15 December 2010

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Dear Sir or Madam,

Re: Invitation to Comment – ED/2010/9 Leases

We welcome the opportunity to comment on the IASB’s Exposure Draft (ED) 2010/9 Leases. I am pleased to respond on behalf of BP p.l.c. to the invitation to comment and our detailed comments to the questions posed in the exposure draft are provided in the Appendix to this letter.

If you wish to discuss any of the comments in this letter, we would be happy to do so. Please do not hesitate to contact myself or Alison Kinnon.

Yours faithfully

Roger Harrington
Vice President & Chief Accounting Officer
APPENDIX – Responses to the Invitation to Comment

Questions 1 – 3 – The accounting model
The exposure draft proposes a new accounting model for leases in which:

(a) a lessee would recognise an asset (the right-of-use asset) representing its right to use an underlying asset during the lease term, and a liability to make lease payments (paragraphs 10 and BC5–BC12). The lessee would amortise the right-of-use asset over the expected lease term or the useful life of the underlying asset if shorter. The lessee would incur interest expense on the liability to make lease payments.

(b) a lessor would apply either a performance obligation approach or a derecognition approach to account for the assets and liabilities arising from a lease depending on whether the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected term of the lease (paragraphs 26, 29 and BC23–BC27).

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 a right-of-use asset and a liability to make lease payments. Once the asset has been made available to the lessee, the obligation to pay lease rentals meets the definition of a liability under the Framework and should therefore be recognised.

We do, however, have concerns about the proposals in the exposure draft relating to some aspects of the model, which we explain in our responses to the other questions that follow.

In addition, we believe that further detailed guidance is required relating to the accounting treatment when there is a significant time interval between inception and commencement of the lease. Paragraphs BC173 and BC174 acknowledge that there can be an interval, but it is assumed that this period is short and the issue is addressed from the perspective that users of the financial statements will require information about such leases that have been entered into but no assets or liabilities have yet been recognised.

However, in practice the interval between inception and commencement can be significant. For example, if the underlying asset in a lease is to be constructed only once inception has occurred, and the construction time is long, then the interval will be significant. In our experience this is the case, for example, for large ships or process plant where the interval could be as long as five years.

In such cases, specific guidance is needed in the final standard to address the measurement of the right-of-use asset that is recognised upon commencement of the lease. We believe that the amount capitalised at commencement should be the present value as at commencement of the lease, discounted using the implicit interest rate determined as at inception. We think this is preferable to using the present value calculated at inception. Comparability between entities will only be achieved if this point is specifically dealt with in the final standard.

We are also concerned that in some circumstances the present value of the lease payments, recognised as a right-of-use asset, can be greater than the fair value of the
underlying asset. This intuitively does not seem to be appropriate and we question whether the final standard should allow for the amounts recognised to be the lower of the present value of the lease payments or the fair value of the underlying asset, similar to the existing requirement in IAS 17. As a matter of principle we do not believe that the right to use an asset can be worth more than the underlying asset.

**(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 note, however, that this represents a significant change in the presentation of the charges in the income statement relating to leases. We believe that it will require substantial effort to explain this change to users of the financial statements and to re-base the key financial metrics that will be affected.

In particular, lease payments will to a large extent appear in the income statement categorised as amortisation expense, which in any analysis is usually a non-cash item. Analysts will need to have a deeper understanding of the accounting treatment of leases to interpret this new presentation.

**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 disagree with the proposal to retain two approaches for lessor accounting as this is inconsistent with the proposals for lessee accounting. We believe that the derecognition approach should be applied for all leases because control of the underlying asset is transferred to the lessee for the period of the lease.

Notwithstanding our view that only the derecognition approach should be used for lessors, we are not sure why the criteria included in the ED (paragraph 28) take account of what is expected to happen after the expected term of the lease under consideration. In our view the residual asset retained on the lessor’s balance sheet is intended to represent this portion of the life of the asset. We believe that this criterion would result in many leases being accounted under the performance obligation approach, for example in cases where a financial lessor relies on selling the asset at the end of the lease.

