



International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

29 August 2013

Dear Sirs,

Exposure Draft ED/2013/6

Invigors is a consulting firm providing solutions for asset finance companies, industry suppliers, manufacturers and captive finance organisations.

Our response to the Exposure Draft “Leases” (“ED”), issued in May 2013 is set out below.

We welcome the Board’s redeliberations since the earlier exposure draft of August 2010, its decision to issue a revised ED and its continuing public outreach on this topic. The Board has clearly recognised the overwhelming concerns about the complexity of the earlier proposals and the revised ED is an improvement in this regard. However the proposals remain complex and we do not believe that any benefits that may arise from these proposals will outweigh the additional costs imposed on the preparers of accounts. We believe that many of the improvements that the IASB has sought through its leases project could have been achieved more simply through the issue of an enhanced version of IAS 17. For this, and other reasons set out below, we would not support the Board issuing a final standard on this subject based on the current ED.

As part of your current outreach process, you have specifically requested comments on ways in which the operation of the ED could be simplified. We would recommend that the board reconsiders two specific aspects. Firstly limiting the requirements for reassessments so that these are only required where there are significant changes and secondly extending the period for the “short term” lease exemption. Our experience is that there are many leases for relatively low value equipment for periods of up to 3 years, in particular 3 years is the typical term of a car contract hire agreement. Consequently we believe that extending the period for exemption from 1 year to 3 years would not have a significant effect on the values shown as liabilities and assets on lessees’ balance sheets, but it would have a very significant effect on the numbers of leases for which these complex calculations are required and hence the compliance costs for lessees. As a means of monitoring the values involved, there could be a disclosure requirement similar to that currently in place in respect of operating lease rentals.

From the statements made by the IASB and others, including users of accounts, it is not clear that these proposals will deliver significant benefits. The indications from users are that they will have no better understanding of the numbers produced by these proposals than they do of those currently available and that some users would continue to make adjustments to published figures to fit their own

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templates. Responses from the IASB at recent outreach meetings appear to indicate that the concrete benefits of these proposals are very limited.

Since issuing the revised ED, the IASB has issued a discussion paper on its conceptual framework, which includes a number of issues relevant to lease accounting. In particular, obligations under lease agreements do not appear to fall within the definition of liability now being proposed in that discussion paper. It would seem important that such issues are fully resolved before continuing with developing lease accounting.

In developing its proposals, the IASB has sought to equate a lease with a purchase funded by a loan, whereas in reality a lease gives rise to a different set of rights and obligations. This has led to proposals failing to reflect the economic reality of leases within companies' income statements.

Whilst recognising that banking regulation is not a direct concern of the IASB, it should be recognised that the capital adequacy requirements of banks are driven by accounting processes. The IASB should liaise with banking regulators to ensure that the final requirements do not result in banks as lessees having a greater capital requirement from property in which they have a leasehold interest than they do from equivalent property ownership interests.

We consider that the lessor accounting model set out for "type B" leases is conceptually inconsistent with the lessee accounting model set out for these leases.

In response to the specific questions set out in the ED, we would comment as follows:

1. identifying a lease – it needs to be made clear that it is the right of the lessor to substitute an asset, rather than the occurrence of such substitutions which determines whether there is an identifiable asset.
2. lessee accounting – it seems clear from the ED that the IASB acknowledge that there is no clear conceptual reason for the introduction of the dual accounting model. The effects of the "type B" model on the lessee's income statement are a better reflection of the way most lessees view the economics of leasing and the IASB should consider adopting this as the single accounting model for lessees.
3. lessor accounting – the lessor accounting model should reflect the lessor's business model: where the lessor's principal interest is in the financing of the underlying asset, a financial basis should be reflected in accounting: where the lessor's interest lies primarily in the management and operation of the underlying asset, a different accounting model is appropriate. Many lessors currently offering operating leases of equipment are primarily financial businesses and the receivable and residual approach set out in the ED is a better reflection of their business model than, and represents a significant improvement over, the current requirements of IFRS.

The proposals set out in the ED require the individual receivable and residual components on the lease asset to be assessed separately for impairment. Equipment lessors will typically take a more holistic approach to the total lease asset, taking into account the value of both components. In particular, whilst a lessor will be concerned at any indication that the lessee will not pay the rentals due in full, that concern will be mitigated to the extent repossession and sale of the underlying asset would result in



realising proceeds in excess of the residual asset. It is not uncommon for lessors to generate a higher profit from a lease which terminates early following default by the lessee than would have been generated if the lease had continued for the full contractual term. We consider that this position is not properly reflected in the proposals and that these need to be readdressed. We also consider that the accounting as set out in example 22 needs to be readdressed with the impairment set first against the deferred income. For completeness, we would confirm that we do not consider that there is generally any equivalent cross-collateralisation from the receivables component to the residual component.

Where a lessor is taking the residual value risk on a leased asset there will be a degree of uncertainty around the profit the lessor expects to generate from the lease. Indeed one cannot say without looking at the lessor's pricing calculations what level of profit or residual value the lessor has reflected in setting its rentals. By way of example, rentals of £14,000 over 3 years for a car with an initial cost of £20,000 could be based on:

- a) a residual value of £9,000 and a margin of £3,000;
- b) a residual value of £8,000 and a margin of £2,000; or
- c) a residual value of £7,000 and a margin of £1,000.

Or other combinations where the margin is £6,000 less than the residual value. Economically the lessor will be indifferent between a, b and c: the margin it is charging the lessee is determined by the level of risk being taken on the residual value [the lessor's forecasts may be that there is a 99% expectation of the car selling for more than £7,000, a 50% expectation of more than £8,000 and a 5% expectation of more than £9,000]. Under current IFRS this lease would be treated as an operating lease and the depreciation charge would vary (both up and down) over the life of the lease as the expectations of the amount to be realised at the end of the lease were updated. However, the receivable and residual methodology set out in the ED requires an impairment to be recognised if the expected realisable value falls below the residual value initially reflected in the accounting, but does not allow for any increase in the expected realisable value to be incorporated until disposal takes place. Thus on the same facts a lessor adopting view a would report different balance sheet and income statement numbers over the term of the lease to a lessor adopting view b or c. We would recommend that you reconsider the accounting requirements that give rise to this inconsistency.

With regard to sale and leaseback transactions, we consider that these should always be recorded as a purchase and a lease by the lessor, irrespective of whether the lessee treats it as a refinancing. It is common practice for an asset to be purchased by a company and then subject to a sale and leaseback very shortly after that initial purchase at a value equal to the supplier's invoiced amount. We see no reasons why the lessor's accounting treatment of such a transaction should differ from that adopted where the lessor purchases the equipment directly from the supplier and leases it to the company under identical terms and conditions.

4. classification of leases – see answers 2 & 3 above

5. lease term – whilst the proposals set out in this ED represent a significant improvement on the earlier ED, we consider that it would be better to retain the definition set out in the current IAS17, based on "reasonably certain". We believe that this definition has the advantage of being familiar to preparers of accounts and we believe it has been robust in practice.

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6. variable lease payments – we believe that the accounting generally used by lessors under IAS 17 in respect of interest variation adjustments is a better methodology than that proposed within the ED.

7. transition – we consider that the proposals put forward in the ED would represent a reasonable approach to transition to a new standard based on the ED

8. disclosures – we consider that the separate disclosure of the receivable and residual element of operating lease assets represents an improvement over the current requirements, but have no other specific comments to make on the disclosure proposals.

Yours faithfully

George Tonks

Partner, Invigors EMEA LLP