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ED/2013/6 Leases

Dear Mr Hoogervorst,

As "Bundesverband Deutscher Leasing-Unternehmen" (BDL) we represent the interests of Germany's leasing companies to legislators, public authorities and the interested public at large. We act on behalf of some 190 leasing companies, ranging from small and medium-sized businesses to international leasing corporations. With an annual investment volume of around €50 billion, the German leasing market belongs to the biggest in Europe, besides the United Kingdom. Leases account for 23% of all equipment investments in Germany and more than 50% of all externally financed equipment investments. Thus leasing contributes significantly to overall economic investment needs, especially in small and medium-sized entities (SMEs). The majority of leased assets are vehicles, machines and IT/office equipment with an average acquisition value of the leased equipment of around €30k.

Our position on the above-mentioned Exposure Draft ED/2013/6 ("Re-ED") is as follows.

Discrepancy between costs and benefits militates against the introduction of the new standard

First of all, it should be expressly noted that IASB and FASB have taken very seriously the massive criticism from constituents relating to the previous Exposure Draft ED/2010/9 Leases. In particular, we welcome the fact that there has been a move away from probability-based measurement (e.g. lease term, variable lease payments). The abandonment of the performance obligation model in lessor accounting is also a step in the right direction.

However, having analysed the revised Exposure Draft ED/2013/6 Leases in detail, we remain convinced overall that it will not improve the information content of lease accounting sufficiently to justify the high costs of introduction and ongoing application of the new standard. This is partly due to the substantial conceptual weaknesses that massively impair the informative value and comparability of the annual financial statements (see 2. below). Also, despite the simplifications to be recognised, the right-of-use accounting burdens the reporting entity with substantial additional work for the recognition, assessment, initial and subsequent measurement and ongoing monitoring of innumerable transactions, as well as a huge number of additional disclosures (see 3. below). As a result, we do not see any improvement over IAS 17 and thus advocate the further development of that latter standard instead of the selective introduction of rights-and-obligations accounting solely for the area of lease transactions (see 4. below).



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2. Conceptual weaknesses impair the informative value and comparability of the financial statements

2.1 No valid distinction between lease and service

The revised Exposure Draft still fails to provide a convincing rationale for why the accounting treatment for lease transactions should differ from that of other executory contracts. Even minimal changes in the underlying facts can tip the assessment as to whether or not there is a lease. These minimal differences in the economic substance of the transaction do not justify the fact that in the one case ("service") nothing is to be recognised in the statement of financial position and the expense is to be distributed on a straight-line basis over the term, while in the other case ("lease") a right-of-use asset and a liability are to be recognised in the statement of financial position and the expense is shown as a declining-balance interest part and a straight-line amortisation part. The lack of a valid economic criterion for differentiating between a lease and a service seriously impairs the informative value and comparability of the financial statements, as demonstrated in the illustrative examples under IE3:

- In Example 1 (Contract for rail cars) the customer acquires comparable transportation capacities for five years in both sub-cases 1A and 1B in exchange for a comparable consideration. Whether the transportation is provided by physically specified wagons (1A) or by alternating wagons (1B) is of no economic significance to the customer. In substance, the rights and obligations are virtually identical. Nevertheless, 1A is to be treated as a lease, 1B is not.
- In Example 2 (Contract for coffee services), the customer obtains the right to use the supplier's equipment, whereby usage is only technically possible using consumables provided by the supplier. Similarly, in Example 3 (Contract for medical equipment), the supplier conveys the right to use equipment to the customer while including a contractual obligation that it may only be deployed using consumables provided by the supplier; in this scenario, the customer has the purely theoretical possibility of procuring the consumables elsewhere by breaching his contractual obligation. Despite the fact that the customer is bound to use the consumables provided by the supplier in both cases, he must account for a lease in Example 3, but not in Example 2.
- In Example 4 (Contract for fibre-optic cable) the customer acquires comparable cable capacities for fifteen years in both sub-cases 4A and 4B in exchange for a comparable consideration. Whether three physically distinct fibre strands within the cable are used for transmission (4A) or any alternating three fibre strands (4B) is of no economic significance to the customer. In substance, the rights and obligations are virtually identical. Nevertheless, 4A is to be treated as a lease, 4B is not.