**(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?

We are concerned that the measurement of the residual asset in the derecognition modal understates the residual asset and overstates the amount derecognised. This is a result of the calculation being based upon the carrying amount of the underlying asset as at inception with no subsequent remeasurement to take account of the unwinding of discount. If we have understood that correctly, it would lead to an understatement of the
lessor’s profit during the lease term and an overstatement during the residual period. From our point of view as a lessee this would be undesirable if this drove commercial behaviour by causing lessors to increase the lease rates required for new-build assets in order to be able to recognise a profit during the initial lease term. On this point we are in agreement with the alternative view expressed in paragraph AV11.

Question 3 – Short-term leases

The exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, 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 lessors would recognise lease payments in profit or 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 IFRSs and would recognise lease payments in profit or loss over the lease term (paragraph 65).

(See also paragraphs BC41–BC46.)

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

We agree in principle that assets and liabilities should be recognised for short-term leases. Short-term leases can be material and their exclusion would re-introduce a two-model approach and defeat one of the objectives of the draft standard. However, some form of relief is required for leases that are not material. We also question the fact that the current proposals are not symmetrical for lessees and lessors.

The current proposal for lessee accounting for short-term leases would not in practice provide any useful relief. Indeed, the election to use undiscounted values would result in higher amounts of assets and liabilities being recognised on the balance sheet, which for most entities is not a desirable outcome.

We believe that the concerns of constituents would more appropriately be addressed by a consideration of the materiality of the leases. As with all other IFRSs the onus should be on entities to use judgement in applying the existing guidance on materiality. It should not be necessary to provide specific guidance in the standard on materiality. We believe that most entities would determine a materiality threshold appropriate for their own circumstances and would continue to use existing operating lease accounting treatment for any leases deemed to be immaterial.

Furthermore, we do not understand how this simplified approach would work in terms of the double entries that would be made. Having recognised an asset and a liability on the balance sheet paragraph 64 of the ED requires the recognition of lease payments in profit
or loss. It isn’t clear to us how the accounting for the asset and liability during the lease term works in this case. If the simplified accounting is retained in a final standard it should be described more clearly, ideally with an example of the double entries required.

Consistent with our response to Question 2, we believe that the accounting for lessees and lessors should be aligned, and therefore disagree with the proposal that a lessor need not recognise assets and liabilities for short-term leases. As noted above, we think that this issue should be addressed on the basis of materiality and this should apply to lessors as well as lessees.

In addition, we have a general concern about how the proposed requirements in the ED apply to short-term leases: we are not convinced that the right-of-use asset recognised for a short-term lease should be presented as property, plant and equipment along with longer-term leases. Whilst there is an underlying asset, it is not expected to be used during more than one period (see IAS 16.6) and it does not seem appropriate to classify it as a non-current asset under IAS 1 paragraphs 60-68. It would be more appropriate to present this within current assets on the balance sheet.

**Question 4 – Definition of a lease**

The exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1–B4 and BC29–BC32). The exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59–BC62) and on distinguishing a lease from a service contract (paragraphs B1–B4 and BC29–BC32).

**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 the definition of a lease as “a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration” is appropriate.

(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 do not agree with the criteria for distinguishing a lease from a contract that represents a purchase or sale as set out in the ED. We believe that it should not be necessary to include such criteria in the leasing standard, but rather a cross-reference to the revenue recognition standard should be inserted and the criteria in that standard used to make the assessment.

(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?
We support the Board’s attempts to address the current subjective distinction between finance leases and operating leases and we believe it is appropriate that the same accounting treatment should apply to all leases within the scope of the standard. Therefore under the proposed approach, the definition of a lease, and the guidance provided to assist in determining when a contract contains a lease, will become more important than was previously the case. This guidance will be used in making judgements about whether assets and liabilities are recognised on the balance sheet and will also consequently affect the timing and characterisation of amounts reported in the income statement. We note that the guidance currently contained in IFRIC 4 ‘Determining whether an Arrangement contains a Lease’ is proposed to be included in the new standard and we agree that this is appropriate. However, given the increased importance of this aspect of the accounting, we believe that the further background and explanations included in IFRIC 4’s Basis for Conclusions and Illustrative Examples should also be carried forward into the new standard.

