issues we have identified include the following. The proposal to introduce a “right-of-use model” for the lessee’s accounting and two models, the “performance obligation approach” and the “derecognition approach”, for the lessor’s accounting mean that accounting is not consistent for lessees and lessors. We advocate symmetrical accounting for lessees and lessors. We therefore instead favour one model being introduced for the lessor’s accounting. EFRAG and Leaseurope also emphasise similar views in their responses to the ED, where they advocate a “single partial derecognition model” and “a simple right-of-use model for all leases” respectively.

We furthermore consider that options to extend should not be included in the valuation of liabilities for either lessees or lessors. The reason for this approach is that uncertainty prevails as to whether the option to extend the contract will be utilised or not. We note that EFRAG has also expressed this opinion in its draft common letter to the ED.
We favour our "liability-to-pay model" – where the point of departure is the contractual aspect of the contract, i.e. what has been agreed between the parties to the contract. The focus in our approach is on the liabilities side of the statement of financial position – on what the lessee is obliged to pay as a minimum, which is to be recognised as a liability. If the lessee does not have any commitment through the option neither does this mean that the lessee has any obligation to value the option or take account of it in valuing an asset and liability item.

FASB/IASB have identified the problems of demarcation and classification with the current IAS 17 as an argument for revising the current rules. In our view, new areas of demarcation and classification will arise for both lessees and lessors with the ED. Lessees will have great difficulties in distinguishing between service contracts and leases as the boards have failed to achieve a robust and functional definition of a lease. Lessors starting from one distinction – finance or operational - in IAS 17 will face not less than five new complex distinctions: 1. To determine if the lease meet the definition of a sale, 2. Transactions accounted for under the derecognition model, 3. Transactions accounted for under the performance obligation model, 4. Short term leases 5. Inconsistency with the revenue recognition ED might result in a fifth category of transactions as transfer of control can be sufficient to qualify a transaction as a sale under the revenue recognition ED but not necessarily under the lease proposals.

Lessor accounting – The proposals to introduce two models, the "performance obligation approach" and the "derecognition approach" for the lessor's accounting mean that the accounting is not consistent for lessors and lessees. IASB/FASB has not provided any clear rationale to support a hybrid model for lessors. Given that IASB/FASB believe in its own critic of the current standard (IAS 17) it does not make sense to propose a new distinction that is difficult to operate and may lead to accounting arbitrage. A difference in the economics of the transactions (or business models) is not a convincing argument as the same can be said about lessees. The performance obligation model does not appear to be consistent with the concept that an asset is a bundle of rights - which implies that rights transferred to the lessee should be derecognised by the lessor. There is also a contradiction in the fact that the lessor's performance obligation (to permit the lessees to use the asset over the lease term) is satisfied continuously while the lessee has an unconditional obligation to pay for the right of use for the full lease term as soon as the lessee has access to the object. In the proposed performance obligation model the lessor does not only recognise a lease receivable but continue to recognise the whole asset. This results in double counting of the same asset. In fact this conceptual flaw is so significant that IASB/FASB are forced to hide it behind a net presentation.

