Sir David Tweedie  
Chairman  
International Accounting Standards Board  
30 Cannon Street  
London  
EC4M 6XH  
United Kingdom  
Sent electronically: www.iasb.org

Madrid, 15th December, 2010

Subject: IASB Exposure Draft ED/2010/9 - Leases

Dear Sir David,

The Spanish Banking Association (AEB)\(^1\) appreciates the opportunity to comment on the Exposure Draft Lease Accounting (ED/2010/9) (henceforth ED) published by the International Accounting Standards Board (IASB) in August 17.

We give our support to the joint efforts of the IASB and FASB to improve International Financial Reporting Standards to provide users of Financial Reporting Standards, in order to provide users of financial statements with information which is of better quality and of greater relevance, thereby aiding comparability.

The existing accounting model for leases has long been criticised for failing to meet the needs of users of financial statements. However, we are not convinced that some of the proposals included in the ED offer an effective improvement in comparability or provide additional relevant information to the users of financial statements and we deem it introduces very significant changes in the lease accounting treatment that might even affect the economic rationale of some types of the lease business if the final standard is not modified. First of all, we believe the ED does not really meet the reasons why it has been said the current accounting model for lessees should be

---

\(^1\) The Spanish Banking Association (AEB) is the voice of the Spanish banking sector representing and defending the collective interests of banks operating in Spain (94 member banks: 59 Spanish and 35 credit entities’ branches of foreign banks operating in Spain), with total consolidated assets of € 2,110 billion as of December 2010 and 109,996 employees in Spain.
modified, i.e., to enhance the comparability among the financial statements of different companies and to better suit the need of users of financial statements. In this regard, although the proposed standard might make easier to put side by side the financial statements of companies with different ways of financing their properties and other significant assets, it introduces a new distortion that certainly will make harder to compare the performance of lessees in different stages of the investment cycle. Moreover, we consider that the proposed standard is contrary to the principle of correlation of incomes and expenses, as it introduces an artificial distribution of lease costs, that can cause the net result of a contract (the benefits obtained from the underlying asset minus the lease cost) whose expected cash flows through the term of the operation are always positive and which is expected to render an overall profit to the lessee being significantly in the red in the early years of the lease. If the lease operations are significant enough this may result in an overall profitable company making public negative results. We deem extremely doubtful that this outcome can be regarded as an improvement.

Conceptually, it seems very difficult to understand the change in the accounting treatment of the so-called right-of-use (ROU), as the definition of this ROU in the application guidance of the ED (3.4) is essentially the same that the one in the current standards (IFRIC 4.9) -which is only natural as the rights and obligations associated with a lease contract have not changed in the meantime- and the conceptual framework in which the criteria for the recognition of an asset in the financial statements are established remains unchanged.

It is said in the basis for conclusions on the ED (BC 7) that the proposals are consistent with the existing conceptual framework but none justification is offered for the change in the treatment of an item which had not been previously classified as a recognizable asset. In our opinion the characterization of the ROU of the leased item for the lease term as an asset itself does not fit in the current IFRS conceptual framework and, as we elaborate later in our response to the IASB’s questionnaire, it is based on the confusion between an asset and the requisites required for its recognition in the financial statements.

Although the Board may be well aware of the problems that can arise from such as inconsistency and it is also said in the basis for conclusions on the ED that the consistency between the lease accounting model and the conceptual framework currently being developed would be possibly only once it project has advanced further, we deem it is an unwise approach to develop a framework to suit an already developed standard. It is our conviction that the framework should be established in advance of any particular standard if the purpose is to develop a high quality complete and consistent set of standards and in consequence we do find the Board’s approach rather troublesome, specially taking into account that the recognition and derecognition of assets has been a highly questioned point in the aftermath of the
failure of some financial institutions. We disagree with the proposed treatment of contingent rentals. First, we deem they are not a present obligation as they only arise if a specified future event occurs, therefore, they should not be included as part of the initial lessee’s liability; second, the estimate of those amounts would be costly and complex, it would increase the subjectivity and uncertainty of the figures included in the financial statements, thus jeopardizing their comparability, and its changes would introduce unnecessary volatility in the profit and loss account; and last, as estimates are made independently by lessee and lessor, they might result in different figures which can make the consolidation procedures more difficult if the lease has been made between group companies.

In our opinion, the amounts due under renewal options should neither be included in the lease receivable nor in the lease payable, as neither rentals payments in an extension period meet the definition of a liability based on the conceptual framework nor rentals receivable meet the one of an asset. Furthermore, its inclusion would require both lessor and lessee to assess the likelihood of the exercise of the option, which would introduce significant uncertainty and subjectivity in the elaboration of the financial statements and jeopardize their comparability since entities in similar situations may end up accounting for similar leases in a very different way.

Additionally, we do not share the Board’s proposal about the lessee’s accounting treatment of the expenses linked to a lease contract. In short, we believe that all of them should be recognized in the lessee’s income statement on the basis of a direct association with the economic benefits which are expected to arise from the leased item. In other words, if the benefits are deemed to be distributed following a straight-line pattern over the term of the lease, the same criterion should be used for the expenses. The advantages of this allocation are, in our opinion, very significant, as it is simpler for lessees to apply, it aligns the income statement and the tax treatment of leases—at least in some jurisdictions—, it reflects the way in which most lease contracts are priced and, it remains the strongest reason in favour of this approach in our opinion, the allocation of expenses reflects the pattern in which the economic benefits from the leased item are received by the lessee.

In practical terms, this implies that the amortisation of the ROU and the liability—the obligation to pay rentals—would net to zero in the income statement through the entire term of the lease and also that, if there is no impairment of the ROU, its amount and the one of the liability would remain the same in the subsequent measurements. Although the IASB rejected in the preliminary Discussion Paper the so-called linked-approach which has a similar impact on the profit and loss account, the reasons for that rejection—mainly, that a liability always must have a financial cost—are not, from our point of view, irrefutable. The same net effect can be obtained with the appropriate temporal allocation of the amortization cost of the ROU.
As for the lessor accounting model, it seems to us difficult to justify why one model can cover all lease situations for lessees but lessors need two different approaches to deal with the same type of contracts and, in any case, we deem that the circumstances under which one or other lessor's approach should be applied need further clarification. Moreover, in our opinion, the performance obligation approach looks severely flawed as it leads to the creation of duplicated assets without a real economic foundation and the correlative recognition of liabilities that do not fit properly in the definition established in the conceptual framework.

Yours sincerely,