Furthermore, it would be useful in practice to provide guidance on how the “output” of an asset should be defined for the purposes of applying the IFRIC 4 requirements. In particular, whether this should be only the output of the main product that the asset is intended to produce, or whether by-products should also be taken into account.

**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 exploit for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33–BC46).

**Question 5 – 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 agree that the scope should include leases of right-of-use assets in a sublease, but exclude leases of biological assets and leases to exploit for or use minerals, oil, natural gas and similar non-regenerative resources. However, we think that a lease of an intangible asset should be accounted for the same way as a lease of a tangible asset and therefore should not be excluded from the scope.
Question 6 – Contracts that contain service components and lease components

The exposure draft proposes that lessees and lessors should apply the proposals in Revenue from Contracts with Customers to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B5–B8 and BC47–BC54). If the service component in a contract that contains service components and lease components is not distinct:

(a) the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.

(b) the IASB proposes that:

(i) a lessee should apply the lease accounting requirements to the combined contract.

(ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.

(iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements, and the service component in accordance with the proposals in Revenue from Contracts with Customers.

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

We believe that if a service component is distinct, it will always be possible to allocate payments to the lease component and the service component on some reasonable basis. Therefore it should not be necessary in paragraph B5(a) of the ED to include a requirement that the whole contract be accounted for as a lease if this is not the case. Notwithstanding this comment, there will be cases where the allocation of payments even to distinct service components will require judgement and estimates would vary from entity to entity.

We think that situations where the service component is not distinct will be quite rare and it would also be helpful if the standard could include an example of a lease with a non-distinct service component.

However, where this is the case, we believe that a lessee should account for the whole contract as appropriate to the component judged to be the main element of the contract, which could be either the lease component or the service component. The proposed rule that lease accounting should be used by default for the entire contract in all such cases could lead to significant overstatement of assets and liabilities in some cases.

Even where the service component is not distinct we would expect that a lessor would have sufficient information to determine a reasonable basis for allocation of payments, and should do so irrespective of which lessor accounting approach is used.
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 treated in the same way as other options, such as renewal options or termination options.

However, our preferred approach to such options generally is a probability threshold approach. Therefore, the exercise price of a purchase option would only be included in the measurement of the lease payments if it is reasonably certain that the option will be exercised.

Questions 8 – 10 – Measurement

The exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that:

(a) assumes 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 (paragraphs 13, 34, 51, B16–B20 and BC114–BC120).

(b) includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21 and BC121–BC131). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be measured reliably.

is updated 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 (paragraphs 17, 39, 56 and BC132–BC136).

Question 8 – Lease term

Question 8 – 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 are generally supportive of the proposal to include certain optional extension periods in the lease term where this will result in a realistic view of the expected lease term and thus the future cash flows that are expected to occur. If this approach is not used and only
initial minimum terms are included, structuring opportunities will arise whereby contracts will have short initial minimum periods with multiple short renewal options.

However, we are concerned that the proposed approach could result in amounts being recognised as lease obligations that do not meet the definition of a liability in the IASB's Framework. Most options in a lease are discretionary and do not become a contractual obligation unless and until the option is exercised.

We would therefore favour a probability threshold, consistent with the existing approach in IAS 17 under which optional secondary periods are only taken into account if it is reasonably certain that the lessee will exercise the option. For example, if there is an economic or operational 'compulsion' to extend the lease. We believe that this will result in relevant and reliable information for users of the financial statements by reflecting what are in substance known obligations. This is the approach used currently to determine obligations under operating leases, as disclosed in the notes to the financial statements, and is therefore well understood. We believe our views in this area are aligned with the alternative view expressed in paragraph AV2.

However, if the proposal in the ED to use the longest possible lease term that is more likely than not to occur is retained, we believe that the guidance could be improved by making clear that the full analysis of the probabilities associated with each and every possible lease term need not be performed in order to arrive at the answer. Entities would only need to perform the analysis, starting with the longest possible lease term and ask the question whether this term is more likely than not to occur, if the answer is "no" then carry on to the next possible lease term, and ask the question again, until a possible lease term is reached for which the answer is "yes".

