SVENSKT NÄRINGSLIV

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

Stockholm 12 September, 2013

IASB Exposure Draft ED/2013/6 Leases

Representing preparers' point of view, the Swedish Enterprise Accounting Group (SEAG) welcomes the opportunity to comment on the Exposure Draft (ED).

Summary of views

We believe that the proposal in ED will not lead to a high quality standard. As an alternative, we propose to review the delimitation between financial and operational leases in IAS 17 in order to ensure that leases that are in substance financial leases also are classified as such. We believe that this together with improved disclosure requirements regarding operational leases is sufficient to solve the concerns the IASB has raised regarding the current standard. We strongly believe that additional disclosure requirements for notes to the accounts would fully meet the needs of analysts, without requiring capitalization of all leases on the face of the accounts as proposed in the ED.

The proposal is conceptually weak and not in line with the Conceptual Framework. The proposed standard seems to be work in progress, since the issue of how to account for leases of intangible assets is not addressed in the ED. We believe that the proposal if adopted will give rise to classification and structuring issues that will be significant and problematic, contrary to what the IASB thinks. We also foresee an increased complexity in financial reporting. Adding to this, the simplifications proposed regarding short term leases are insufficient. We believe that leases regarding non-core assets should be scoped out of the standard and/or that the definition of short term leases should be extended to longer periods.

We do not believe that the ED improves financial reporting for leases to such an extent as it is stated by the IASB. Further, it is clear that the ED if implemented will lead to significantly increased costs for preparers. We therefore disagree with the assessment in the ED that the benefits outweigh the increased costs.

In the Appendix, we have commented on most of the questions asked by the IASB in the ED. We have also expressed our views on some other issues related to the proposal in the ED.

Svenskt Näringsliv   Confederation of Swedish Enterprise
Postadress/Address: SE-114 82 Stockholm   Besök/Visitors: Storgatan 19   Telefon/Phone: +46 (0)8 553 430 00
www.svensktnaringsliv.se   Org. Nr: 802000-1858

We are pleased to be at your service in case further clarification to our comments will be needed.

Yours sincerely,

CONFEDERATION OF SWEDISH ENTERPRISE

Dr Claes Norberg
Professor, Director Accountancy
Secretary of the Swedish Enterprise Accounting Group

The Swedish Enterprise Accounting Group (SEAG) represents more than 50 international industrial and commercial groups, most of them listed. The largest SEAG companies are active through sales or production in more than 100 countries.

Appendix

Scope

Question 1: identifying a lease

This revised Exposure Draft defines a lease as "a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration". An entity would determine whether a contract contains a lease by assessing whether:

(a) fulfilment of the contract depends on the use of an identified asset; and
(b) the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset. 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.

Fulfillment of the contract depends on the use of an identified asset

We will here comment on the difficulties of assessing what is an identified asset to be used for a period of time according to the ED.

Substantive right to substitute an asset
It is not always clear what is meant with the condition "if the supplier has a substantive right to substitute the asset". Must it be explicitly stated in the contract that the asset can be replaced or can other circumstances related to the agreement between the contracting parties or business practice serve as evidence of such a right?

The distinction between service contracts and lease agreements
We believe it is unclear if some contracts are service contracts or lease agreements according to the ED. We would like to see more guidance and examples to clarify the differences. In the IE there is an example of a coffee machine (does not contain a lease) and medical equipment (contains a lease). The reason why the IASB comes to different conclusions in the two examples is not clear to us.

It is, however, clear that the classification demands a significant degree of judgment. If all the agreements an entity enter into must be assessed in detail (like in the examples in the IE), the administrative work and time spend on just assessing if a contract is a service agreement or lease agreement and the procedures of just concluding if the agreements fall under the revenue or the leases standard will be very time consuming. We will here provide some examples of the difficulties in classifying contracts into service and lease agreements.

This will be challenging concerning e.g. different types of *charter contracts*. The assessment can lead to a material impact and differences in accounting. For example, a time-charter contract on a fixed trade with 100 % capacity utilization from a customer can be assessed as a service contract. However, if the customer has the possibility to influence the trade, time table or other operative decisions the contract could be assessed to be a leasing contract, depending on the extent of such influence. Even the possibility; theoretical or economical, for the ship owner to use other vessels will impact the assessment of the contract. From a strict economic point of view, is there actually a difference between the agreements? Is there a risk that business decisions will be taken based on accounting principles? A detailed guidance is necessary to facilitate the assessment whether a contract is a lease or a service agreement.