The Boards will hardly be able to demonstrate that the identity in the economic substance of the transactions assigned in each of the three example pairs is adequately reflected in a decision-useful way by the two fundamentally different accounting concepts (right-of-use vs. executory contract). That is because the proposed accounting treatment suggests economic differences between the entities that do not in fact exist.

The fact that just minimal economic differences are taken as a reason for making a distinction between a lease and a service and therefore between right-of-use accounting and executory contract treatment is all the more questionable if one considers the starting point of the reform project. The Boards name as "one of the biggest criticisms of IAS 17" the fact that operating and finance leases are accounted for very differently even though they are "very similar" from an economic perspective (see BC354). This clearly disregards the fact that the distinction between operating and finance leases is based on an established eco-



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nomic assessment of the allocation of risks and rewards between the parties. For finance leases, the financing character of the transaction is economically at the forefront. The lessee is striving to finance and secure the availability of a specific asset. Accordingly, these transactions are treated like debt-financed purchases. Operating leases, by contrast, relate to the procurement of a more or less comprehensive service which includes the use of an external asset. The lessee wants flexible and temporary access to these assets/services, seeking to reduce operational complexity and to avoid asset-related risks. Consequently, these leases are recognised like services.

So, while IAS 17 provides a thoroughly valid economic rationale for the different accounting treatment of finance and operating leases, the Boards have so far failed to produce such a justification for the distinction between a lease and a service. At any rate, the economic differences between a lease and a service are much less in the above illustrative examples than they could ever be in the distinction between operating and finance leases under IAS 17.

2.2 No valid distinction between Type A lease and Type B lease

With the reintroduction of a classification, the Boards are abandoning their original objective of creating a single financial reporting model for all types of leases. Insofar as the reform has been justified by the argument that the classification in IAS 17 was complex and costly, the Re-ED can no longer claim this. The set of indicators for IAS 17, which has been in use for many years and which many stakeholders are familiar with (see BC54), is now to be replaced by an entirely new set, which includes a large number of undefined legal concepts, has not been proven in terms of practicability and remains to be implemented in systems at great cost.

Moreover, the new classification will not improve the information provided about the economic substance of a transaction. Property leases are recognised in the lessee's statement of financial position as debt-financed purchases, while in the income statement — where they are usually classified as Type B leases — they are reported merely as surrender-of-use transactions with the total expenses accounted for on a straight-line basis and without a separately recognised interest part. This will confuse key ratios between balance sheet and income statement positions, particularly between liabilities and interest expense. On the lessor side, the operating lease treatment of Type B leases simply cannot be reconciled in general with a right-of-use concept.

By contrast, for equipment leases (usually Type A) there is still a frontloading effect, although in these cases the economic intention of the parties involved is usually the procurement of a service that is constant over time. Thus it is difficult to understand why a company which, e. g., acquires mobility by leasing a car for three years under a full-service agreement and always replacing it with an identical car leased under the same terms and conditions should recognise the expenses in a saw-toothed pattern over time.

Furthermore, two leases with the same terms, the same lease payments and the same economic lives of the underlying assets can be classified differently depending on whether the assets are equipment or property (see example for Question 2 in the appendix). Thus although they are comparable leases with comparable rights and obligations, they would be accounted for in completely different ways.

At this point, we would like to remind you of the expense recognition model proposed by the European leasing industry that would provide an appropriate alternative under the premise of right-of-use accounting. This model could be applied consistently to all types of leases. It provides for the right-of-use asset to be amortised on an annuity basis (similar to the procedure now proposed for Type B leases). Regarded together, the increasing bal-



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ance of the amortisation and the declining interest part result in a straight-line expense that properly reflects the economic substance of constant usage over time.

2.3 The reference to the underlying asset in the definition of a lease and the classification criteria conflicts with the concept of rights-and-obligations accounting

The above comments underline the general conceptual inconsistency with regard to the role of the underlying asset:

On the one hand, the distinction between lease and service, and equally the classification of Type A vs. Type B leases, focus very subtly on the specific features of the underlying asset. The question of lease or service is determined by the circumstance of whether the asset has been physically specified or merely defined in terms of its specifications. The question of Type A vs. Type B is determined by the circumstance of whether the asset is equipment or property, what its economic life is and to what extent it is subject to consumption.