In addition, the example provided in the standard should be one for which the correct answer is unambiguous and can be determined only by using the correct method. If we have understood it correctly, the correct method is to look at the cumulative probabilities starting with the longest possible lease term, and stopping when a cumulative probability greater than 50% is reached -- in the example provided this results in a lease term of 15 years. However, for the same example, the same answer of 15 years could also be reached by looking at the probabilities starting with the shortest lease term. It would therefore be helpful if a revised example could be provided.

We believe a practical issue will arise where a lessee has a portfolio of leases of similar assets, for example a fleet of leased ships, where there is an intention to exercise renewal options on a certain number of leases, but it is not known which specific leases.

**Question 9 - Lease payments**

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<th>Question: 9 – 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?</th>
<th>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?</th>
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<td>Do you agree that lessees 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?</td>
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Where a contingency is outside of the lessee’s control, we agree with the Board’s conclusion that contingent amounts under a leasing arrangement represent a liability and should therefore be recognised in the lease obligation and the right of use asset.

However, where the contingency is within the lessee’s control, such as payments linked to usage or performance, we are not convinced that there is a liability to be recognised. Similar to our response to Question 8 regarding the determination of the lease term, we do however think that where a contingency is within the lessee’s control and is “reasonably certain”, it would be appropriate to include amounts payable under contingent rental arrangements. We believe that this will result in relevant and reliable information for users of the financial statements by reflecting what are in substance known obligations.

Regarding the method of measurement of contingent rentals, we disagree with using a probability-weighted expected outcome approach. The mechanics of this method are complex and onerous and somewhat artificial. The final answer will be affected by the number of possible outcomes considered as well as the highly judgemental probabilities assigned to each possible outcome. It is not obvious what a reasonable number of outcomes would be where the possibilities are continuous rather than discrete, such as when the contingency depends upon an index or rate. Clearly the analysis of possible outcomes and probabilities should be based on unbiased inputs that represent management’s best estimates, but in our view, this will be open to manipulation, even unintentionally, in order to arrive at the outcome that management considers to be its best estimate of the future rental payments. We believe that the derived answer will be no more appropriate or accurate than simply using management’s best estimate of the amounts ultimately expected to be paid. The selected contingent rentals based on management’s best estimate should represent a reasonable balance of upside and downside risk.

Where contingent rentals are based on an index or rate the ED (paragraph 14) indicates that the estimate should be based on readily available forward rates or indices, but if none are readily available then prevailing rates should be used. There is no further guidance as to what is meant by “readily available” i.e. do these have to be externally available forward rates, or will internal forecasts suffice. In our view, where there is no readily available external source of information internal forecasts should be used, providing that these are reasonable and supportable and represent management’s best estimate in a similar way to the requirements of IAS 36 for determining a value in use for impairment testing.

We have a particular concern regarding the proposal in paragraph 19 of the ED dealing with variable interest rates. If our understanding is correct, the intention is that where contingent rentals are dependent upon a variable interest rate the impacts of a change in this rate would be: (i) future contingent rentals would be re-estimated, and the resulting change in the liability would be reflected as an adjustment to the right of use asset, in accordance with paragraph 18(b); and (ii) the rate used to discount the payments would be adjusted with the resulting change in the lease liability recognised in profit or loss. We believe that this creates an accounting mis-match and potential significant volatility in profit or loss by treating the two items differently despite the fact that they arise from the same circumstance. In practice these two adjustments to the lease liability will largely offset and we would prefer that either the impact of the change in the discount rate is also taken as an adjustment to the right of use asset, or that the liability is not re-measured at all for changes in the variable interest rate, with this latter option being our preference.

We agree with the inclusion of payments under term option penalties and residual value guarantees that are specified in the lease in the measurement of the assets and liabilities, subject to the comments above as for contingent rentals regarding the method of measurement.
We 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. We believe that such items will be capable of reliable measurement in the majority of cases.