Difficulties in interpreting the draft standard also arise regarding parts of a specific asset. Compare e.g. vessels with separable tanks with shared tanks. If a number of parties choose to share several vessels with a couple of tanks on every vessel, will the capacity exception be applicable or not? Probably not, according to how the ED is drafted. However, compare that example with the situation where generic raw materials belonging to different customers are mixed in the same tank (oil, gas etc.). In this example, it can be argued that the customer is renting capacity to store and not an identified asset and thus the contract should not be classified as a lease. It can be argued that the economic substance of the transactions are similar to each other. But differences in the way that the contracts are drafted might lead to different accounting treatment.

Another example regarding *road transports* can illustrate the distinction. A customer rents one truck from a trucking company that owns ten identical trucks. The trucking company decides which truck to use for the contract. Assume that the customer instead rents a truck from a small trucking company that owns just one truck. Our conclusion is that the first contract can be viewed as a service contract while the other contract can be viewed as a lease. The economic substance of the contracts in the examples is similar but they might be accounted for differently. We believe that this will not contribute to useful information. There is a risk for divergence in practice and in accounting.

A third example deals with *utility and telecom*. For those industries it is not always clear if an asset is identified or not. Utility and telecom companies have a lot of agreements relating to capacity and power that go through cables. Often several parties are connected and share the same cable. It is not clear if some agreements include an identifiable asset or not. This can be illustrated by the following example. A cable is initially is connected Customer A. How should the agreement be classified if Customer A ends the contract early and the cable in the contract could be exchanged to a connection to Customer B under the same contract?

Separating components in a contract
Paragraph 20 of the draft standard requires separation of components in a contract. In situations where there are a number of components in a contract, lease and non-lease (service), the larger asset/-s should be decisive if the contract contains a lease or not. There are many situations where non-lease items are not even distinguishable. Even if they are, any picking out of bits and pieces, treating them differently, would put an extreme burden on administration in entities. Some kind of simplification is needed in order to make this requirement operational. Our view is that only material lease components should need to be identified.

Furthermore, classification issues also arises from leasing arrangements with complex underlying assets, e.g. oil rigs or drilling vessels where the customer demands various degrees of operation and service during the lease term. Relative prices are often adjusted between asset and service in order to achieve a total maximum profitability. How this shall be handled within the scope of combined lease contracts according to the ED is not clear.

The contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration

In paragraphs 13-17 of the draft standard the ability to direct the use and to make decisions about the asset that most significantly affect the economic benefits is discussed. Further on, in paragraphs 18-19 the ability to derive the benefits from the use and the right to obtain substantially all the benefits is covered. Both *most significant* and *substantially all* leave the preparer with judgment that needs to be taken into account when assessing if the agreement is in the scope of the Leases standard nor not. We note that the language used in the draft standard differs from e.g. IFRIC 4 when determining what a lease is. We believe that it is important to use a consistent language in IFRS. We therefore ask the IASB to review the criteria and explain to what extent changes are proposed compared to e.g. IFRIC 4.

We also would like to add to the definition something which clearly differentiates it from the purchase of the asset, for instance "...without acquiring legal ownership of the asset" either at the end of the definition, or as point (c) in the assessment criteria.

Practical effects of the proposed definition of a lease

We believe that the issues mentioned above including the assessment if the contract includes an identified asset, if it is a service or lease agreement, to determine if it is most significant/substantially all etc. could result in “abuse” of the standard’s scope and definitions. It could be argued that is more clear in IAS 17 if a contract is a lease or not and if agreements are in the scope or not. The aim with the new standard should be to make it more clear and decrease the risk for “abuse”.

We believe that the proposed standard can increase the risk of structuring a lease agreement to make sure the agreement is not in scope of the standard. We see that there is a lot to consider before we can conclude if we are in scope of the standard or not, e.g. do we have a identified asset or does the supplier has a substantive right to substitute the asset (paragraph 8-10, IE - example 1), do we have a capacity portion of an asset or not – what is the definition of substantially all of the capacity of the cable (paragraph 10), do we have a service agreement or lease agreement (IE - example 2-3) etc.?