We prefer instead that one model be introduced for the lessor’s accounting. We support the derecognition approach. The derecognition approach does not fail to represent if the lessor is exposed to asset risk as the lessor is required to maintain the residual asset in its books. The fear that lessors could recognise revenue Day 1 for services not delivered as lessors shall separate service components even when they are not distinct are groundless. The recognition of gain is conceptually consistent with a derecognition model. Lessors who are in the economic position of a manufacturer/dealer should be able to recognise manufacturer/dealer gains immediately. This is possible under IAS 17 and works well. The accounting rules should not dictate the business model or organisation of companies. The accounting rules should be neutral with respect to how manufacturers or dealers resolve sales-supporting financing, including leasing. It should be possible for a normal sale profit or loss to be recognised as such regardless of whether lease financing is provided through the same company, a group (finance) company, a bank or another external finance company.
Linked approach
Subsequent measurement should, like at the commencement of the contract, continue to reflect the fact that the lessee’s liability to make lease payments and its right to use the lease asset originate from the same contract. Should the right of use model be applied we therefore favour a "linked approach" between the asset and liability sides for all leases. The lessee’s right of use asset should be measured on an amortised cost basis using mortgage-based amortisation to appropriately reflect its pattern of consumption of economic benefits. With reference to the proposal of the boards, the unique characteristic of a leased right of use asset implies a separate presentation in the statement of financial position, as tangible assets but separately from other assets that the lessee does not lease. Rights to use do not have the same nature as ownership rights and one should therefore not look to existing depreciation requirements for tangible assets but should instead use a stand alone method where, as mentioned, mortgage-based amortisation is used. The liability should be amortised according to the same methodology. With the proposed subsequent measurement in the ED costs for lessees will be dramatically increased in the earlier parts of lease contracts. This does in our view not represent a true and fair view of the economics of lease contracts.

Reduced comparability and understanding, increased complexity and not in line with efforts to simplify the regulatory framework in the EU
As a result of rules for example on subjective measurement which are difficult to apply, the subjective elements in the application of the accounting rules are increasing and are having the effect of lowering the quality of the financial information. The complexity of the ED may therefore mean that we have reduced comparability and understanding, which may jeopardise fair presentation in accounting in comparison with current rules. Such a development does not benefit those who prepare, use or are standard setters for financial information.

A key argument against the ED is the increased complexity associated with the proposal and the consequences this may have principally for those who prepare financial information. In our judgement, the current problems of defining what can be regarded as constituting a finance lease or operating lease will be replaced by problems principally with complex valuation and measurement issues.

The accounting standards (IFRS) adopted by IASB today are global standards. National standards bodies in more than 100 countries require or allow IFRS to be applied. In the European Union (EU), the European Parliament and the European Council have decided through a Regulation (1606/2002/EC) that the Member States are to apply IFRS in preparing consolidated accounts if the company’s securities are listed on a regulated market in a Member State. Entities in the EU thus represent a significant portion of those that prepare IFRS accounts. The European Council of the EU for the first time in 2000 initiated a process (the Lisbon process) under which the European Commission, in June 2002, drew up an action plan for simplifying and improving the regulatory environment for entities. The purpose of the plan is to boost the competitiveness of entities in the EU. The EU has decided on a reduction of 25% by 2012. We therefore consider the ED not to be in line with the efforts to simplify the regulatory environment which the EU and its Member States are pursuing for the benefit of entities. We view the ED as a major step in the opposite direction.

Simplification requirements for short-term leases should be expanded
We advocated in our response to the DP that some form of exemption be introduced in the envisaged new standard. In order to mitigate these problems, a simplified method is now proposed for lessees and lessors to recognise leases whose maximum lease term (including any options to renew or extend the contract) is twelve months or less. This proposal does not signify any actual simplification in practice for entities. Our opinion is that the concept of
simplified accounting should be expanded. We consequently believe that the proposal for simplified requirements for short-term leases should be revised and expanded. The Associations therefore consider that short-term leases should be treated according to the current model for operating leases so that it thereby becomes a real exemption for entities in practice. EFRAG has also put forward a similar approach in its draft comment letter on the ED. An exemption of this kind is particularly important for SMEs.

**The proposal is not suitable for premises**
Leases relating to premises are specific types of contracts where the proposal for accounting for lessees in the ED is not at all suitable, i.e. these contracts should be excluded from the standard. The complexity and subjectivity of the assessments in the ED will in all probability have very substantial effects on, among others, entities in retailing, which in several cases may lead to entirely unreasonable effects on the balance-sheet totals of these entities. The entities business plans are normally not exceeding 5 years. To consider a lease term exceeding both the business plan and the contractual term would mean recognition of assets and liabilities lacking the evidence that is required in all other transaction, for example support from management budgets and other types of plans. We question whether users of financial statements will find information useful, which is not supported by a company’s usual planning process. In addition, applying the right of use approach amounts may in many situations exceed market values, especially for certain types of real estate such as retail shops and offices in good locations. The proposal in the ED also leads to information which should be covered by confidentiality being made public.