But when it comes to accounting treatment, the asset suddenly plays no further role. From this point on, the only items recognised are right-of-use assets, liabilities, receivables and residuals. The asset itself no longer appears in the statement of financial position at all (except in the case of lessor accounting for Type B and short term leases). We fail to see any conceptual consistency in this approach.

2.4 No improvement in the informative value and comparability of the financial statements

In addition to the highlighted major conceptual flaws, the informative value and comparability of the financial statements are also impaired by increasing volatility of the carrying amounts. The necessity of constantly reassessing value-determining factors and the prescribed impairment requirements can, over time, result in strongly fluctuating and thus difficult to interpret and barely comparable changes in values.

Furthermore, there are countless other contradictions, both within the proposed new leasing standard and compared with other IFRSs, of which we name only a few by way of example:

- When distinguishing between lease and service, the concept of control is treated differently than in the assessment of sale and leaseback transactions, which refers back to the proposed revenue recognition standard (ED/2011/6). There are also deviations from the concept of control in the consolidation standard IFRS 10.
- In some cases, measuring the lease liability in accordance with the proposed leasing standard leads to completely different values than would result from measurement according to the financial instruments standard IFRS 9, especially where there are purchase and extension options. There are also objections to the definition of liability in the framework.
- Head- and sub-leases which are to be classified as Type B lead to odd structures in the intermediate lessor's statement of financial position.

All of this does not help the new standard to make any significant improvement in the informative value of lease accounting. This assessment is also confirmed by talks with individual users and analysts. Contrary to what the published opinion from their professional bodies may suggest, they articulate substantial doubt about the informative value. It can be



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assumed that the users of financial statements will continue to refer to additional calculations and a revaluation of carrying amounts in their future analyses. The Boards' declared aim of simplifying the process will not be achieved. This may be caused by the fact that there is a broad variety of views within the user community about what the economic substance of a lease transaction is and what the consequences for financial reporting to be derived from this should be. Moreover, within the very broad scope of the standard assessments of the economic nature of a lease will naturally fluctuate substantially depending on the specific type of transaction. For this reason alone, a "one-size-fits-all" solution that calls for the recognition of all types of leases under all circumstances in the lessee's statement of financial position cannot work.

3. Change in systems and high degree of complexity give rise to immense accounting costs

3.1 Massively increased basic complexity due to rights-and-obligations accounting

Currently, for operating leases, lessees only have to recognise an expense, whereas rightof-use accounting requires a large number of additional process steps. Each transaction to be considered must be assessed in terms of the nature of the lease and, if necessary, broken down into its constituent parts. Then the lease term, the relevant (if applicable, variable) lease payments and the discount rate must be determined in order to make the initial measurement. For the purposes of subsequent measurement, it is necessary to classify leases as Type A or Type B and both the right-of-use asset and the lease liability must be carried forward in the statement of financial position (divided into Type A and Type B) and regularly reviewed for the need for reassessment or impairment. Finally, extensive disclosures also have to be generated so as to make it possible to interpret the financial statement figures under the right-of-use model at all. The individual process steps often require vast quantities of data to be collected, analysed and evaluated, as well as extensive professional judgement to be applied. In general, the need is for ongoing monitoring and reassessment instead of "set it and forget it". This increases the basic complexity of lease accounting many times over. All the more so, since the described process steps also have to be carried out for non-core assets. In this context, it should be noted that 93% of current operating lease assets have a cost of less than €50k and the average deal size is even less than €30k (source: Leaseurope). The said complexity contradicts the customers' economic reasons for choosing (operating) leasing so as to obtain a service that offers flexible and temporary access to assets without having to deal with the hassle and cost of asset management. However, accounting should not be driving businesses' economic decisions.

3.2 Accounting treatment is largely determined by parameters beyond the preparer's horizon

The concept of the new draft standard is set out in such a way that preparers of the financial statements are repeatedly forced to process information that they do not have to hand and that they cannot assess from their horizon of experience.

