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Brasilia, Distrito Federal – Brazil
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September 13th, 2013

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: Exposure Draft ED/2013/6 Leases

Dear Board Members,

The Comitê de Pronunciamentos Contábeis - CPC (Brazilian Accounting Pronouncements Committee)¹ welcomes the opportunity to comment on the Exposure Draft ED/2013/6 Leases.

Our comments and responses to the specific questions listed in the Exposure Draft (ED) are included in the following pages. Overall, we agree with the proposals of the ED, except for the concept of classifying the contracts into two types (A and B), since we believe that despite the leased asset be property or non-property type, all leases should be treated in the same consistent way. In addition, we believe that the performance obligation approach should be the only method applicable for lessors, instead of having two types of accounting models.

In addition, we included in the other comments section of this letter the following topics:

(a) Discount rates

One aspect of the proposals that will involve a considerable amount of complexity for preparers and, in special, lessees, is the determination of the discount rates to be used in measuring lease liabilities. Estimating these rates requires certain knowledge about the risks and returns of leased assets, which the lessee generally does not have.

(b) FX gains or losses

According to the proposals in the Exposure Draft, FX gains or losses would be accounted for as required by IAS 21. We would like emphasize that the proposals for lease accounting could drastically increase profit or loss volatility for lessees and this is particularly problematic for companies that operate in emerging economies. Also, the

¹ The Brazilian Accounting Pronouncements Committee (CPC) is a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidelines for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), BMFBOVESPA (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).



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requirements of IAS 21 seem inappropriate for lease arrangements, in which the liability is directly linked to leased asset.

(c) Examples

The Exposure Draft is accompanied by illustrative examples. However, we would like to state our opinion that the examples provided little help in understanding how the principles should be applied and which factors had more importance in reaching a conclusion.

(d) Fieldwork activities

The proposals for changes in lease accounting may have significant impacts in the preparation of financial statements of many entities across industries. In this sense, we strongly recommend the conduction of fieldwork activities in order to access these impacts.

If you have any questions about our comments, please contact us at operacoes@cpc.org.br.

Yours sincerely,

Idésio da Silva Coelho Júnior
Chair of International Affairs
Comitê de Pronunciamentos Contábeis - CPC



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Question 1

Do you agree with the definition of a lease and the proposed requirements in paragraphs 6–19 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

Response to question 1

We recognize that the current proposed definition of a lease is an improvement when compared to the previous one included in the first Exposure Draft issued by the Board in 2010. However, we believe that such definition still requires some important changes in order to avoid ambiguous interpretation on how it is supposed to be applied in practice. This ambiguity creates unnecessary subjectivity and could cause the improper classification of executory contracts as leases. Such situation could occur in the accounting for executory contracts with asset identification. We explore below how the proposed wording could result in the scenario described by us.

(a) Ability to direct the use

We agree with the principle that “a customer has the ability to direct the use of an asset when the contract conveys rights that give the customer the ability to make decisions about the use of the asset that most significantly affect the economic benefits to be derived from use of the asset throughout the term of the contract.” However, we believe that the Exposure Draft addresses the application of this principle superficially, as it provides insufficient and conflictive guidance between paragraphs 14 (a) and 17. Paragraph 14 (a) states that “how and what purpose the asset is employed during the term of the contract;”, whereas paragraph 17 states that “right that give a customer the ability to specify the output of an asset (...) would not, in isolation, mean that a customer has the ability to direct the use of that asset...” For example, considering that an entity contracts certain services and for the duly performance, the provider specifies the asset that will be employed in the service in the contract. Under paragraph 14 (a), one may conclude that the entity has the ability to direct the use of the asset, when in fact the entity does not control neither operate the asset, having only the ability to specify the output of the asset, but not the ability to direct its use. Since this situation might be common in several industries, we believe that paragraph 14 (a) should be removed to avoid misinterpretations of the definition of contracts that contain leases.

(b) Ability to derive the benefits from use

We agree with the principle that “a customer’s ability to derive the benefits from use of an asset refers to its right to obtain substantially all of the potential economic benefits from use of the asset throughout the term of the contract.” However, we disagree with the criteria provided in paragraph 19 to determine when a customer does not have the ability to derive the benefits from use of an asset. These criteria suggest that a customer will have the ability to derive the benefits from use of an asset if necessary additional goods or services could be hypothetically obtained by the customer in the market or applied by the customer itself. But, the existence of substitute goods or services is irrelevant if the customer is contractually prohibited from using goods or



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services other than the supplier's. For instance, the customer will not be able to derive the benefits from use of an asset operated by the supplier if the customer cannot change supplier, even though other service-providers could be hypothetically contracted. In this sense, we strongly recommend a change in the criteria in order to clarify that the customer should evaluate whether it is contractually able to derive the significant benefits from the use of an asset.