**Question 10 – Reassessment**

**Question 10 – 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 that reassessment of the lease term and contingent rental payments is needed under the right-of-use approach. However, we are concerned about the level of effort required to reassess lease obligations every period. This issue will be particularly relevant for those entities that prepare half-yearly or quarterly financial statements. Some companies have numerous leases, and to evaluate each one is likely to become onerous. Typically an entity would normally assess an option for business purposes only as the option was nearing the time at which it becomes exercisable. We acknowledge the Board’s efforts to reduce the burden on entities by requiring reassessment only if facts and circumstances indicate that there would be a significant change in the liability since the previous reporting period. We are uncertain how this might work in practice, as it may be that a lot of work would be required to determine whether or not the impact would be significant. For example, a small change in circumstances may have an immaterial impact on individual leases, but a material impact for all the leases of an entity in aggregate. It is not clear from the ED whether “significant” should be interpreted in the context of an individual lease or for an entity as a whole. How entities approach this may depend on the systems and processes that they have in place to monitor and account for leases, and will possibly be a factor in decisions that entities make regarding investment in new systems and processes. This will be one of the many practical issues that entities will need to grapple with on implementation of the new standard.

One practical expedient that entities may consider adopting to reduce volatility arising from frequent periodic reassessment as well as attempting to limit the effort required would be to take account of whether a potentially “significant” change in a variable factor has been sustained over a reasonable timeframe before taking it into account in remeasurement.

As noted in our response to Question 8, our preference would be a probability threshold for determining the lease term, and this would require less frequent adjustments to the lease term, normally only when nearing the time at which the option becomes exercisable or by exception where there is a material change in circumstances that makes such exercise reasonably certain.

Having said that, we believe there is an argument that where the contingency relates to changes in an interest rate, the asset and liability should not be remeasured. This is explained in more detail in our response to Question 9.

On another specific point, we would assume that where credits might be expected at the end of the lease, for example, if there is agreed profit sharing between lessor and lessee on surplus proceeds of the sale of the underlying asset at the end of the lease term, the
lessee would treat these as negative contingent rentals. If so, the estimated credits accruing to the lessee would be included in the remeasurement of the lease liability in the same way as other contingent rentals. It would be helpful if the final standard would include specific guidance on this point.

**Question 11 – Sale and leaseback**

The exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents the sale of the underlying asset, the leaseback would also meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66–67, B31 and BC160–BC167).

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 it is not necessary for the leasing standard to contain the criteria for the classification of a transaction as a sale. Rather, the standard should cross-reference to the revenue recognition standard and transactions should be assessed on this basis. More importantly, the leasing standard should not contain criteria that are different from the revenue recognition standard.

The leaseback of the asset should be assessed separately in the same way as any other lease under the guidance in the leasing standard.

**Questions 12 – 14 – 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–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 agree that the assets and liabilities arising from leases should be presented separately in the financial statements, but that lessees should be allowed to choose to provide this information in the notes rather than within the primary statements. Mandatory presentation on the face of the balance sheet would likely lead to a cluttered presentation for many entities.

We agree that right-of-use assets should be presented as if they were tangible assets within property, plant and equipment or investment property as appropriate, but separately from owned assets. However, we draw your attention to our response to Question 3
regarding the appropriateness of classification of short-term right-of-use assets as non-current on the balance sheet.

(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 noted in our responses to other questions, we are not generally supportive of the performance obligation approach for lessors. Notwithstanding this view, it would seem appropriate, if such an approach is retained in the final standard to adopt the proposed presentation.

(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?

Consistent with our response to part (a) of this question, we agree that the assets and liabilities arising from leases should be presented separately within the financial statements, but that lessors should be allowed to choose to provide this information in the notes rather than within the primary statements.

(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?

Consistent with our responses to parts (a) and (c) of this question, we agree that the assets and liabilities arising from subleases should be presented separately within the financial statements, but that entities should be allowed to choose to provide this information in the notes rather than within the primary statements.

**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?

We agree that the income and expense arising from leases should be presented separately in the financial statements, but that entities should be allowed to choose to provide this
information in the notes rather than within the primary statements. Mandatory presentation on the face of the income statement would likely lead to a cluttered presentation for many entities.