When deciding between a lease and a service, for example, the *lessee* must assess to what extent the *lessor* faces "barriers (economic or otherwise)" in relation to substituting the leased asset. Further, preparers of financial statements require knowledge about consumables available from other suppliers with which they have nothing to do (see IE3, Example 2 "Contract for coffee service" and Example 3 "Contract for medical equipment"), or about the "physical distinctness" of the underlying asset (see IE3, Example 4 "Contract for fibre-optic cable") which, in case of doubt, only engineers can assess.

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When determining and if necessary reassessing the lease term, the *lessor* must assess the expected behaviour of the *lessee*. He must consider from the lessee's subjective viewpoint whether there are any "significant economic incentives" for exercising an option or whether such incentives have changed over time.

Due to the significant influence of the described "external" accounting parameters, the costs of obtaining and processing information are increased and the validity of the accounting data is decreased. This is all the more true in retail business, where thousands of contracts with relatively small values are subject to the accounting process. For external observers, e.g., the auditors, there is no practical way of checking the values determined by the preparer of the financial statements under these circumstances.

3.3 Complete system conversion will cause horrendous adjustment costs

The right-of-use accounting means completely new territory for all affected persons – preparers, users, auditors, regulators, the judiciary, etc. First of all, preparers of financial statements will incur horrendous costs to convert their IT systems. This is particularly true given that both lessees and lessors are generally forced to use customised systems due to the lack of standard solutions available. But the conversion will also entail considerable costs for training, orientation and consultation for the other groups named. Add to this a great deal of uncertainty in accounting practice, given the large number of new concepts to be introduced, for which it will no longer be possible to rely on the wealth of longstanding experience when interpreting them. The indirect costs incurred, for example, by the need to adjust covenants (if this is even possible) or convert rating systems must not be forgotten.

4. Further development of IAS 17 is preferable over the isolated introduction of rightsand-obligations accounting solely in the field of leases

The above comments have shown that, even though the project has been running for almost seven years now, the current model for reforming lease accounting is still not conceptually convincing and will fail substantially to meet the reform objectives set by the Boards themselves. The extent of the improvement in informative value is in no way reasonably proportionate to the costs of conversion and ongoing application. This is due not least to the fact that the Boards' intention is to introduce rights-and-obligations accounting in an isolated way for leases only. Ultimately, in fact *all* contracts – including for instance in the area of services – entail rights and obligations for the parties involved, which arise when the contract has been signed. And in actuality *all* these contracts incorporate a time value of money component (unless they are paid for up-front), albeit without making them a financing contract. As long as other services continue to be treated as executory contracts, it is incomprehensible to readers of financial statements and, in view of the economic substance of the transactions, unfathomable, why when an identified asset is involved, suddenly a fundamentally different accounting treatment is to be used.

As long as this dilemma remains unresolved, we will advocate further development of the tried and tested IAS 17 instead of the isolated introduction of rights-and-obligations accounting in the area of leasing. If nothing else, the many unresolved conceptual problems of the new draft standard shed a different light on the in our opinion unjustly vilified IAS 17:

 IAS 17 with its distinction between finance and operating leases is based on principles as well as a substantiated economic assessment of the allocation of risks and rewards between the parties involved in a transaction. It draws consistent accounting conse-



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quences in accordance with the economic substance of the transaction derived from this – temporary surrender-of-use vs. financing transaction. Unlike the classification into Type A vs. Type B as set out in the Re-ED, this takes place with conceptual consistency in both the income statement and the statement of financial position.

- In terms of lessor accounting, there is in any case no substantial criticism of IAS 17. The changes proposed by the Boards in this area, which are extremely complex to implement, are owing entirely to the conversion to a rights-and-obligations accounting system. The objective of adequately reflecting the economic activities of the lessor is completely satisfied by IAS 17. Improvements in the information content of reporting in this field are neither to be expected nor necessary.
- The often repeated charge of vulnerability to structuring is ultimately applied unjustly to IAS 17. It is mainly based on the "bright lines", which have been imported in implementation practice from US GAAP (75% economic life test, 90% recovery of investment test), but which IAS 17 does not conceptually provide for at all and which contradict its principle of substance-over-form.