The accounting model

Question 2: lessee accounting

> *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?*

We agree that recognition, measurement and presentation should differ for different types of leases. However, we disagree with the proposal in the ED. According to our view the present approach in IAS 17, distinguishing between financial and operational leases, should be applied also in the future. Our principal view is that leases that are equal/similar to a purchase of an asset should be accounted for as a financial lease as today. This should be applied on leases where in substance all economic benefits are consumed during the lease term and where the risks and the rewards are passed on to the lessee. Leases where this is not the case should be accounted for as operational leases as in IAS 17 today. We acknowledge that it might be necessary to review the delimitation between financial and operational leases in IAS 17 in order to ensure that leases that are in substance financial leases also are classified as such. We believe that this together with improved disclosure requirements regarding operational leases is sufficient to solve the concerns the IASB has raised regarding the current standard.

We believe that it is important the IASB apples the principle of “smart regulation”, meaning that amendments should be targeted and cost-effective. Also, we believe that amendments should be conceptually sound in order to lead to a real improvement in financial reporting. We do not believe that the proposals in the ED will lead to such an improvement in financial reporting compared to the current IAS 17 that they should be implemented. We believe that the proposed model is conceptually weak and increases complexity to presentation. We are therefore not convinced that users of financial reporting will be better off than today.

The approach with a “right of use asset” for all types of leases cannot be motivated by a reference to the current Conceptual Framework. We have noted that IASB proposes a change in the Conceptual Framework along with those lines in the DP issued earlier this year. We believe that the question of how to define an asset and the consequences of introducing an amended definition for financial reporting in general should be solved within the review of the Conceptual Framework before amending specific standards.

The presentation of assets and liabilities combined with a lease expense in the P/L for type B leases is a compromise between different approaches leading to an accounting solution that lacks conceptual backing. We believe that IASB should take clear position. Either should all leases be accounted for in the same way or there should be a distinction between different types of leases as in IAS 17. We also believe that users will have difficulties in understanding the type A/type B model and users will probably have to make adjustments because of this. The improvements the IASB hopes to achieve through the amendments in ED compared to IAS 17 might therefore be not be as high as expected.

Question 3: lessor accounting

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?

We believe that the suggested model for lessors is not the solution to the identified problems as the model still creates boarder-line decisions and structuring opportunities. The lessor model diverges from the recognition pattern presented in the lessee model and the lessee and lessor side are hence not mirrored. We therefore refer to the discussion under question 2, and suggest to keep the current IAS 17 until a theoretically robust standard is presented.

Question 4: classification of leases

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?

We have made some general comments regarding the proposed classification under question 2 and 3.Therefore please refer to our comments to these questions. Adding to those comments, we would also like to point out that the draft standard is vague and this will lead to interpretational questions regarding classification. We will give some examples.

Lessors and lessees need to assess if the lessee consumes more than an *insignificant portion* of the underlying asset to be able to decide the accounting principle for the lease contract. It is not entirely clear in the ED how to interpret “an insignificant portion of the underlying asset”. This is important since the assessment will have a material impact not only on balance items but also on revenue amount and classification in P&L.

The receivable and residual approach for lessors is complicated and affected by underlying estimates on future residual values. In some industries, the contract amounts are significant and also a small change can therefore have a material effect.

Also, the definition of *economic life* is not clear. An example from shipping can illustrate this. When a major dry-docking of a vessel is performed, its cost is recognized in the carrying amount of the item of equipment (vessel) and depreciated over the estimated useful lives (2-5 years). Dry-docking must be performed according to a regulated time schedule depending on the country’s laws and regulations. Hence, the dry-docking must be performed to be able to use the vessel. Will this fact have impact on the economic life (2-5 years?) of the total asset and consequently an application of either an approach that results in a straight-line or non-straight-line lease expense? Further, shall the capitalized cost for dry-docking be included in the amounts referable to the lease contract? This will impact the amount of the balance sheet item and may also impact the result for the lessor.