**Decreased competition**
As the proposals in the ED can be expected to reduce the attractiveness of leasing as a form of financing, it will have an adverse impact on the specialised leasing entities which, unlike financial groups of entities, for example, find it difficult to offer other financing alternatives. The reason why the attractiveness of leasing as a form of financing will decrease is the increased complexity of the accounting rules which the ED entails and the associated cost increases for lessees and lessors. A decrease in the number of leasing entities in turn leads to decreased competition among lessors, which adversely affects the opportunities of customers for supply of financing.

**Supply of financing is made more difficult for companies**
The ED leads to the fact that the supply of financing is made more difficult for companies as plant and machinery cannot be used as security for financing to the same extent as previously. This will mean that companies instead seek other forms of financing. The proposal will therefore most probably have a negative effect on leasing as a form of financing. At the same time leasing is a very important source of financing to companies globally. This is especially true for SMEs.

**Discrimination in relation to other forms of financing and deterioration in financing options**
The increased complexity entailed by the proposal for customers may, as mentioned, lead to leasing as a form of financing becoming less attractive and also being discriminated against in relation to other forms of financing. Discrimination also exists in the situation that the leased asset is recognised at a higher value in the lessee’s statement of financial position than if an equivalent asset had been acquired by purchase. The proposal’s requirement for continuous revaluation of the leased asset and increased costs of lease administration, for example, are other discriminatory elements. We regard this as an unfortunate trend in view of the fact that leasing as a form of financing accounts for a significant share of global corporate financing. We consider it crucially important that the accounting rules allow different business models. Based on this approach, our view is that the rules should be
adapted to the entities' business models, and not vice-versa. The accounting should therefore illustrate what the entities do and not steer the entities towards what to do.

We judge that the proposal, if it is implemented, will detrimentally affect the options for the financing of companies, which would have an adverse impact on companies and economic development in general. Under the current rules on leasing, the lessor uses the volume of security in the objects in an efficient way. This enables companies and society to create growth. If this state of affairs is adversely changed by the ED, the opportunities for growth in companies and society will also decrease. The accounting rules must not be formulated so that they inhibit growth.

**Increased volatility and procyclicality**
The requirements for the lessees and the lessors to reassess the carrying amount of the liability/right to receive lease payments, if facts or circumstances indicate that there would be significant change in the liability/right to receive lease payments since the previous reporting period, will not only be costly for those who prepare financial statements but may also lead to increased volatility in the financial position and profits of entities and to procyclicality.

Lessees are probably more optimistic about the prospects of extending or not extending leases in good economic times and more restrictive in worse economic times, and assets and liabilities are therefore affected by the lessee's optimism or pessimism in different economic situations.

In addition, entities business models may be adversely affected by the ED. It is not acceptable from a number of points of view for accounting rules to be formulated in such a way that they lead to lower efficiency and deterioration in financial growth.

**Knock-on effect on SMEs and other unlisted companies**
If the proposal is implemented, the new standard, like IAS 17 and its principles, will be applied by a substantially broader circle than listed companies. In addition to this, there is IASB's new standard for SMEs, which is based on applicable IFRSs. Changes in IFRS standards may therefore affect the SME standard. SMEs with business offers including leasing and service to IFRSs companies will be immediately affected, as such customers will consider other solutions. The proposal must consequently be assessed on the basis of what effects it has on unlisted companies, including SMEs. It is noted in this context that leasing as a form of financing accounts for a significant share of the total financing needs of SMEs in particular. The element of structuring, which is a recurring argument for the introduction of the new standard, does not exist at all in this group of entities. Despite this the proposal, if implemented, would lead to a worsening of opportunities for company financing and higher costs as a consequence of an increased administrative burden. As we have noted above, a thorough impact assessment is lacking, and this also applies to the issue of how other than listed companies are affected. Such an assessment should be done before any new standard is introduced.