Through additional disclosures in the notes within the existing system, a further development of IAS 17 could meet the diverse information needs of the users of financial statements much better and with greater differentiation than the single-value recognition of a right-of-use asset. By relying on the tried and tested, conceptually consistent IAS 17, horrendous costs of conversion and substantial additional expenses for ongoing accounting could be avoided without impairing the informative value of lease accounting compared with the Boards' proposed reform.

For further detailed comments, please see the answers to the questionnaire on the Re-ED attached as an appendix. Furthermore, we refer to the comment letter of our European umbrella organisation Leaseurope, the content of which we support in full.

Best regards,

Bundesverband Deutscher Leasing-Unternehmen e. V.

Horst Fittler
Managing Director

Dr. Martin Vosseler

Director



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Appendix: Answers on Questions

Question 1: Identifying a Lease

No, we do not agree with the proposed definition of a lease. We consider the distinction made between a lease and a service to be one of the central conceptual weaknesses of the draft standard (see also General Comments 2.1).

In substance, the criteria for defining a lease do not provide justification for treating leases differently from other executory contracts. When applying the definition, in some cases a lease and a service are so similar from an economic perspective (see examples 1 to 4 under IE3) that the proposed two completely different accounting concepts, right-of-use and executory contract, are misleading with regard to the equivalent economic substance of the transactions. This will massively impair the informative value and comparability of the financial statements.

In general, it is not conceptually reconcilable that the definition of a lease depends crucially on the existence of and control over an identified asset, but when it comes to the accounting treatment, it is no longer the asset, but rather a right-of-use that is recognised.

Furthermore, the application of the lease definition is fraught with complexity. This is because preparers of the financial statements must process information that they do not have to hand and that lies outside of their sphere of experience (e.g., with regard to the existence of "barriers (economic or otherwise)" or "physical distinctness", see also General Comments 3.2).

In our opinion, potentially amending the definition of a lease would also be of no use as long as the fundamental problem is not resolved, i.e., that rights-and-obligations accounting is to be introduced in an isolated and selective way in the area of leasing, while executory contract treatment is to be retained for other transactions that are very similar in substance. Given this conceptual flaw, each distinction between lease and non-lease – wherever it may be specified – will remain arbitrary.

Question 2: Lessee Accounting

No, we do not agree with the proposed model for lessee accounting and its classification of expense recognition by degree of consumption.

On the one hand, we are indeed convinced that there cannot be a "one-size-fits-all" approach to accounting for all types of leases. The potential scope of the leasing standard is extremely broad and ranges from mere services that include the use of an external asset through to transactions with a dominant financing character that are similar to debt-financed purchases. A single accounting model intended to cover all leases under all circumstances in the lessee's balance sheet cannot sufficiently reflect the wide variety of economic substance of the transactions.

On the other hand, however, the proposed differentiation into Type A and Type B leases is too simplistic, because it focuses only on recognition of expenses and disregards the statement of financial position aspects. As a result, Type B leases are reflected in the statement of financial position as debt-financed purchases, while in the income statement they are reported as mere surrender-of-use transactions with the total expenses recognised on a straight-line basis and without making a distinction between the interest part and the amortisation part. This creates a conceptual difference between the statement of financial position and the income statement,

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such that they no longer plausibly relate to each other. For Type A leases, by contrast, there is still a frontloading effect, which contradicts the prevailing nature of these transactions (as far as they are qualified as operating leases under the current IAS 17) as the purchase of a service that is constant over time and that is not more or less a financing contract than any other type of contractual commitment. In light of the conceptual distortions, which affect all areas of the financial statements, the proposed classification can only be seen from our perspective as a failed compromise between IASB and FASB given their incompatible views with regard to the adequate recognition of expenses.