Measurement

Question 5: lease term

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?

We in principle agree with the proposals on the lease term. However, our view is that an entity shall not reassess the lease term unless there has been a change in the terms of the contract or the lessee has decided to use an option to terminate or extend the contract. As we interpret the proposal the lessee as well as the lessor must assess whether to reassess the lease term or not at each reporting period, which is very administrative burdensome.

Further, relevant factors regarding reassessment (paragraph 27 and B6) are rather vague which could lead to structuring opportunities. What is “significant economic incentive” in concrete? Should significance e.g. be assessed on the level of the reporting entity or the specific lease contract?

It is clear that the information will be complex and that systems must be changed in order to support those estimates throughout all reporting entities within a group. We are not at all convinced that the information required will be so much improved that the unavoidable and significant cost increase for preparers can be defended. In a large firm with thousands of lease contracts regarding different types of assets with different lease terms, options etc. this requirement will create a nightmare. Example 14 gives an indication of this but to understand the real effects concrete illustrations are needed. We would be happy to share our examples with the IASB.

Question 6: variable lease payments

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?

We appreciate the fact that the IASB has changed the proposals in the ED compared to the ED 2010 to include in the measurements of lease assets and liabilities only variable lease payments that either depend on an index or a rate or are in-substance fixed payments, rather than requiring the inclusion of an estimate of all variable lease payments.

However, we believe that a reassessment of variable lease payments depending on an index or a rate at the end of each reporting period will lead to a significant amount of work for preparers. For example, in our jurisdiction the rent for premises are often based on a consumer price index (CPI). This means that when the CPI changes then the entity need to re-calculate the value of the new cash flows from the contract and thereby end up with revised balance sheet items for property and the attached lease liability. Assuming that such reassessments in many cases will lead to small changes of reported amounts, we do not believe that the benefits for users are larger than the costs for preparers. The requirement for reassessment of variable lease payments could therefore be deleted without any significant loss of useful information.

Transition

Question 7: transition

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

Representing a preparer’s view, we are in favour of a *full prospective approach* due to the fact that the proposed approach in the ED will lead to a significant administrative burden for preparers. However, we are aware of the implications this approach would have on the comparability between entities and over time in an entity. Because of this we can endorse the proposed modified retrospective approach. A full retrospective application would be devastating for preparers in terms of cost and effort. It is therefore very important that the modified retrospective approach is included in the standard. The modified retrospective approach will require more time for implementation than the full prospective approach and it is therefore important that sufficient implementation time is given. We believe that the approach described in C10-C12 regarding leases previously classified as financial leases is appropriate.

Adding to this, we ask the IASB to clarify what is stated in C20 regarding sale and leaseback transactions. Should reassessment under the draft Revenue from Contracts with Customers only take place in the cases (a) and (b)? What if there are other situations under draft Revenue from Contracts with Customers that must be reassessed? Should they not be reassessed if either of (a) and (b) in C20 are not fulfilled? Clarify C20 in relation to C21, which we believe is enough in draft Leases to clarify which sale and leaseback transactions that must be reassessed.

Lastly, we agree with the exclusion of the disclosure requirements in IAS 8 paragraph 28 (f)(i) and (ii). However, when applying the modified retrospective approach we believe that the disclosure requirements in IAS 8 paragraph 28 (g) should be excluded as well.

Disclosure

Question 8: disclosure

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?

We here present our views regarding disclosure requirements. We also give some comments on the proposed presentation requirements for lessee and lessor.

We believe that the requirements for disclosures in the ED should be reviewed in the light of the action plan regarding disclosure requirements in IFRS as set out by the IASB in its press release from 28 May 2013. We believe that there is a discrepancy between the general message regarding disclosures conveyed by the IASB and the requirements in the Leases ED.

Lessee

The criticism of the current accounting model for leases in IAS 17 has mainly been related to the fact that some leasing arrangements are kept outside the balance sheet. By requiring all leases to be shown on the balance sheet in the ED this “flaw” has been fixed. But despite this change, a significant expansion of disclosure requirements is also proposed in the ED. The required disclosures, both qualitative and quantitative, will be more extensive in the proposed leasing standard than in IAS 17.