As mentioned in previous sections, decreased competition in the leasing market will adversely affect the opportunities of SMEs for supply of financing, which will lead to higher prices for financing of the customer's operation. The whole economy in society is consequently affected in an undesirable way. These are effects that standard setters, legislators etc. must take into account, formulating instead standards that have long-term positive effects on the business environment the economy in general.
Lack of a proposal for the entry into force of the ED leads to uncertainty
The ED does not contain any proposal for the entry into force of the proposed provisions. At the same time, the ED contains proposals that signify a complete "re-think" on the recognition of leases for both lessees and lessors. If the proposals are introduced, they will, among other things, necessitate reorganisation of entities' business systems, initial recording and general ledger. We regard these requirements as far-reaching, with the result that entities need time to plan and reorganise their accounting systems. We consider it crucially important that the accounting rules allow different business models. Based on this approach, our view is that the rules should be adapted to the entities' business models, and not vice-versa. The accounting should therefore provide a picture of what the entities do and not steer the entities towards what to do. We therefore consider it very important that entities are given adequate time to adapt to the future accounting standard. The time taken by this work should not be underestimated. As the ED appears at present, the proposals lead to the creation of uncertainty for those who draw up and use the envisaged new standard.

3. The Associations’ responses to the specific questions contained in the ED

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?

The Associations favour retaining the current standard for accounting of leases (IAS 17) as we consider it to work well and to be an established and accepted standard. The issues that FASB/IASB has identified could be remedied by the requirements for supplementary disclosures in the financial statements of both lessees and lessors being expanded. The key element must reasonably be that relevant information is presented and not to introduce a new accounting model when there are simpler and more cost-effective solutions.

However, if the FASB/IASB insists that IAS 17 should be replaced, we are of the opinion that a new standard should be based on the above mentioned "liability-to-pay model" rather than the proposed "right of use approach". From a conceptual point of view we believe that the accounting approach should start from the contractual aspect of the contract, i.e. what has been agreed between the parties to the contract. The focus in our approach is on the liabilities side of the statement of financial position – on what the lessee is obliged to pay as a minimum, which is to be recognised as a liability.

The following can be mentioned among the benefits of our approach: our model is less administratively burdensome than the proposal in the ED, our model provides a fairer picture (see IASB Board Member Stephen Cooper’s alternative view in the Basis for Conclusions), and creates better stability in statements of financial position and statements of comprehensive income, thus resulting in less volatility in the financial position and results of entities.

If the focus in the approach is on the "liability-to-pay model" instead of on the "right-of-use model", several of the problems with which the ED is associated disappear. An example of this is the treatment of options to extend and contingent rentals. Regarding the treatment of
options in leases, we consider that these form an important part of the contracts, but that information on these should suitably be given in the supplementary disclosures.

Contracts relating to premises are specific types of contracts where the proposal for accounting for lessees in the ED is not at all suitable, i.e. these contracts should be excluded from the standard. The proposal in the ED will, in all probability, have very substantial effects on, among others, entities in retailing, which in several cases may lead to entirely unreasonable effects on the balance-sheet totals of these entities. Examples of this are the entity's plans to retain its office premises or contingent rentals which are linked to the tenant's usage or performance. The entities business plans are normally not exceeding 5 years. To consider a lease term exceeding both the business plan and the contractual term would mean recognition of assets and liabilities lacking the evidence that is required in all other transaction, for example support from management budgets and other types of plans. We question whether users of financial statements will find information useful, which is not supported by a company's usual planning process. In addition, applying the right of use approach amounts may in many situations exceed market values, especially for certain types of real estate such as retail shops and offices in good locations.

