

Dear Sir/Madam,

I am broadly in favour of the objectives which this proposed new approach to leasing is trying to achieve. Commitments under operating leases represent real obligations for entities and, as such, it is right that these obligations be recognised on the balance sheet to allow investors to make fully informed decisions. However, in this attempt to reflect commercial reality, the legal position cannot be ignored. If a lessor is still the legal owner of an asset, it is quite wrong for that asset to be derecognised on the balance sheet. A lender seeking security for a loan would be misled as to the assets held by an entity if they were derecognised in this way. An alternative approach is therefore necessary.

Where ownership of an asset transfers to a lessee as the result of a lease agreement, the current approach under IAS 17 to finance leases should still be followed; i.e. asset treated as sold by lessor to lessee, lessee recognises lease liability and lessor recognises lease receivable. This adequately reflects the commercial reality of the transaction.

If however ownership does not transfer as a result of the lease agreement, whether a lease liability arises depends on whether the lessee has the ability to control the use of the asset, as paragraph 7 of Exposure Draft ED/2013/6 makes clear. Where the lessee can't control the use of the asset, effectively the lessor is performing a service on behalf of the lessee and, as such, any liability would only accrue as the service is performed. Therefore, in such cases, the current approach under IAS 17 to operating leases should be adopted; i.e. lease income/payments recognised on a straight line basis throughout the duration of the contract by the lessor/lessee respectively.

In cases where the lessee does have the ability to control the use of the asset, a liability should be recognised. Essentially the lessee has acquired, from the lessor, not the asset itself, but the right to use the asset for a period of time. Therefore the lessee would recognise an intangible 'Right of Use' asset to reflect the right acquired, and a corresponding lease liability, both of which would equal the present value of the minimum lease payments. But what of the lessor?

The lessor is still the legal owner of the asset and, as such, the asset should remain on its balance sheet. At the commencement of the lease contract the lessor has, in effect, sold a right to the lessee and, as such, a lease receivable should be recognised to reflect the income due to the lessor in relation to that right. However, since the right accrues to the lessee over the period of the lease contract, the income should be deferred and released to the income statement over the period of the lease. Since this deferred income represents a right held by a third party over the entity's assets it's disclosure in the balance sheet should reflect this; e.g. something to the effect of "Rights of Use held by Third Parties over Non-current Assets". The amortisation of this third party right would then constitute the release of the deferred income. The lease receivable and the third party right/deferred income recognised on the balance sheet would both equal the present value of the minimum lease payments.

Once it has been established that a lease liability exists arising from the transfer of a Right of Use asset, then the current approach proposed by the exposure draft should be followed to determine whether the lease is a Type A or a Type B lease, and the attendant accounting treatment applied.

Embedded in this document is an Excel file (see overleaf) providing a brief overview detailing how this proposed alternative approach to leasing would operate, along with a worked example for a Type A lease. Although there is clearly much flesh to be put on the bones in relation to this proposed approach, I think it reflects the best compromise between commercial and legal reality. Moreover, I

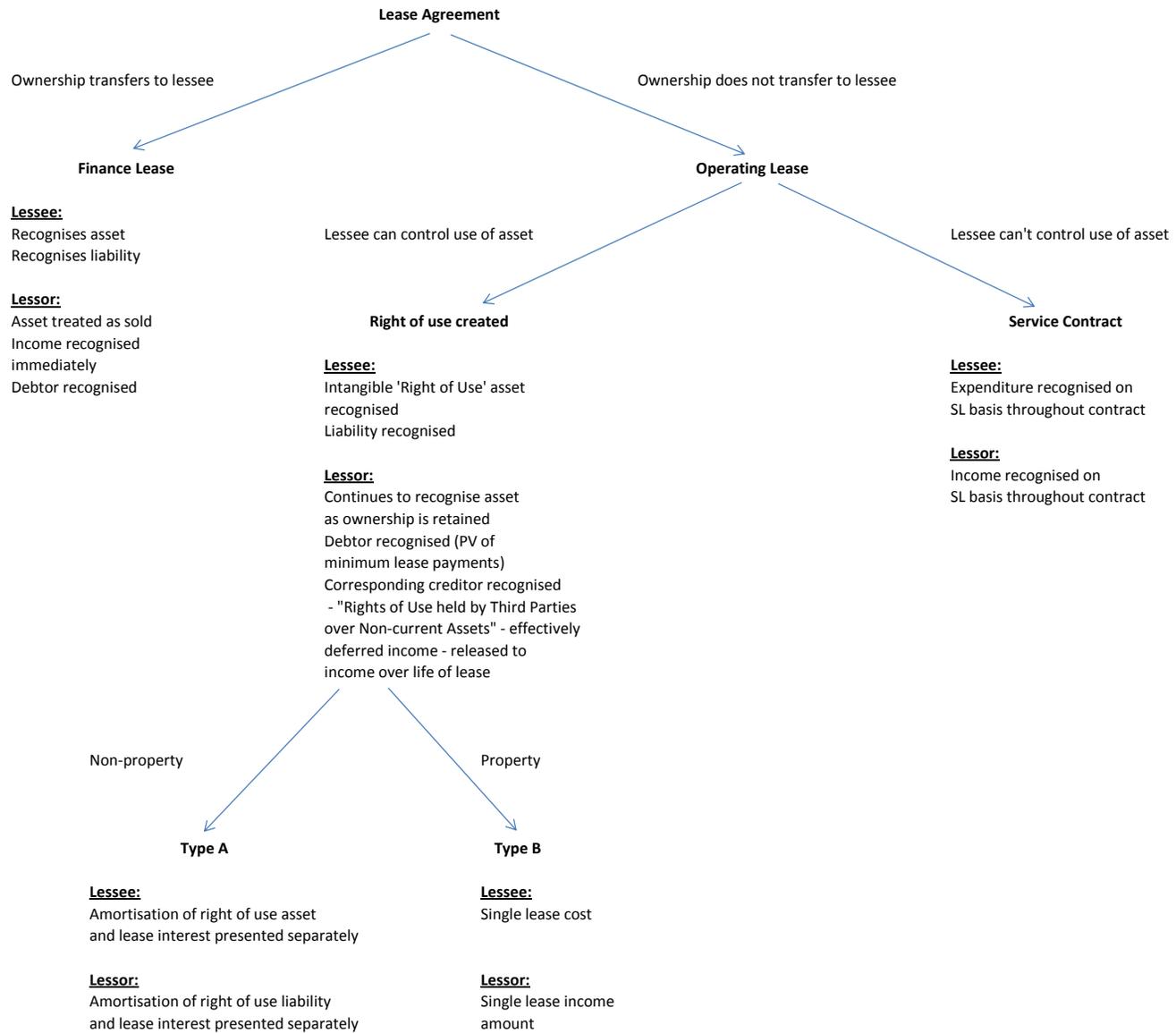
think that it still achieves the original objectives of the exposure draft, while at the same time providing a more simplified approach that will be much easier for organisations to apply.