We question if all required information is useful for an external reader when it is currently not available for the internal decision-makers in an entity. It will also be difficult to collect all the required information with current IT systems used by preparers. New investments in IT-systems will therefore be necessary to collect all information required by the standard. It is therefore very important that presentation and disclosure requirements are meaningful to motivate increased costs for preparers.

We believe that the disclosure requirements for leasing arrangements will exceed those for assets in general and other financial liabilities. If the aim with the proposed standard is to decrease the differences in accounting and presentation between acquiring an asset through a purchase or through a leasing arrangement, we believe that also the disclosure requirements shall be similar in those situations. This will be further explained below.

Presentation
In the ED it is stated that lease liabilities should be presented separately from other liabilities and that Type A and Type B lease liabilities should be presented separately. We believe this requirement could lead to an information overload in the balance sheet and would rather prefer the possibility to present the information in the notes. For many companies Type B

lease liabilities would not be significant amounts and we believe the users would benefit if included in the lines "other liabilities" and specified in the notes.

According to our experience, users of the financial reports are often interested in the concept of "Net debt". We therefore believe that it is important that there is a connection between financial liabilities and what is presented in the financial net. We interpret the ED so that the unwinding of the discount from a type B lease liability should be presented within operating activities which accordingly should imply that the lease liability from a type B lease is regarded as an operating liability and working capital. We think this must be clarified from a conceptual point of view in the new leasing standard. Presentation requirements for lease liabilities should, we believe, be in line with those for financial liabilities and operating liabilities respectively.

Disclosure

In paragraph 59 of the draft standard it is stated that the lessee shall consider aggregating or disaggregating disclosures to present useful information. While we in principle agree, we believe that it will be difficult to aggregate information regarding lease contracts of diverse character without losing the usability for the reader. We therefore believe that the requirements should be clarified taking this into account.

The qualitative information required by paragraph 60 (a-c) can be questioned from a business perspective. We consider the amount of qualitative information about contracts between two parties within a leasing arrangement to be more extensive than what is required for other agreements. This could be information that would be unfavourable from a competitive point of view but could also in some cases reveal information about the financial position of counter-parties. We therefore suggest that the proposed requirements are reviewed.

We have also identified some examples where we believe that the draft standard requires more disclosures than other IFRS standards and accordingly we believe that entering into a leasing arrangement could be unfavourable compared to other alternatives from a disclosure perspective.

In paragraph 64 the disclosure requirements for lease liabilities exceeds, according to our view, those required for any other operating and financial liabilities. We also foresee problems to collect information about cash paid.

In paragraph 65 it is required that variable lease payments shall be disclosed. The income statement contains a lot of variable costs that are not disclosed in detail and hence this should not be required for leasing arrangements either.

In paragraph 67 it is required to disclose a reconciliation of the undiscounted cash flow to the lease liability in the statement of the financial position. This is not required by IFRS 7 for other liabilities and should not be for lease liabilities either.

To conclude, we believe that the disclosure requirements should be reduced and aligned with requirements for assets and financing in general if the proposal how to account for leases in the ED is finalized.

Lessor

Presentation

Paragraph 91 is vague. If an entity applies both business models shall then information on profit and loss be disaggregated into two line items? Paragraph 91 (a) and (b) are given as "examples" but the text in (a) and (b) is written as a conditional requirement ("if /…/ shall present").

Cash flows from both type A and type B lease agreements shall be classified as operating activities in the statement of cash flows of lessors. A lessee, on the other hand, shall classify payments in the statement of cash flows depending on what the payments relate to. The result is an asymmetrical presentation that could be misleading and difficult to understand if one views the financial reports of both the lessee and the lessor.