Added to this is the fact that the classification into Type A and Type B leases entails many undefined legal concepts ("insignificant", "property", "significant economic incentive") which make practical application more difficult. The applied criteria are also unconvincing from a theoretical standpoint, as can be seen in the following example (based on KPMG (2013), "New on the Horizon: Leases", p. 14):

- Company A enters into a lease of a ship, Company B of an office building. Both leases have a term of seven years, both assets an applicable economic life of 30 years and a fair value at the commencement date of € 5,600k. In both cases, the lease payments amount to € 600k p.a. with a present value of € 3,900k.
- According to the classification criteria of the Re-ED, the ship lease is to be classified as
 Type A (23.3% of the economic life and 69.6% of the fair value is "more than insignificant"),
 the office lease, however, is to be classified as Type B (23.3% of the economic life is not "a
 major part"; 69.6% of the fair value is not "substantially all").
- Both leases have exactly the same parameters and therefore the same rights and obligations for the parties involved. However, for the ship lease, the total expense is recognised on a declining-balance basis, comprising the declining-balance interest part of the lease payments and the straight-line amortisation of the right-of-use asset. For the office lease, by contrast, lease expenses are recognised on a straight-line basis. Thus a difference in substance between the two transactions is suggested where none exists. The informative value and comparability of the financial statements are massively impaired. The unequal accounting treatment depending on asset class produces economically incomprehensible results.

We are of the opinion that the tried and tested distinction between operating and finance leases according to IAS 17, with which the stakeholders are familiar (see BC54, 289(c)), is vastly superior to the classification proposed in the Re-ED, because it is derived from a principle-based, valid economic approach, that is the allocation of risks and rewards between the parties. On this basis, consistent consequences are drawn in both the statement of financial position and the income statement which result in a true and fair representation of the substance of the transaction – temporary surrender-of-use (operating lease) vs. financing transaction (finance lease).

Question 3: Lessor Accounting

First of all, we acknowledge that the model now proposed for lessor accounting is a significant improvement over the dual model of the previous Exposure Draft and its performance obligation approach. Furthermore, we are of the opinion that the lessor side should also reflect the wide variety of economic substance of the potential transactions by using different accounting models.

However, as already set out in Question 2, we do not agree with the proposed classification into Type A and Type B leases. The proposal is also unconvincing from the lessor accounting perspective, both conceptually and in terms of its practicability. In our view, there is no conceptual



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justification in the context of right-of-use accounting for why Type B leases are to be treated by the lessor like current operating leases. Because if – as the Boards assert – part of the potential benefits have been finally "sold" to the lessee, such that the lessee recognises the right of use and a corresponding liability, then this cannot be reconciled with unchanged recognition of the leased asset in the lessor's statement of financial position.

On the lessor side, too, we deem the distinction between operating and finance leases according to IAS 17, with its consistent consequences for the statement of financial position and income statement, to be the conceptually much more convincing alternative.

With regard to the subject of lessor impairment, please refer to the detailed statement in the comment letter of our European umbrella organisation Leaseurope, with which we also expressly concur. In effect, it must be ensured that both the receivable and the residual asset are included in the impairment base, i.e., that for the purposes of lessor impairment, the entire investment in the lease (or in the language of the Re-ED, the "lease assets") forms the unit of account. This corresponds to the calculations of the lessor and his practical approach in impairment cases, where the proceeds from the sale of the leased asset are used to secure the entire investment in the lease – without being arbitrarily broken down into receivable and residual asset. If a need for impairment of the residual asset arises owing to deterioration in its expected residual value, the lessor should account for this by adjusting the unwinding of the discount of the residual asset accordingly. The current estimated residual value then forms the target value for the accretion of the residual asset.

Question 4: Classification of leases

No, we do not agree and we refer to our answers to Questions 2 and 3 with regard to our objections and preferences for an alternative approach.

Question 5: Lease term

First of all, we acknowledge that the current proposals for determining the lease term represent a substantial improvement over the probability-based measurement suggested in the previous Exposure Draft. But we have doubts about how possible it will be in practice to apply the concept of "significant economic incentive". It is not sufficiently clear which criteria are to be used to assess the existence of this condition. It would have been simpler to stick with the distinction of whether or not an option is "reasonably certain", as under IAS 17. The more so, as the Boards clearly do not intend any significant difference in terms of content with the new wording (see BC140: "similar threshold").

