14 December 2010

Dear Sirs,

Exposure Draft – LEASES

Barclays is a UK-based financial services group, with a large international presence predominantly in Europe, the USA, Africa and Asia. It is engaged primarily in banking, investment banking and investment management. In terms of market capitalisation, Barclays is one of the largest financial services companies in the world. Barclays has been involved in banking for over 300 years and operates in over 50 countries with more than 156,000 employees.

We are pleased to submit our comments on the Exposure Draft ‘Leases’.

Our response to the detailed questions is set out in the Appendix to this letter. We draw your attention to our general views on the exposure draft which are as follows:

- We are strongly supportive of convergence between IFRS and US GAAP, including the opportunity provided by this project to create a common high quality standard on the accounting for leases;

- We support the efforts of the IASB and FASB (the ‘Boards’) to require the recognition and measurement of assets and liabilities for lessees. We believe that the proposed right-of-use approach will generally meet the Boards’ objective to report relevant and representationally faithful information to users of financial statements; and

- We consider that the proposed ‘hybrid approach’ for lessors is inconsistent with the proposed lessee approach, and would not represent a meaningful improvement to financial reporting that would justify the costs of implementation, which would be significant. We believe that the proposed approach will be difficult to apply, and will perpetuate (and possibly exacerbate) the application problems that arise under the existing requirements for lessors.

Particular aspects of the proposals with which we are especially concerned include:

- **Term extension options.** The need to estimate and recognise term extension options will require considerable judgement. As a lessor, it is often difficult to predict with any certainty whether the lease term will be longer than the minimum contractual period. Furthermore accounting for such a feature as if it has already been exercised is inconsistent with the Boards’ own conceptual frameworks, does not reflect the flexibility that such features provide to lessees, significantly increases complexity and, we believe, will not provide users of financial statements with useful
Information. We suggest that the Boards consider disclosure of such features and/or introduce a higher probability threshold for recognition purposes; and

- **Short-term leases.** The proposed simplified lessee accounting for short-term leases does not, in our view, represent a meaningful simplification. We have a large number of lessee short-term leases. The proposed accounting would not avoid the need to identify and track a large number of short-term leases with all the attendant costs. We also believe that including such leases on the statement of financial position provides little, if any, useful information to investors. We suggest that the Boards consider requiring such leases to be accounted for on an accruals basis, similar to the way that operating leases are accounted for today.

We believe that the proposals for lessors need significant further development and, given the current workload of the Boards, we consider that such development is not achievable in the short-term. We consider that the area of most concern to users of financial statements continues to be lessee accounting and therefore urge the Boards to take the unique near-term opportunity that is available to significantly improve lessee accounting. We believe that the issues (such as sub-leases) that will arise from completing lessee accounting before lessor accounting can be satisfactorily addressed in the short-term. We suggest the Boards focus their efforts on completing the accounting for lessees.

We trust that the IASB find our comments helpful. If you would like to discuss our response in more detail, then please contact Wendy Stanford (Wendy.Stanford@Barclays.com) at 1 Churchill Place London E14 5HP.

Yours faithfully,

C. G. Lucas
Group Finance Director
Appendix
Responses to detailed questions

The accounting model

Question 1: Lessees

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

We agree that a lessee should recognise assets and liabilities relating to all lease contracts. The rights and obligations arising from lease contracts meet the definition of assets and liabilities in accordance with the conceptual framework and will align lease accounting with other standards which recognise assets and liabilities arising from contractual arrangements. The right-of-use model for lessees addresses many of the issues that arise from the current requirements of IAS 17, Leases.

We have detailed concerns with the measurement of the right-of-use asset and liability to make lease payments for complex lease arrangements which we raise in our responses to questions 8 (lease term) and 10 (reassessments).

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

We agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments.

We are concerned about the impact of the change from the current recognition profile arising from the front loading of interest on transition, and possible impacts on other key performance indicators (such as the leverage ratio). However, the proposed method of recognition is broadly similar to the accounting treatment for an owned asset, and the related funding, and notwithstanding the concerns expressed, we support achieving accounting parity between leasing and owning an asset wherever possible.

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?

We do not support the proposed hybrid approach for lessors. We do not believe that the proposed ‘hybrid approach’ for lessors is consistent with the proposed lessee approach, or represents a meaningful improvement to financial reporting that justifies the significant cost of implementation.