Disclosure

Also for the lessors we believe that the disclosure requirements have increased compared to the current leasing standard and we question to what extent this has been based on solid evidence from users of financial reports. We strongly believe that disclosure requirements should be similar when assets or goods are sold according the revenue standard and when assets or goods are sold through a leasing arrangement. We therefore question the following disclosure requirements in the ED:

- Profit and loss recognized at the commencement date according to paragraph 101 a) as there is no requirement to disclose profit and loss for other products sold.
- Unwinding of discount according to paragraph 101 a ii) and iii) is not required for other receivables, except for as a total for all financial assets measured at amortized cost according to IFRS 7.20 b).
- In paragraph 101 c) it is required that lease income relating to variable lease payments not included in the measurement of the lease receivable shall be disclosed. The income statement contains a lot of variable income that is not disclosed in detail and should hence not be required for leasing arrangements.
- Short-term lease income as if the number is significant it should be disclosed according to paragraph IAS 1.97 or otherwise not disclosed.
- In paragraph 103 it is required to disclose a reconciliation of the undiscounted cash flow to the lease receivable in the statement of the financial position. This is not required by IFRS 7 for other receivables and should not be for lease receivables either. Also cash received according to paragraph 103 c) is not available in current IT-systems and the cost to collect this information would outweigh the benefits.
- In paragraph 106 it is required for type A leases to disclose a maturity analysis of the undiscounted cash flows of the lease receivable in the statement of financial position. This is not required by IFRS 7 for other receivables and should not be for lease receivables either. The equivalent maturity analysis is also required for type B leases according to paragraph 109, which is not required for e.g. long-term service contracts.

IAS 40 Investment Property

Question 12 (IASB-only): Consequential amendments to IAS 40

The IASB is proposing amendments to other IFRSs as a result of the proposals in this revised Exposure Draft, including amendments to IAS 40 Investment Property. The amendments to IAS 40 propose that a right-of-use asset arising from a lease of property *would be within the scope of IAS 40 if the leased property meets the definition of investment property. This would represent a change from the current scope of IAS 40, which permits, but does not require, property held under an operating lease to be accounted for as investment property using the fair value model in IAS 40 if it meets the definition of investment property.*

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?

We agree with the proposal.

Other comments

Scope of the standard (intangible assets)

Intangible assets are not within the scope of the standard. In the Basis for Conclusions it is stated that a separate and comprehensive review of the accounting for intangible assets should be performed before requiring leases of intangible assets to be accounted for under the proposed leases requirement. We believe this review shall be performed before the proposed leasing standard is finalized.

The proposed leasing standard will lead to a significant increase in administrative work (including a lot of estimates and judgment) for reporting entities. To first exclude intangible assets and then maybe include such assets at a later stage would lead to even more work for preparers. According to our view, it is better to make all changes once (“Big Bang”).

Non-core assets or short term assets

We believe that non-core assets or short term leases that are not essential to the operations of an entity and not material, like a coffee machines, computers or copy machines, should be excluded from the standard. The costs for preparers associated with recognizing and measuring the assets and liabilities from such lease contracts add little if no value to users of the financial reports.

The relief for short-term (12 month) lease agreements given in the ED is of limited practical value. In the light of the difficulties defining a lease and distinguishing a lease from a service contract that we have described in this Comment Letter, as well as the practical approach taken regarding other lease issues in the ED (e.g. property is always classified as a type B lease), we believe that the IASB could and should have taken a more practical approach regarding non-core/short term assets for the benefit of both preparers and users.

Sale and leaseback transactions

We believe that the guidance regarding sale and leaseback transactions is somewhat unclear, especially the relation between paragraphs 11 and 112. To us it is not clear if the conditions described in paragraph 112 (a) and (b), when a transferor is deemed to have control, are comprehensive or not. It would be helpful if this could be clarified.

Subleases

We have not found any guidance or illustrative examples in the ED regarding the accounting treatment in an entity that has both a lessee and a lessor agreement for the same (identical) asset (sublease). It is e.g. not clear if netting is allowed in the statement of financial position.

We would therefore welcome a clarification regarding the accounting for and presentation of subleases.

Effects analysis

In the Effects Analysis (BC 329-BC 439 and the case studies in Appendix D to Basis for Conclusions) the IASB has given a comprehensive narrative description of the expected costs and benefits. The conclusion is that the benefits that would arise from the proposal substantially exceed the expected costs. A general comment regarding this conclusion is that it is not clear to us to what extent the IASB considers cost to be a constraint in its decision-making process.

We believe that the effects analysis performed by the IASB has substantial limitations and the conclusions drawn by the IASB must be viewed in the light of this. The model used by the IASB can be summarized as weighing to what degree financial reporting is improved against incremental costs incurred by preparers adapting to the amended financial reporting requirements. The key elements in judging improvement in the Leases project seems to be more faithful presentation and increased transparency.