We consider the requirement to carry out a reassessment at each reporting date to be very problematic. On the one hand, it leads to volatile statement of financial position values and fluctuating impacts on earnings, which can only be interpreted with difficulty and impair the comparability of the financial statements, particularly since the required estimates are subjective and almost impossible to verify. On the other hand, the reassessment requirement entails substantial administrative work, especially for large lease portfolios. This is all the more true given that the lessor must make estimates about the presumptive behaviour of the lessee, which by nature lies beyond his sphere of information and experience. Even omitting market-based factors from the reassessment does not make the process appreciably easier, since it is nearly impossible in practice to separate out the influence of contract-based, asset-based, market-based and entity-based factors.



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With regard to short-term leases, it should be noted that they too must first be checked for the existence of extension options, which can entail substantial administrative work. Because extension options result in the exclusion of the short-term lease rule even if there is no "significant economic incentive" for exercising them, only relatively few transactions are likely to benefit from the intended simplification effect. In general, we believe that under ordinary circumstances also for leases with terms of two or three years, readers of financial statements do not have any need for the information provided by the full application of right-of-use accounting.

Question 6: Variable lease payments

To begin with, we welcome the fact that, in the interests of reducing complexity, the Boards have moved away from their original plans for probability-based recognition of variable lease payments. In the context of right-of-use accounting, we also consider it to be proper that usage or performance-based variable lease payments should not be routinely included in carrying amounts, since they are avoidable from the perspective of the lessee and, for that reason alone, do not meet the requirement of an unconditional obligation within the meaning of the IFRS liability criteria.

On the lessor side, the treatment of variable lease payments that have had an impact on the interest rate that the lessor charges the lessee seems to us to be complicated. The method for taking these payments into account via the measurement of the residual asset may appear to be justified with regard to the presentation of the lessor's profit. As far as its practical applicability and the associated complex procedures are concerned, we have significant doubts. There is also a question of whether recognising the variable lease payments under "residual assets" would accurately reflect the economic substance of these payments.

Question 7: Transition

The transitional provisions, which only allow a choice between the full and a modified retrospective approach, entail an immense amount of conversion work for the affected entities. Lessees will be forced to precisely analyse practically all existing leases (especially current operating leases) and to recognise and measure them in the financial statements in accordance with the transition procedures. This process is further complicated by the distinction between Type A and Type B leases. Lessors will also have to completely convert their systems in an extremely costly and time-consuming process.

If the decision was made to go ahead with implementing the current proposals despite the general imbalance between costs and benefits, then a grandfathering clause for old cases should at least be considered. This would also mitigate the indirect effects that arise, for example, when financial covenants are broken merely due to application of the new accounting provisions, without anything having changed financially at the affected entity. The same applies in the area of sale and leaseback transactions, where conversion would incur huge costs as well as having a substantial impact on financial statements due to a lack of special transition provisions. In any case, it would have to be ensured that affected entities had enough time before the first-time application of a new standard became binding (if it should actually come to that).

In general it should be noted that, no matter what transition method is used, simply recognising existing operating leases will wipe equity from the lessee's statement of financial position, while nothing has changed in the financial situation of that entity. With regard to the information content and the comparability of the financial statements, this is also a highly questionable result.

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Question 8: Disclosures

We are of the opinion that the wide-ranging information needs of the different user groups and the variety in substance of the different transactions would be much better reflected by additional disclosures than through single-value carrying amounts under right-of-use accounting.

That said, we find it wholly incomprehensible that the Boards are planning a massive expansion of the disclosures *in addition* to right-of-use accounting. The only way we are able to interpret this is that the Boards themselves harbour considerable doubt about the informative value of the figures in the financial statements under their proposals. If the new accounting model actually satisfied the information needs of users by delivering the appropriate information, as claimed by the Boards, then it would be expected that the scope of disclosures would be reduced.

The nature and scope of the required additional disclosures entail further extra work for the preparers of financial statements, adding to the already horrendous costs of applying the new accounting rules. Ultimately, it is necessary to set up complete sub-ledger accounting to satisfy the requirements. By contrast, the introduction of additional disclosures while retaining the established IAS 17, as preferred by the leasing industry and many other constituents, would be achievable at a much lower cost. The entities' systems have long been set up to meet the information requirements of an IAS 17 environment. In this context, the desired qualitative improvement in the disclosures could be realised at reasonable cost and without having to make radical changes to systems.