The proposal in the ED makes it difficult for the lessee to distinguish between lease and service in the contract. For these reasons we do not support this part of the ED as we regard the proposal as excessively complex.

We believe that the FASB/IASB approach to lessee accounting is inconsistent with the Framework and will not provide users of accounts with improved information. We therefore do not favour the proposed approach.

Should the proposed standard in the ED be applied we agree that the lessee should recognise amortisation of the right of use asset. As mentioned under section 1 "Summary of our position and key concerns" we however do not agree with the proposed method of amortisation in accordance with today's requirements for tangible assets/owned rights. We instead favour a linked approach where the liability is amortised using a mortgage-based amortisation and the asset is amortised according to the same methodology.

Question 2: Lessor

(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?

Conceptually we find it difficult to see how the proposal with two models, the "performance obligation approach" and the "derecognition approach" for accounting for the lessor is linked to the proposal for accounting for the lessee. An equivalent approach with proposals for associated models has been put forward by EFRAG and Leaseurope, among others, as conceptually responsible alternatives. We have some criticisms of the "performance obligation approach". We find it difficult to see why the lessor who has relinquished control of the object needs to account for a performance obligation.
Lessors starting from one distinction – finance or operational - in IAS 17 will face not less than five new complex distinctions: 1. To determine if the lease meet the definition of a sale, 2. Transactions accounted for under the derecognition model, 3. Transactions accounted for under the performance obligation model, 4. Short term leases 5. Inconsistency with the revenue recognition ED might result in a fifth category of transactions as transfer of control can be sufficient to qualify a transaction as a sale under the Revenue Recognition ED but not necessarily under the lease proposals.

As just mentioned we consider that with the proposal in the ED the problems of demarcation which have been cited with the current standard with regard to the distinction between finance leases and operating leases will persist. We therefore wish to have one accounting model for lessors which is linked to the accounting for lessees. We therefore advocate the derecognition model. If the object is disposed of through sale and is financed by the seller or if the object is disposed of and financed through an external financier, this should result in the same accounting for the seller. We therefore favour Day-1 manufacturer/dealer gains being recognised immediately. The accounting rules should support the entities' different business models.

**Question 3: Short-term leases**

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 Associations question whether the proposal to use “simplified requirements for short-term leases” in reality signifies any actual simplification in practice for entities. Our opinion is therefore to consider that the concept of simplified accounting should be expanded. We consequently consider that the proposal for simplified requirements for short-term leases should be revised and expanded. The Associations therefore also consider that short-term leases should be treated according to the current model for operating leases so that it thereby becomes a real exemption for companies in practice. EFRAG has also adopted a similar approach in its draft comment letter on the ED. An exemption of this kind is particularly important for SMEs. For options to extend the lease term please see our response to question 8.

**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?

(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?

No, we do not consider that either the definition or the guidance is sufficiently developed in the ED. As the ED is formulated at present, this leads to a lack of clarity among users of the standard. We consequently advocate that the definition and guidance be developed more in order to then be incorporated into the actual standard, and not placed in an appendix.

(b) Do you agree with the criteria in paragraph 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?

No, we don't think it is enough to say that “an entity shall consider all relevant facts and circumstances when determining whether control of the underlying asset is transferred at the
end of the contract". This concept is not sufficiently developed in the ED and therefore we believe that it needs to be more elaborated on.

We are concerned that the proposal is not fully consistent with the Revenue Recognition ED which only requires the transfer of control as a condition to recognize a sale. We believe that in some circumstances (for instance, when contingent payments exist) a transaction would not qualify for as a sale under the ED but may qualify as such in the Revenue Recognition ED.

Question 5: Scope exclusions

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?