Yours sincerely,

Paul Adams LLB ACA



Leases - Alternative
Approach.xlsx



Example of Right of Use Asset Lease - Type A:

Asset with a carrying amount of £7,500. Lease payable of 3 years, annual payments of £2,400 payable at the start of the year. Interest Rate of 6.87%.

PV of minimum lease payments :

Year	Payment	PV
1	2,400.00	2,245.72
2	2,400.00	2,101.36
3	2,400.00	1,966.27
		<u>6,313.35</u>

Interest: 6.87%

Lessee:

	<u>Balance Sheet</u>			<u>Income & Exp</u>			<u>Total</u>
	Right of Use Asset	Lease Payable	Bank	Amortisation	Interest		
Year 1:							
Opening	-	-	-	-	-	-	-
Right of Use Asset acquired	6,313.35	(6,313.35)	-	-	-	-	-
Amortisation	(2,104.45)	-	-	2,104.45	-	-	-
Interest	-	(433.73)	-	-	433.73	-	-
Lease Payment	-	2,400.00	(2,400.00)	-	-	-	-
Closing	<u>4,208.90</u>	<u>(4,347.08)</u>	<u>(2,400.00)</u>	<u>2,104.45</u>	<u>433.73</u>	-	-
Year 2:							
Opening	4,208.90	(4,347.08)	(2,400.00)	2,104.45	433.73	-	-
Amortisation	(2,104.45)	-	-	2,104.45	-	-	-
Interest	-	(298.64)	-	-	298.64	-	-
Lease Payment	-	2,400.00	(2,400.00)	-	-	-	-
	<u>2,104.45</u>	<u>(2,245.72)</u>	<u>(4,800.00)</u>	<u>4,208.90</u>	<u>732.37</u>	-	-
Year 3:							
Opening	2,104.45	(2,245.72)	(4,800.00)	4,208.90	732.37	-	-
Amortisation	(2,104.45)	-	-	2,104.45	-	-	-
Interest	-	(154.28)	-	-	154.28	-	-
Lease Payment	-	2,400.00	(2,400.00)	-	-	-	-
	<u>-</u>	<u>-</u>	<u>(7,200.00)</u>	<u>6,313.35</u>	<u>886.65</u>	-	-

Lessor:

	<u>Balance Sheet</u>				<u>Income & Exp</u>				<u>Total</u>
	Fixed Asset	Third Party Right	Lease Receivable	Bank	Amortisation	Lease Income	Interest		
Year 1:									
Opening	7,500.00	-	-	(7,500.00)	-	-	-	-	-
Right of Use transferred	-	(6,313.35)	6,313.35	-	-	-	-	-	-
Deprn/Amortisation	(1,000.00)	2,104.45	-	-	1,000.00	(2,104.45)	-	-	-
Interest	-	-	433.73	-	-	-	(433.73)	-	-
Lease Payment	-	-	(2,400.00)	2,400.00	-	-	-	-	-
Closing	<u>6,500.00</u>	<u>(4,208.90)</u>	<u>4,347.08</u>	<u>(5,100.00)</u>	<u>1,000.00</u>	<u>(2,104.45)</u>	<u>(433.73)</u>	-	-
Year 2:									
Opening	6,500.00	(4,208.90)	4,347.08	(5,100.00)	1,000.00	(2,104.45)	(433.73)	-	-
Deprn/Amortisation	(1,000.00)	2,104.45	-	-	1,000.00	(2,104.45)	-	-	-
Interest	-	-	298.64	-	-	-	(298.64)	-	-
Lease Payment	-	-	(2,400.00)	2,400.00	-	-	-	-	-
	<u>5,500.00</u>	<u>(2,104.45)</u>	<u>2,245.72</u>	<u>(2,700.00)</u>	<u>2,000.00</u>	<u>(4,208.90)</u>	<u>(732.37)</u>	-	-
Year 3:									
Opening	5,500.00	(2,104.45)	2,245.72	(2,700.00)	2,000.00	(4,208.90)	(732.37)	-	-
Deprn/Amortisation	(1,000.00)	2,104.45	-	-	1,000.00	(2,104.45)	-	-	-
Interest	-	-	154.28	-	-	-	(154.28)	-	-
Lease Payment	-	-	(2,400.00)	2,400.00	-	-	-	-	-
	<u>4,500.00</u>	<u>-</u>	<u>-</u>	<u>(300.00)</u>	<u>3,000.00</u>	<u>(6,313.35)</u>	<u>(886.65)</u>	-	-