**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 agree that the cash flows arising from leases should be presented separately in the financial statements, but that entities should be allowed to choose to provide this information in the notes rather than within the primary statements. Mandatory presentation on the face of the cash flow statement would likely lead to a cluttered presentation for many entities.

**Question 15 – Disclosure**

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 agree that lessees and lessors should disclose quantitative and qualitative information to meet the objectives described.

We do note, however, that some of the detailed narrative disclosure requirements set out in the ED, for example in paragraph 73, will be quite difficult to satisfy in a meaningful way for an entity with numerous (10,000+) leases. The difficulty will be striking a balance between developing concise disclosures that are meaningful, versus voluminous detailed disclosures.

We are also concerned specifically about the apparent requirement in paragraph 77 of the ED to provide a reconciliation of opening and closing balances of lease liabilities, disaggregated by class of underlying asset. Whilst we agree that such disclosure for right-of-use assets by class of asset is useful and consistent with the disclosure requirement for owned assets, we do not see that the equivalent disclosure for lease liabilities would provide useful information to users of the financial statements. We would not object to providing such a reconciliation for lease liabilities in aggregate but consider it unnecessary to disaggregate it by class of asset.
In addition, we are not convinced that the initial direct costs incurred during the reporting period and included in the measurement of the right-of-use asset is a useful piece of information for users of the financial statements.

**Question 16 – Transition**

(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 98-96 and BC186-BC193). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?

(b) Do you think full retrospective application of lease accounting requirements 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?

We agree that a simplified retrospective approach should be permitted, based on remaining lease payments as at the date of initial adoption. Entities would not be required to restate amounts in the financial statements relating to leases that have expired prior to the date of adoption. In many cases this approach will help to reduce the effort required to restate the comparative financial information.

We do, however, believe that a full retrospective approach should also be permitted. This is principally because this is the more “pure” approach to the adoption of a new accounting policy. In addition, we believe that the simplified approach, whilst having practical advantages, will have adverse impacts that entities should be allowed to avoid if they so wish.

In particular, if our understanding is correct, we believe that the effect of basing the calculations on the remaining lease payments as at the date of adoption will be to charge higher costs to profit or loss over the remaining term of the lease, than would otherwise have been the case if the new accounting had been applied since the beginning of the lease. This is a result of the change from recognising lease payments in profit or loss on a straight line basis under existing IAS 17, to the new treatment which front loads the lease interest expense into the earlier periods of the lease term.

Entities should have the option of weighing up the pros and cons of avoiding this distortion in the income statement, versus the additional effort that would be required to do full retrospective restatement.

An intermediate alternative approach that could be used to address the issue of the distortion in the income statement upon adoption would be to permit the initial measurement of the transitional assets and liabilities as at the commencement of the lease (even where this precedes the date of adoption of the standard). This could be permitted using current assumptions rather than attempting to determine assumptions that might have been applied at the time.
Question 17 – Benefits and costs

*Paragraphs BC200–BC206 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 have not conducted a detailed analysis of the costs that we would incur on adoption of the proposals, if they are carried forward into the new standard. Given that we estimate that we have in excess of 10,000 leases across the group, which is global in its reach, a certain level of cost would be incurred simply to carry out such an analysis.

Our concerns about the cost of implementation of the proposals, as well as the ongoing costs post-implementation, mirror those outlined in paragraph BC 203.

We believe that we would likely need to expend significant amounts to implement new systems and processes for leases, to gather detailed lease data, carry out the detailed calculations on initial recognition and to carry out the required reassessments.

In our foregoing responses to the various questions posed, we have in several cases suggested practical expedients that could be utilised in order to reduce the amount of effort and associated costs that will be incurred by preparers of financial statements on adoption of the new standard. Certain aspects of the proposals appear to be over-engineered and imply that a high degree of accuracy is achievable for amounts that essentially are estimates.

In our view, the case that the benefits of the proposals outweigh the costs has not yet been adequately evidenced. The Board should not underestimate the costs involved with this proposed change which we believe will be many times greater than any costs currently incurred by users of financial information in developing surrogate information. We would therefore urge the Board to take up the practical suggestions made by ourselves and other preparers of financial statements.