Yes, we agree with the ED on this aspect and the statements made in BC36. It may be mentioned as a reason for this position that there are already significant problems in the ED in distinguishing between leases and service contracts. We consider that further increasing the complexity of the standard by additionally introducing intangible assets into the scope of the standard would make it more difficult to apply. Furthermore, we believe that a thorough cost and benefit analysis should first be carried out and presented before the boards consider including intangible assets into the scope of the standard.

Question 6: Contracts that contain service components and lease components

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

We advocate the IASB model ahead of the FASB model. However, we see problems with application of the IASB model, which we consider to lead to unreasonable administrative requirements in application of the proposed standard. Our emphatic view is therefore that the benefit of applying such a model is disproportionate to the costs of applying it.

Question 7: Purchase options

Do you agree that a lease 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?

Yes, we agree with the ED, as it is in line with our "liability-to-pay model". Options should only be accounted for when they are exercised. Reasons for that approach include, among others, factors such as complexity, reliability and information accuracy. Instead we believe that information about purchase options should be included in the disclosures of the financial statements.

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?
No, we do not agree with the ED on this aspect. Conceptually we do not agree that options to extend should be included in determination of the lease term for either lessees or lessors. The reason for this position is that uncertainty prevails as to whether the option to extend the lease will be utilised or not. The subjective requirements for assessments which the ED provides for may complicate analysis of financial information for analysts as the information is not comparable. We propose instead an approach under which only the contractual obligations are to be included in the valuation of liabilities (“liability-to-pay model”, see section 1 of our response and headline “Several conceptual issues have been identified”). We also consider this approach to be in line with the IASB Framework and the definition of liability.

**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?

**Contingent rentals**

No, we do not agree with the ED on this aspect. Instead we believe that the current wording in IAS 17 regarding variable payments should be retained, i.e. they should not be included in any lease payments at all regardless of category of contingent rental. Consequently there is no need to separate different categories of contingent rentals.

In our opinion the contractual obligations should dictate the valuation of assets and liabilities. Since variable payment by definition is neither an obligation nor a right that is clearly stated at a fixed amount in a lease contract, they should not be subject to any balance sheet accounting. We consequently advocate variable rentals being carried as expense/income in the statement of comprehensive income as and when they arise for lessees and lessors.

**Charges**

Regarding charges such as term option penalties, we consider that these should not be included in any valuation until a decision has been taken to exercise such an option. They should then be treated as provisions in accordance with IAS 37.

**Residual value guarantees**

Regarding the lessee we consider that if the lessee has an established commitment at the start of the lease, for example to be responsible for a negative difference between book value and the fair value at the end of the lease, this obligation should be taken into account in the valuation of liabilities but only when that amount can be measured reliably. The converse applies that if there is no such commitment from the start of the lease, nor is any residual value guarantee to be recognised in the valuation of liabilities.
On the lessor side our opinion is that the lessor should regard the guaranteed amount as a lease payment under the derecognition approach. This should apply regardless of who the guarantor is, except for intra-group members such as a parent company, subsidiary etc. It is only when the residual value is not guaranteed by any party, that the lessor should recognise a residual value asset separately. This would be useful for users since the balance sheet clearly would state to what extent the lessor holds residual value risks.

Since we do not agree with the proposed performance obligation approach, we do not comment on any accounting for residual value guarantees under that approach.

**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 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?

No, we do not agree with the ED on this aspect. We consider that only the contractual commitments form a point of departure for what is to be valued. For this reason we do not consider that anything of which the value or size is unknown should be included in the determination of a liability or asset. On the other hand, we consider that material changes to contractual commitments should be taken into account in the valuation of a liability or asset, i.e. if the lessee decides to exercise an option to extend the lease this should be taken into account and included in the statement of financial position.

We question how "significant change" should be assessed. Should it be assessed on the basis of the individual contract or in the portfolio as a whole? We note that assessments may be difficult when the timescale of the contracts is more than five years. We consider it extremely difficult to make assessments for such a long timescale. We further consider that in the event that impairment testing of the asset becomes relevant this should be done in accordance with IAS 37.