We believe that the proposed approach will be difficult to apply, and will perpetuate (and possibly exacerbate) the application problems that arise under existing requirements for lessors. The existing requirements for lessors are also substantially working in practice.

We believe that a lessor model based on the derecognition model would be more consistent with the right-of-use model, and that the performance obligation approach is conceptually inconsistent with the proposed lessee model.
Under the lessee model the lessee recognises an asset and a liability to pay on the basis that it has a right to use that asset and has a present obligation to pay for that right of use.

In order for the lessee to have such an unconditional right of use and obligation to pay, the lessor must have transferred the right of use of the asset and, correspondingly has the right to receive lease payments under the lease contract. If the Boards’ objective is to create a consistent lessee/lessor accounting approach, and the Boards pursue a right-of-use approach for lessees, then the derecognition model should prevail.

Another concern we have with the performance obligation approach is the double counting of the economic benefits arising from the leased asset. Under the performance obligation approach the lessor is recognising the leased asset as well as the right to receive the cash flows from leasing that asset (the lease receivable). The lessor is not able to generate other sources of cash flow from the leased asset until the end of the lease term when it may be sold or leased again. We believe that such double counting will not provide useful information to users of financial statements because it does not faithfully represent the economics of a lease transaction.

If the Boards proceed with the proposed hybrid approach, we believe that considerably more application guidance will be required about what constitutes significant risk transfer especially regarding the impact of residual value guarantees. In our capacity as a lessor, we may have risk sharing arrangements for the disposal of an asset. We believe that the proposed guidance will not allow us to determine how to treat leases with risk sharing agreements on disposal of the asset.

(b) Do you agree with the Boards’ proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

As discussed above, we do not support the performance obligation approach.

We support the proposed treatment for recognition of income and expenses for the derecognition approach, with the exception of the proposed prohibition from revaluing the residual asset. Holding the residual asset at a carrying amount determined at inception of the lease (less any subsequent impairment) does not reflect economic reality, and could result in significant gains/losses at the end of the lease. This will not provide useful information to investors, as compared to proportionately recognising income throughout the period of the lease. We agree with Stephen Cooper’s alternative view that the residual asset should be accreted each year to reflect the time value of money.

Such an approach will provide more useful information about the return to the lessor arising from the residual asset retained.

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?

We support a simplified approach for short-term leases given the substantial operational burden that would be imposed by a requirement to apply the leasing proposals to all leases.

However, we do not believe that the proposed simplified accounting for lessees actually is simplified accounting (in terms of addressing the operational burden of identification and tracking individual short term leases).
We suggest that the Boards consider applying the existing requirements for operating leases to short-term leases for lessees, as defined, with supporting disclosures. We believe that such leases are not normally of significant interest to investors in understanding the future cash flows of the entity, and a requirement for supporting disclosures could provide users of financial statements with useful information about the type and magnitude of short-term leases. Such an approach would also align lessee accounting with the proposals for lessors.

Definition of a lease

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?

The definition of a lease has been substantially carried forward from IAS 17 and IFRIC 4; we have no concerns with the definition in IAS 17 but have experienced application issues in applying the IFRIC 4 (and equivalent US GAAP) guidance. It would seem to us that this project is the opportunity to address those practice issues.

(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?

We are concerned that the proposals are not consistent with the revenue recognition proposals which require a transfer of control in order to recognise revenue from a sale. We do not see a need to introduce complexity and possible confusion by having two separate definitions. The definition of sale should be based on the definition in the revenue standard without additional references being made to risks and benefits especially given that risk and benefits are considered as being inherent in the definition of transfer of control anyway. From a practical point of view, using two definitions means that there is a possibility that contracts with features such as bargain purchase options may be neither a lease contract nor a sale/purchase contract.

If the proposed approach is finalised, we believe that more application guidance will be required on how to apply the “all but a trivial amount of the risks and benefits” in the context of lease contracts.