Question 18 – Other comments

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

We have some specific comments, noted below, that are not covered by the questions above. In some cases these are areas where we believe there are gaps in the guidance contained in the current ED but where we believe guidance will be required to assist preparers and to prevent diversity of treatment arising in practice and so to improve comparability.

**Discount rate to be used to calculate the present value of the lease payments**

Paragraph 12(a) of the ED requires that the liability is discounted using “the lessee’s incremental borrowing rate, or, if it can be readily determined, the rate the lessor charges the lessee”. It is not clear, in the case that the rate the lessor charges to lessee is known, whether there is a choice between the two rates, or whether this rate must be used.
In addition, we believe that it may be helpful to provide an example of the determination of the rate that the lessor charges the lessee. We are not certain how, in certain scenarios, the rate would be determined. For example, how would a ship operator time-chartering a ship calculate this rate when the lease payments are essentially set by reference to the freight market rather than by calculating a finance cost? Or perhaps this is a suitable example of when the rate charged by the lessor is not readily determinable by the lessee?

**Incremental borrowing rates**

It would be useful to include specific guidance in the standard regarding the incremental borrowing rates to be used in a group context.

In a large group, individual lessee entities may not have any other borrowings on which to base an estimate of incremental borrowing rates. In many groups treasury operations are managed on a centralised basis, with the entity borrowing funds generally rather than related to specific assets. Such cases are acknowledged in IAS 23 ‘Borrowing Costs’ which explicitly allows entities to use weighted average capitalisation rates for the purpose of determining the borrowing costs to be capitalised on qualifying assets.

We believe it would be helpful, in these circumstances, to allow entities to determine one set of incremental borrowing rates that would be applied by all group entities accounting for leases for the purposes of the group consolidated financial statements. This could include different rates for leases of different classes of asset and for differing lease terms or currencies. If the Board agrees with this practical expedient, it should be included explicitly in the final standard.

**Leases relating to jointly controlled assets (JCAs)**

There is a lack of guidance currently relating to the interaction between IAS 17 and IAS 31, in the case of an operator of a JCA who signs a lease as the lessee, on behalf of all the co-venturers in the JCA. It seems clear in IAS 31 that the right-of-use asset should be recognised by each co-venturer in relation to its proportionate share, however, it is not clear what should be recognised by the operator and its co-venturers in relation to the lease liability. In particular, should the operator recognise the gross lease liability on its balance sheet, or only its proportionate net share. In the oil and gas industry lease agreements are typically signed only by the operator of a JCA, and the co-venturers have a liability to reimburse the operator for its share of costs as they are incurred under a more general joint venture agreement.

Clearly, this has also been an issue under IAS 17 for the purpose of disclosure of commitments under operating leases, but the issue will become more important when assets and liabilities are recognised on the balance sheet.

**Residual value guarantees provided by an entity not related to the lessee**

We could not find any guidance in the ED on how lessors would account for residual value guarantees provided by entities not related to the lessee. We believe this is a fairly common feature for certain leases.

**Intra-group subleases**

Within large groups there are likely to be lessee entities that sublease assets to other entities within the same group. In these cases we believe it is essential that the accounting for the lessor and lessee entities is symmetrical such that the balances can be eliminated on consolidation where the terms of the head lease and
sublease are identical. Even where this is the case, the need to eliminate right-of-use assets and lease liabilities, both of which are potentially subject to periodic reassessment is likely to be onerous in practice. This is one of the issues that will be challenging on implementation of the new standard, leading to our view that an extended implementation period will be required.

**Implementation lead time**

Given the scale of this change for many entities and the many practical challenges that entities will face, we believe that a long implementation lead time will be required. We think that a period of at least 24 months should be allowed from issuance of the new standard before the mandatory effective date.

**Significant interval between inception and commencement of a lease**

We believe that further detailed guidance is required relating to the accounting treatment when there is a significant time interval between inception and commencement of the lease. This is dealt with further in our response to Question 1(a).