This kind of effects analysis has no relation to effects analysis in general due to the fact the scope of the analysis is very limited. A more comprehensive effects analysis tries to make an assessment of if a (regulatory) change will increase net welfare in society. In order to do so, other factors than those taken into consideration by the IASB must be brought into the model. An example of a model that includes more variables is some form of Computable General Equilibrium (CGE) model.

One of the conclusions stated in the Effects Analysis is that costs will increase for preparers (lessees and lessors) while the costs will remain the same for users (BC413 and BC439). While we understand that the IASB believes that the improvement in financial reporting is the (only) relevant factor to be taken into consideration regarding benefits, we believe that it would have be valuable if the IASB at least would have made some reflections in relation to this conclusion.

In the Effects Analysis, the IASB also describes some other potential effects of the proposed ED besides improvements in financial reporting and incremental costs for preparers. There is a discussion about behavior changes and structuring, increased costs of borrowing for lessees and effects on debt covenants and regulatory capital (BC365-BC374). The expected consequences are according to the BC:

- Some changes of structure of leases are expected.
- Borrowing costs for some lessees might increase and decrease for others.
- Proposals might increase the amount of risk weighted assets and thus the regulatory capital.
- If debt covenants are linked to IFRS, some entities might no longer comply with the covenants without changes of terms and conditions.

When describing those effects, the IASB also makes a disclaimer, saying that the role of the IASB is not to address territory-specific or entity-specific regulations or prudential regulations. This means that the discussions of those effects are “nice to know” but are not taken into account by the IASB in its assessment of effects. This is interesting since in a more comprehensive effects analysis model than the one performed by the IASB those conclusions might have had a material impact on the final assessment of the benefits and costs of the proposal.

While acknowledging that the IASB believes that a broader effects analysis is beyond the remits of its mission, the whole exercise can be questioned. If any meaningful effects analysis is going to be performed by the IASB, we believe that concrete improvement can be made in the following areas.
.

- Clarify which factors are taken into account in the assessment of effects. This is confusing since there is a discussion in the BC about possible effects that are outside the scope of the analysis performed by the IASB.

- Clarify how information and data have been gathered and selected. It is stated that the IASB gains insight on the likely effects of the proposals through its formal exposure of proposals, analysis and consultations with relevant parties (BC329). This description is too vague and makes it impossible for a reader to make its own analysis on the information and data used by the IASB.

- At least try to make some numerical estimate of effects. It is amazing that the IASB representing the world of accounting finds it so very difficult to give any kind of numbers related to the estimated effects.

- No alternatives are assessed in the effects analysis of the ED. In the Leases project much of the discussion is focused on the need to show the lease liabilities in the balance sheet of lessees. While the ED of course will lead to that effect, a key issue is if financial reporting can be enough improved by amending disclosure requirements instead. The IASB clearly says no to this. But this decision is made without any explicit reference to an effects analysis regarding e.g. costs and benefits of this alternative. We believe that a meaningful standard-setting process should demonstrate the different effects of possible alternatives.

Finally, we would like to make a comment regarding the effects for preparers of the Leases ED. It is clear that many of the proposals, regarding e.g. reassessment of lease terms, will be very complex and force all reporting entities within a group to change their systems at a significant cost. Entities would need to identify and review each single agreement in detail to first decide if the agreement is within the scope of the standard (a service agreement or a lease), evaluate if the asset is an intangible asset or not, determine if the agreement shall be classified as a type A, type B or short term lease and take options to extend the contact and KPIs into consideration. After that entities need to enter all information into some system and record this on a monthly basis. Changes to agreements must also be monitored on a regular basis. The administration and accounting procedures will be very time consuming and very costly for entities with a large number of agreements.

We believe that the costs associated with the administration, e.g. hiring more employees to work with lease agreement administration, consultancy fees for implementation and costs to implement computer systems (for valuation, accounting and administration of the agreements) must be evaluated and compared to the benefits of the proposed standard. Adding to this, entities will encounter internal “invisible” costs when trying to explain accounting standards that might be difficult to understand within the organization.