**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 do not consider there to be a need for any special rules on sale and leaseback transactions. Our conceptual point of departure is as follows. It should first be considered whether a sale exists or not. In the interpretation of the ED, the control concept in sale of an asset is based on the legal relationship rather than the economic substance of the transaction. In the event that no sale exists, nor does any "leaseback" of the object exist. If a sale exists, on the other hand, the "leaseback" transaction should be assessed like any lease. We consider our proposal for a "liability-to-pay model" to address this issue. The same requirements should apply whether it is a sale or a lease (principle of equal treatment), which EFRAG also advocates, see their draft comment letter, paragraph 114. In addition, we consider that the concept of "financing" in paragraph 67 of the ED needs to be developed.
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 (paragraph 25 and BC143-BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?

We consider that, as a principal rule, the lessee should present separately the obligation to “make lease payments” and “right-of-use assets”. However, having said that, if the obligation or right is immaterial in relation to the principal activity of the entity or group, it should be possible for disclosure in the notes to be permitted in the standard. As we have already stated, we consider that liability should only include the contractual obligations in the lease (the “liability-to-pay model”).

(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?

As we have already mentioned, we have objections to the “performance obligation approach”. The reasons behind this position are partly conceptual, partly administrative, as well as the complexity that the proposals in the ED contain. A conceptual shortcoming we have noted in the performance obligation approach is the proposal to mix assets and liabilities on the same side of the statement of financial position, and we have difficulty in seeing the reason for this. Furthermore, we wish to refer to our response to question 2 and to EFRAG’s draft comment letter on this aspect.

(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?

We consider that “residual assets” and “right to receive payments” should be recognised separately. However, we wish to clarify our position by noting that we consider requirements for separate recognition in a legal entity to be reasonable, but if the principal activity of the entity or group is other than leasing, disclosure in the notes should be a sufficient requirement in the standard.

(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 advocate the standard providing scope for freedom of choice on this issue, i.e. presentation in the statement of financial position or disclosure in the notes. We
consequently advocate a management approach where the materiality of the item should guide the assessment.

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 BC 158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

We do not consider that the same requirements should be set for lessors as for lessees. Our view is that an assessment of materiality should instead dictate the requirements for recognition for both lessors and lessees. Provided that "lease income and lease expense" are material items in the entity's activity, we consider it reasonable to have requirements for separate reporting from "other income and expense in profit loss" in a legal entity, but in the consolidated accounts a requirement for disclosure in the notes may be sufficient as the assessment of materiality may differ from the assessment in the legal entity.

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 consider this issue to belong in the FASB/IASB project on "Financial Statement Presentation". The reason for our position is that we anticipate great changes regarding the content and presentation of the statement of cash flows. FASB/IASB should therefore await development in this project before adopting a position on how leasing should be handled in the statement of cash flows. From a conceptual standpoint, handling differently appears less appropriate.

Question 15

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

(a) Identifies and explains the amounts recognised in the financial statements arising from leases; and

(b) Describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows (paragraphs 70-86 and BC168-BC183)? Why or why not? If not, how would you amend the objectives and why?

We note that the requirements in the ED for the recognition of leasing are far-reaching, not just with regard to presentation in the statement of financial position and statement of comprehensive income, but also with regard to the requirements for supplementary disclosures. We note that the requirements for supplementary disclosures become difficult to fulfill when different types of contract exist for the lessor or at the lessee. At what level are the proposed requirements to be fulfilled – at contract level or at portfolio level?

The Associations would like to see all the requirements split into mandatory requirements and requirements that are voluntary in nature. As the ED is formulated at present, we
understand all the requirements to be mandatory, in relation to which we have doubts. We would therefore like to see greater flexibility in the application of supplementary disclosures than is expressed by the ED. In addition, the proposal in the ED leads to information which should be covered by confidentiality being made public.