(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 noted above, the guidance in paragraphs B1-B4 are similar to those in IFRIC 4 (and equivalent US GAAP) today. We believe that guidance is not sufficient to for us to differentiate between a service contract and a lease. As a lessee, Barclays has service contracts which substantially meet the definition of a service contract but may contain a small leasing element. An example of this would be service contracts in which we are provided with a printer but also other services such as printing, photocopying, service engineer, and other maintenance. Under IFRS today this distinction is not important as the recognition pattern is similar. However, under the proposals such contracts could be treated as leases in their entirety, which do not reflect the economic nature of the contract. We believe that further guidance is required to ensure that such service contracts are explicitly out of scope.
Scope

Question 5: Scope exclusions

The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33–BC46). Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and why?

We have no comments on the scope exclusions.

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–B8and 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?

We agree that distinct service components should be accounted for in accordance with the Revenue exposure draft. However we consider that further guidance around what constitutes distinct services is necessary as the current definition is unclear. We would propose that, rather than a rules-based approach to identifying service components, the Boards develop a principles-based approach. Such an approach would require judgement, but avoid some of the Interpretational issues that will inevitably be created by the proposed definition, and would also be consistent with the principle-based approach to standard setting advocated by the Boards.

Barclay's property leases typically include additional fixed rate payments for security, common maintenance costs, landscaping and other costs which may be included in the quoted lease terms. For some of these costs, particularly those related to common real estate services such as landscaping and elevator services, it may be difficult to apply this definition when they are clearly no different from other maintenance services. Reiterating the point we made under question 1 b) about aligning lease accounting with that of owned assets, we believe these types of costs are service/executory costs, and should not be included in the measurement of the lease assets and lease liabilities. If we were to own the asset such future operating costs would not be capitalised. Additionally to split these elements out from the other service
charges that do meet the definition could also be difficult. We believe the Boards should explicitly clarify
that executory/common area costs are excluded for purpose of applying paragraph B7.

As noted previously, we do not support the hybrid approach for lessor accounting. However, if the Boards
proceed with that approach, we suggest that all service costs (whether distinct or not) be separated from
lease contracts for lessors. This avoids recognising executory items as if they have already been performed.

Question 7: Purchase options

The exposure draft proposes that a lease contract should be considered as terminated when an option to
purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by
the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraphs 8, BC63 and
BC64). Do you agree that a lessee or a lessor should account for purchase options only when they are
exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase
options and why?

We believe that purchase options should be accounted for in the same way as options to extend the lease.
Purchase options in economic substance are no different to renewal options for the economic life of the
asset. Failure to align the accounting could result in possible structuring opportunities. Please see our
response to question 8 below for our proposal on accounting for extension options.

Measurement

Question 8: Lease term

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

We agree that such options should not be separated from the underlying lease contract but we do not
support the inclusion of these options in the liability until the definition of an asset or liability has been
satisfied under the Boards own conceptual framework.

Amounts recognised as liabilities on the statement of financial position should represent an entity’s
contractual obligations. To the extent that we are not contractually and legally obligated to extend any rent
renewal options under the lease as a lessee, we should not be recognising a liability.

Our view is similar to that advanced by Stephen Cooper in his alternative view. Optional lease terms are
dependent on future business conditions and it is therefore inappropriate to reflect these in the additional
measurement, unless it is virtually certain that they will be exercised. Such an approach is pragmatic in that
it is operational and minimises any structuring opportunities within the confines of the Boards conceptual
frameworks.

From an operational perspective there would be considerable judgement applied in order to determine the
lease period that is more likely than not to occur and it is particularly onerous to consider potential rent
periods for all leases. Reducing the requirement only to capture options that are virtually certain to be
exercised would also aid in reducing the extent of estimates and judgements that would be involved in
determining the right of use asset and obligation to make lease payments minimising overstated assets and
liabilities (and resulting leverage and other KPI ratios).
We have even greater concerns from a lessor perspective as we have limited control over whether a customer will extend the lease period. At the lease inception we have reasonable information about a client’s intention for extending the lease and the lease is often priced accordingly. However as we move throughout the life of the lease this information becomes “stale”, thus making it difficult to accurately reassess these assumptions. This would again result in subjective estimates that cannot be adequately updated on a regular basis for new information. Setting the benchmark at a “virtually certain” level would go a long way to address this.

Information that is useful to users of financial statements about the existence and possible effect of such options is best included as disclosure in the notes to the financial statements, and such information should be provided at a portfolio basis to avoid disclosure of commercially sensitive information. The lessee or lessor should provide details about any rent renewal options and management’s judgements about likelihood of renewals based on current businesses conditions.

