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

30 November 2010  

RE: Exposure Draft (ED / 2010 / 9) – Leases  

Dear Sir / Madam,  

Thank you for the opportunity to comment on your Exposure Draft – Leases (ED) and, on behalf of Tata Steel Europe Limited, I have outlined our comments on this ED below.  

Our detailed responses to each of your questions raised in the ED are set out in the appendix to this letter. Whilst we recognise the Board’s attention in the area of lease transactions given the current differences in accounting models, we are extremely concerned that the application of the requirements to low value assets will create an unnecessary and significant burden on preparers of accounts that is not justified on cost-benefit grounds. We would strongly encourage the Board to reconsider the application of this ED to short-term lease arrangements. Our view is that such assets should be completely excluded from the scope of these requirements and that the option to continue with the existing accounting requirements for these contracts should be maintained.  

Nor do we agree with the proposal that a lessee or lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into the effect of any options to extend or terminate the lease. Lease payments in optional lease periods do not meet the definition of a liability as the lessee does not have an unconditional obligation to pay them. In this regard we support the alternative view as set out in AV3, in that options to cancel and extend leases provide a lessee with flexibility to react to changing business circumstances and their inclusion would result in overstating liabilities and related measures of financial leverage.  

I trust that you find our comments useful within the next stage of the development of the accounting requirements in this area.  

Yours sincerely  

Frank Royle  
Director Finance  
Tata Steel Europe Limited
APPENDIX

Question 1: Lessees

(a) Do you agree that a lessee should recognise a right-of-use asset and a liability for its obligation to make lease payments? Why or why not? If not, what alternative model would you propose and why?

We agree with the proposed lessee accounting model. The recognition of a right-of-use asset reflects the fundamentals of the arrangement entered into i.e. the benefit of the asset for the period of the lease whilst incurring the obligation to make lease payments over this period. The proposal will also remove the current differences in accounting models (and subjective judgments in the distinction of each) for finance and operating leases that can result in similar transactions being accounted for very differently. We believe that the proposal will, therefore, increase comparability and transparency for users of accounts. However, as noted in our covering letter above and also in our answers to the further questions below, we are concerned that the application of these requirements to low value assets and short-term leases will create an unnecessary and significant burden on preparers of accounts that is not justified on cost-benefit grounds.

(b) Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on its liability for lease payments? Why or why not? If not, what alternative model would you propose and why?

We believe that describing the decrease in the right-of-use asset as a rental expense in the income statement is more appropriate on the basis that the decrease represents the costs for the use of the leased item. We believe that this treatment (as opposed to amortisation) will also then differentiate between 'in substance purchases' and 'right-of-use' assets given the respective underlying nature of each arrangement.

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?

Lessor accounting is not of specific relevance to us from our own reporting perspective and we have, therefore, limited our comments to lessee accounting only.
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 recognise 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 recognise assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSSs and would recognise lease payments in profit or loss over the lease term (paragraph 65).

Do you agree that a lessee should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

Although we recognise the Board’s proposals to provide simplified requirements for short-term leases, we are concerned that these do not go far enough and, in light of the fact that the costs of tracking and recording a large number of short-term leases are likely to outweigh the benefits, are of the view that such short-term leases should be completely excluded from the scope of these requirements.

Question 4

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

We agree that a lease is defined appropriately within the ED.

(b) Do you agree with the criteria for distinguishing a lease from a purchase or sale in paragraphs B9 and B10? Why or why not? If not, what alternative criteria would you propose and why?

We agree with the criteria for distinguishing a lease from a purchase or sale.

(c) Do you think that the guidance provided for distinguishing leases from service contracts in paragraphs B1-B4 is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

We think that the guidance for distinguishing leases from service contracts in paragraphs B1-B4 is sufficient.
Question 5: Scope exclusions

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

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

Other than our comments above in relation to the scope exclusions for low-value and short-term leases, we agree with the proposed scope.

Question 6: Contracts that contain both service 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, B6-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 the approach on accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

We agree with the approach on accounting for leases that contain service and lease components.

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 BC63 and BC64).
Do you agree that a lessee or a lessor should account for purchase options when they are exercised? Why or why not? If not, when do you think that a lessee or a lessor should account for a purchase option and why?

We agree that the exercise price of an option is not a lease payment and should not be included in the measurement of assets and liabilities arising from a lease and that a contract should be considered as terminated when an option to purchase the underlying asset 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?

We do not agree with the proposal that a lessee or lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into the effect of any options to extend or terminate the lease. Lease payments in optional lease periods do not meet the definition of a liability as the lessee does not have an unconditional obligation to pay them. In this regard we support the alternative view as set out in IAS 3, in that options to cancel and extend leases provide a lessee with flexibility to react to changing business circumstances and their inclusion would result in overstating liabilities and related measures of financial leverage.

**Question 9: Lease payments**

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease contract should be included in the measurement of lease assets and lease liabilities using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?

Do you agree that lessors 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?

We believe that contingent rentals and expected payments under term option penalties should not be included in the measurement of lease assets and lease liabilities since these amounts are inherently difficult to measure reliably at the inception of the contract and, in line with our response to question 8 above, we do not believe that such payments meet the definition of a liability.

**Question 10: Reassessment**

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?
We agree with the proposal, but question the value of such a requirement and therefore whether the costs of implementing information systems to capture such information would outweigh the respective benefits. The requirement to reassess estimates entails significant incremental effort compared to the current model, under which the accounting is set at inception and revisited only if there is a modification or extension of the lease.

**Question 11**

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

We agree with the criteria for classification as a sale and leaseback transaction.

**Question 12: Statement of financial position**

(a) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment or investment property as appropriate, but separately from assets that the lessee does not lease (paragraphs 25 and BC143-BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?

(b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

(c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

From a lessee perspective we agree with the presentation of the right-of-use asset according to the nature of underlying leased item. However, we do not believe that this is necessary on the face of the statement of financial position, but instead can be separately presented in the notes to the financial position.
Question 13: Statement of comprehensive income

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expenses in profit or loss (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

We agree that there should be separate disclosure of lease income and lease expense, but believe that this can be adequately shown in the notes to the accounts.

Question 14: Statement of cash flows

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

In line with the answers to questions 12 and 13, we believe that this information can be adequately disclosed in the notes to the accounts.

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 lease contracts; and

(b) describes how lease contracts may affect the amount, timing, and uncertainty of the entity’s future cash flows?

Why or why not? If not, how would you amend the objectives and why?

We agree that lessees and lessors should disclose quantitative and qualitative information in relation to lease contracts.

Question 16

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

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

(c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?
Although the proposal includes a simplified retrospective transitional approach, we believe that the full retrospective application of lease accounting should be a permitted option for those entities wishing to do so. From a cost benefit perspective we also think that the Board should consider allowing a prospective adoption option.

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 outweigh the cost? Why or why not?*

As noted in our responses above, we are concerned that the application of these requirements to low value assets will create an unnecessary and significant burden on preparers of accounts that is not justified on cost-benefit grounds. We would strongly encourage the Board to reconsider the application of this ED to short-term lease arrangements and our view is that such assets should be completely excluded from the scope of these requirements, thus reducing the costs of application. The lack of grandfathering of existing leases will require an extensive data gathering exercise in order to capture all relevant contracts and we would highlight that this, along with the implementation of management systems to monitor such contracts, will be a timely and costly exercise for preparers of accounts.

Question 18

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

We have no further comments on the proposals.