(c) Applying the definition with and without our proposed changes

In order to clarify the impact of our proposals, we would like to illustrate the following example. Suppose a customer contracts a carrier to transport goods during a two years period using an identified asset. The operation of the asset remains with the carrier, who cannot be changed by the customer, even though other carriers in the market could hypothetically operate the identified asset.

According to the definition proposed by the Board, one might conclude that the customer controls the use of the identified asset, because the customer can: (a) determine how and for what purpose the asset is employed during the term of the contract by deciding when and where the goods should be transported to; and (b) derive the benefits from use of the identified asset, because the customer could hypothetically contract other carriers to operate it.

However, such contract should be classified as executory, and be recorded at the time the service is rendered/received by the customer, because the customer cannot: (a) determine how the asset is operated during the term of the contract, since the operation is conducted by the carrier; and (b) derive the benefits from use of the identified asset, because the customer is contractually restricted from changing the operator. The customer's ability to determine when and where the goods should be transported to merely refers to the an specification of the output of the asset (as described in paragraph 17).

(d) Improvement of paragraph 17

Notwithstanding our comments above, we believe paragraph 17 should be also improved to address situations in which the customer has the ability to specify the output, with some other decision-making rights relating to the use of the asset. We believe this situation could be addressed using criteria similar to the ones employed by the Board in IFRS 10 (paragraphs 18, and B58-B72), where it describes how to differentiate an agent from a principal. In this case, the customer should have effective power to specify the output and effective control on the assets, and not have delegated powers from the lessor.

Question 2

Do you agree that the recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?



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Question 3

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Question 4

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 28–34, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

Response to questions 2, 3 and 4

We do not agree that the accounting for leases should differentiate according to the portion of consumption of the economic benefits embedded in the underlying asset. Except for tangible assets with indefinite useful lives such as land, any other tangible asset will have a decline of expected service potential as it is used, simply because the use itself unavoidably implies the consumption of some service potential. This remains true even if the consumption of service potential is insignificant enough not to affect the value of the asset, which probably would not be the case for most properties because these are generally depreciable according to IAS 16.

Conceptually, we believe that lessors should account for leases as follows: (a) leases involving tangible assets with indefinite useful lives should be accounted for as type B leases; and (b) leases involving tangible assets with definite useful lives should be accounted for as type A leases. However, mainly because of the way residual values should be accounted for in type A leases, this approach would be extremely burdensome for lessors and could produce results with little informational value for users of financial statements. In this sense, we would strongly recommend the Board to consider adopting the performance obligation approach, developed during the leases project, as the single accounting model for lessors.

In the case of lessees, we believe that all leases should be accounted for as type A leases. This recommendation follows our request for symmetry in the accounting by lessees and lessors. We also think that it would be inappropriate to link the accounting for a right-of-use asset with the consumption with the underlying asset. For instance, even though land does not lose service potential to the lessor, the right-of-use over land held by the lessee does if the lease contract has a specified term.

Question 5

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

Response to question 5



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We generally agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors. However, we believe that the Board should clarify the precise meaning of the term 'significant', as it is employed in paragraph 25. Thresholds such as this will tend to create difficulties in practical application of the proposals.

Question 6

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

Response to question 6

We fully support the proposals on the measurement of variable lease payments. In particular, we see as very appropriate the proposal not to include variable payments based on use (other than fixed in-substance) in the measurement of the lease liability. Nevertheless, we have two recommendations on this matter.

(a) Examples of variable payments

Appendix A does not detail the circumstances under which variability can arise. This explanation can, however, be found in paragraph BC148. Nevertheless, we noticed that none of the circumstances listed mention the variability caused by the lessor's performance derived from the use of the asset. Even though these specific variable payments should tend to cause the contract to be classified as executory, we still it is necessary to clarify their existence.

(b) Variable lease payments that are in in-substance fixed payments

The Exposure Draft proposes the use of the very important, but still unexplained concept, of variable lease payments that are in in-substance fixed payments. This concept is only superficially addressed in some of the examples that accompany the Exposure Draft. In these examples, one might conclude that in-substance fixed payments generally involve the establishment of floor payments. If so, we fully agree with concept. However, the lack of clarity may lead some to interpret that in-substance fixed payments relate to the likelihood of expected variable payments. We fully disagree with this interpretation as it involves an executory component of the contract. Hence, we urge the Board to clarify that in-substance fixed payments do not include expected variable payments.

Question 7

Paragraphs C2–C22 state that a lessee and a lessor would recognise and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and



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why? Are there any additional transition issues the boards should consider? If yes, what are they and why?