Question 9: Lease payments

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 have no comments on this question.

Question 10: Reassessment

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

As we noted in our response to questions 8 above, we do not support the proposals regarding including options to extend in the initial measurement. Increasing the probability threshold at which such options are recognised may address some of the complexity and onerous operational issues that will arise from frequent reassessment and revisions.

If the Boards continue with this proposal we support the requirement to reassess and re-measure the asset and liabilities only when a change in circumstances indicates this is necessary. We believe performing a reassessment at each balance sheet date would be onerous, with limited (if any) benefit to investors.

Therefore, we support the proposal that reassessment should only be carried out in the limited circumstances where there is a significant change. We would appreciate further guidance around indicators that there has been significant change as it could potentially be difficult to determine whether a change in facts and circumstance would significantly impact the lease without carrying out a detailed calculation.

We reiterate the point made in our response to question 8 above that as the life of the lease passes it becomes very difficult for Barclays as a lessor to accurately reassess a customer’s intention.
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?

We believe that sale and leaseback transactions should only result in a sale if the recognition criteria in the proposed revenue standard are met.

We do not agree that a higher threshold should be introduced for sale and leaseback transactions, as is suggested by paragraph B31 of the exposure draft, or that a separate sale definition should be created only for the purpose of sale and leaseback transactions.

We are also concerned there is no transitional relief for ‘failed’ sale and leaseback transactions that on transition need to be accounted for as financing transactions and encourage the Boards to reconsider whether this is needed.

Presentation

The exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25–27, 42–45, 60–63 and BC142–BC159).

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–BC143)? 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 agree that the obligation to pay lease rentals should be presented separately from other liabilities. However we do not agree that mandatory disclosure on the balance sheet is necessary and the guidance in IAS 1 is sufficient. Unless the item is sufficiently material or if separate disclosure on the face of the balance sheet is relevant to an understanding of an entity’s financial position, we believe inclusion in another line item with disclosure in a note is acceptable.

We agree with the Boards proposal that the right of use asset should be presented as a tangible asset within property, plant and equipment or investment properties but separately from other owned assets based on the nature of the underlying leased item. However we are concerned that the proposed measurement of the right of use asset, particularly with respect to amortisation and impairment, could be interpreted by some to be more akin to an intangible asset. An interpretation by a prudential regulator of the right of use asset being an intangible asset (and hence possibly a deduction from regulatory capital) could have significant implications for regulated entities such as Barclays. Therefore we believe the Boards should explicitly state that lease assets should be presented based on the underlying assets within property, plant and equipment or investment property as appropriate to avoid confusion.

(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?

If the Boards finalise the hybrid approach for lessors we would support the proposed “linked presentation”. However, as we mentioned in our response to question 12 (a) we do not support inclusion of this information on the balance sheet unless it is relevant to the understanding of the entity’s financial position.

(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 prefer the derecognition approach and, as cited in our response to question 12 (a), we do not support inclusion of this information on the balance sheet unless it is relevant to the understanding of the entity’s financial position.

(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 have no comments on this question.

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?

As noted in our response to question 12(a) above, we believe there is sufficient guidance in IAS 1 as to what should be disclosed on the face of the primary statements. We would prefer disclosures generally to be in the notes instead unless separate presentation is relevant to an understanding of an entity’s financial performance.

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 do not have any specific comments related to presentation in the statement of cash flows. However please refer to our response to question 12 for our thoughts on separate presentation in primary financial statements more generally.
Disclosure

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 welcome the requirement to disclose relevant quantitative and qualitative information to provide users with useful information about the impact of lease arrangements and we are particularly supportive of the requirement in paragraph 71 allowing aggregation of disclosures if items have similar characteristics (for example, on a portfolio basis).

Our concerns are with regard to paragraph 73 a) (iii) as information related to rent renewals clauses and renewal intentions is commercially sensitive. Therefore we believe it important that any such disclosure should only be required on an aggregated basis. As a user of financial statements ourselves, we would also welcome disclosure about other obligations related to lease arrangements - such as whether the entity is the party responsible for maintenance and other expenses related to the asset. This provides useful information about potential impacts to future cash flows.

Transition

Question 16(a)

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

For Barclays, a full retrospective approach will in many cases be onerous and we are supportive of the simplified approach put forward in the exposure draft.