Furthermore, we consider the requirements for supplementary disclosures in the ED to be directly discriminatory towards leasing as a form of financing in comparison with other forms of financing. EFRAG also considers the requirements for supplementary disclosures to be too far-reaching and expresses similar views in its draft comment letter on the ED.

**Question 16**

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

We note that the requirements in the ED necessitate a long transition period for both lessors and lessees. Although the ED contains a “simplified retrospective approach”, our view is that FASB/IASB must take account of all the issues that arise in the reorganisation of activity the ED entails with the possibility of a long transition period for entities.

We would like to see clarification of the term “fair value” in paragraph 95 (b). What is the meaning of the term? How is it to be calculated? We consider that it should be a present value of the residual value.

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

Yes, we agree with the ED on this aspect as we consider that “full retrospective application” should be made possible for those entities that so wish.

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

Yes, given the scope and complexity and the high costs with which the ED is associated, a long transition period is required for entities to adapt to the new standard. According to our understanding of paragraph 39 in IAS 1 and the requirements stated here, a history of three years is required in conversion of the items in the statement of financial position. To illustrate this with an example, a requirement for entry into force of the envisaged new standard in 2013 would mean that comparative figures must also be presented for 2011-2013. Entities must, in other words, already start gathering information now in order to meet these requirements. The question is how reasonable such a requirement is.

**Question 17**

Paragraphs BC200-BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?
We wish to question the benefit of the ED. We do not consider that FASB/IASB have demonstrated that the benefit outweighs the costs associated with the envisaged new standard. The Associations wonder, with all the elements of subjective assessments with which the ED is associated, whether this really leads to a situation where "users would receive better information about expected cash flows".

When new or amended rules are introduced, a reasonable requirement is that they should be preceded by a thorough impact assessment. The reason why an impact assessment is needed is that it must be ensured that rules are not introduced or amended without there being an observed need and that the proposed rules are appropriate and proportionate to their purpose. In addition, the assessment is needed to ensure legal certainty for those who are going to apply the amended or new standardisation. This creates the necessary basis for predictability and transparency in standardisation. We consider the cost-benefit considerations in the ED Basis for Conclusions to be fragments of an impact assessment and not to provide sufficient backing for the proposal. We would therefore like to see, firstly, greater clarification of the problems FASB/IASB consider to exist with the current standard and, secondly, an analysis of the effects of the proposal principally for those who prepare and use financial statements. In addition, it must be shown that introducing a new standard offers benefits in comparison with developing and refining the current standard. We therefore consider that the underlying purpose of the ED has not been achieved, and we consider that this must be shown through an impact assessment.

The Associations' view is that the ED adds to the complexity of accounting for leases. Our overall judgement is that the advantages of the proposals do not outweigh the drawbacks associated with the proposal. The Associations consider that the current standard for accounting for leases (IAS 17) works well and is an established and accepted standard that should be retained, where the requirements for supplementary disclosures can be developed.

Instead we therefore advocate our "liability-to-pay model" for the lessee's accounting, which leads to less complexity in the standard, while our model is significantly less administratively burdensome for entities. With regard to accounting for lessors, we advocate the derecognition approach. Nor do we consider that FASB/IASB have done any weighing-up of different interests in the ED in their cost and benefit analysis which we regard as remarkable.

Question 18

Do you have any other comments on the proposals?

We find it difficult to understand why FASB/IASB is treating the Leases project so urgently. We would prefer the quality of the envisaged new standard to take precedence over the time frame on which the project is based. Our view is that the focus should be on a product of high quality rather than political considerations dictating the time frame of the project and consequently its contents. We therefore support EFRAG's draft comment letter, in which it also argues that the Leases project should be given more time to ensure the quality of the project. We therefore presume that FASB/IASB will take account of the critical views received on the ED, and then send out a Reexposure Draft Leases for comments.

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