Response to question 7

We believe that only a modified retrospective approach should be permitted, in order to ensure comparability among entities adopting the standard. However, we would like to recommend a change in the modified retrospective approach so that, at the beginning of the earliest comparative period presented, lessees could recognize a right-of-use asset measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the effective date.

Our proposal is not only based in the reduction of costs that it would permit, but also on the informational gain that users of the financial statements would benefit from. This is because the right-of-use asset would be measured at a more updated amount representing the economic benefits expected to be obtained. There is no benefit in having the asset measured at an estimated historical cost which provides very little useful information.

Finally, concerning the transitional provisions, for contracts existing at the date of transition but for which the remaining contractual term is equal or inferior to 12 months lessees and lessors should be permitted to elect the application of simplified requirements as described in paragraphs 118 to 120.

Question 8

Paragraphs 58–67 and 98–109 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments; reconciliations of amounts recognised in the statement of financial position; and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

Response to question 8

We agree with the proposed disclosure requirements for lessees and lessors.

Question 9

To strive for a reasonable balance between the costs and benefits of information, the FASB decided to provide the following specified reliefs for nonpublic entities:

(a) To permit a nonpublic entity to make an accounting policy election to use a risk-free discount rate to measure the lease liability. If an entity elects to use a risk-free discount rate, that fact should be disclosed.

(b) To exempt a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability.

Will these specified reliefs for nonpublic entities help reduce the cost of implementing the new lease accounting requirements without unduly sacrificing information



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necessary for users of their financial statements? If not, what changes do you propose and why?

Response to question 9

We agree with the specified reliefs for nonpublic entities and that information provided to users will be adequate. However, we point out that the Boards should provide guidance to nonpublic entities that will go public in the future. Remeasuring lease liabilities at the time of going public in situations on which the entity elected the use of risk-free discount rate may be troublesome, for example.

Question 10

Do you agree that it is not necessary to provide different recognition and measurement requirements for related party leases (for example, to require the lease to be accounted for based on the economic substance of the lease rather than the legally enforceable terms and conditions)? If not, what different recognition and measurement requirements do you propose and why?

Question 11

Do you agree that it is not necessary to provide additional disclosures (beyond those required by Topic 850) for related party leases? If not, what additional disclosure requirements would you propose and why?

Responses to questions 10 and 11

We agree that it is not necessary to provide different recognition and measurement requirements for related parties leases. We believe that no additional disclosures should be required, considering that ASC 850 is duly applied.

Question 12

Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

Response to question 12

We agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property.

Other comments

(a) Discount rates

One aspect of the proposals that will involve a considerable amount of complexity for preparers and, in special, lessees, is the determination of the discount rates to be used in measuring lease liabilities. Estimating these rates requires certain knowledge about the risks and returns of leased assets, which the lessee generally does not have. The



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lessee will focus on the risks and returns of its own operations, of which the leased asset is a component, but generally not the main one. Therefore, we would like to recommend that, as a practical expedient, the Board should permit portfolio approaches in estimating discount rates of lease liabilities.

We would also like to point out that the discount rate issue may become extremely relevant depending on the final decision of the Board concerning the definition of leases. If the definition proposed by Board in the Exposure Draft is adopted, many contracts that involve more than the use of an asset may be classified as leases, as alerted by us in our response to question 1. In this case, incremental borrowing rates could drastically differ from the rates lessors charge lessees. This is because the incremental borrowing rate will not incorporate many of the risks factored by the lessor when it charges the lessee. Therefore, we urge the Board to consider our comments on the definition of leases.

(b) FX gains or losses

According to the proposals in the Exposure Draft, FX gains or losses would be accounted for as required by IAS 21. We would like emphasize that the proposals for lease accounting could drastically increase profit or loss volatility for lessees and this is particularly problematic for companies that operate in emerging economies. Also, the requirements of IAS 21 seem inappropriate for lease arrangements, in which the liability is directly linked to leased asset. We believe the Board should further discuss this issue before completing the project on lease accounting.

(c) Examples

The Exposure Draft is accompanied by illustrative examples. However, we would like to state our opinion that the examples provided little help in understanding how the principles should be applied and which factors had more importance in reaching a conclusion.

(d) Fieldwork activities

The proposals for changes in lease accounting may have significant impacts in the preparation of financial statements of many entities across industries. In this sense, we strongly recommend the conduction of fieldwork activities in order to access these impacts as soon as the Board finishes re-deliberating the proposals after the comment period for the Exposure Draft Leases is closed. Those fieldwork activities should be executed in several jurisdictions, encompassing several industries and types of arrangements.