However, in some cases the benefits of full retrospective application may exceed the costs. This would occur if the impact on transition produced a disproportionately high aggregate expense in the early part of a lease compared with rental income that would otherwise be recognised with profit relief not occurring until latter periods. Therefore we support the alternative approaches suggested by Stephen Cooper (paragraph AV11) for optional retrospective application.

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

Full retrospective application should be permitted on an optional basis, elected on a lease by lease basis. This is the default transition approach preferred by the Boards, and an entity should not be prohibited from retrospectively applying new requirements (subject to the restrictions set out in IAS 8).

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

We will respond to the IASB’s requests for views on the effective dates in due course.
Specifically related to leases we believe that the new leasing proposals will require significant time to implement and we would welcome a long implementation period. This will also allow reasonable time for other affected stakeholders (such as local tax authorities and prudential regulators) to consider and adjust current legislation and regulation where required reducing the likelihood of dual reporting requirements.

Benefits and costs

Question 17

Paragraphs BC200–BC205 set out the Boards’ assessment of the costs and benefits of the proposed requirements. Do you agree with the Boards’ assessment that the benefits of the proposals would outweigh the costs? Why or why not?

We are concerned that the Boards have not conducted sufficient research in this area. While we are supportive of the proposals to recognise all assets and liabilities arising under lease contracts on the balance sheet and agree this is a substantial improvement on the existing standard, the operational burden incurred to implement the proposals is considerable. The requirement to account for renewal options and other contingencies at the inception of the lease contract significantly contributes to the cost given the requirement for management to look beyond the regular business planning cycle when making judgements. We are not convinced the additional costs this will incur will be outweighed by the benefit provided to the user given the anecdotal nature of the information that they will receive.

We also remain to be convinced the extent to which users will rely on the amounts provided and we believe they may continue to make their own adjustments. Therefore the investors may equally benefit from enhanced disclosure about expected lease terms and other options, allowing them to adjust the numbers provided in the balance sheet based on minimum lease payments as they consider necessary.

Barclays would also need to make modifications to existing lease accounting systems to capture data related to individual lease arrangements, rent renewal options, management intentions in relation to leases as well as recognise interest using the effective interest basis. The required software is not currently available in the marketplace and this may hinder implementation.

The cost of the implementing the proposals extends further than the impact to the financial reporting process as the assets, liabilities and profit recognised also need to be allocated out to relevant business units through the management reporting process as the majority of leasing arrangements are held centrally. Many businesses may have difficulty allocating assets such as property between segments especially when various segments occupy the same property. While there is an established process for allocating rental payments on this basis there is considerably increased complexity involved to allocate assets, resulting risk weighted assets for regulatory purposes, liabilities and interest and capital payments on this same basis (notwithstanding the additional implications of accounting for lease options throughout the life of the lease - especially when reassessments to estimates are made).

Barclays lending arrangements will also need to be reviewed based on any resulting impacts to customer’s financial ratios and performance measures and lending documentation such as covenant calculations will need to be updated.

Many existing leases are also priced and sold according to specific tax treatment. The tax treatment and impact of the proposals will vary across jurisdictions but as an example in the UK, since 2006, the tax treatment follows current accounting treatment. If the tax rules were aligned with the proposed lease accounting then existing pricing structures would need to be reviewed, and there may even be an impact to
current lease arrangements. If tax rules were not amended, dual records would need to be maintained as the tax would continue to be calculated based on the current finance and operating lease distinction.

For a financial institution the proposed model will also have resulting capital implications. The impact as a lessor is likely to be minimal but as a lessee our balance sheet assets will increase and more capital may be required.

Other comments

Question 18

Do you have any other comments on the proposals?

Interpretation of incremental borrowing rate

The exposure draft requires that a lessee determine the present value of lease payments using their incremental borrowing rate if the rate implicit in the lease is not known.

The guidance provided in paragraph B12 states that the rate used would reflect the nature of the transaction and the specific terms of the lease. When purchasing property or leasing property the majority of the funding will be borrowing and the remainder will be funded through equity. Our interpretation of paragraph B12 is therefore that the incremental borrowing rate would be calculated based on a weighted average cost of capital. We ask that you clarify this is the intended interpretation. If so we ask that this be explicitly stated to avoid any undue confusion that may occur in the interpretation of this requirement.