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Our ref : IASB – 442 D
Direct dial : (+31) 20 301 0391
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Re : **Comment on 'Exposure Draft ED/2013/6 Leases'**

Dear members of the International Accounting Standards Board,

The Dutch Accounting Standards Board (DASB) appreciates the opportunity to respond on your 'Exposure Draft ED/2013/6 Leases'.

The DASB consists of three delegations, respectively representing the users, the preparers and the auditors of the financial statements. Leases has become a topic where the respective delegations have different views and consequently, the responses to the detailed questions in the appendix predominately only reflect the responses from two delegations. In general there are two different opinions regarding the exposure draft.

The users of the financial statements agree with the ED including the 'right-of-use' model, i.e. that the lessee obtains a right to use the underlying asset for a period. 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.

As the users support the majority of the ED, the remaining comments in this cover letter as well as the responses to the questions, as included in the appendix, predominately reflect the responses from the other delegations in the DASB.

The preparers and the auditors of the financial statements partly concur with the draft comment letter of EFRAG. For the comments they concur with EFRAG their response is incorporated in this letter.

The preparers and the auditors believe that the current distinction between operating lease and finance lease is sometimes arbitrary and different accounting for the two models could conceptually be challenged. They agree with the IASB that the right-of-use model if applied to the right population of leases has the potential to bring useful information to users of those financing arrangements which are kept off balance sheet today.

However, not all lease transactions have the same characteristics (for example, consumption of the underlying asset may vary as the IASB recognises) and in their view there are some leases for which the right-of-use model is not appropriate and that might rightly be not presented on the balance sheet.

The IASB has emphasised in its communications that the project was intended to recognise financial liabilities that are currently left off balance sheet. Focussing on this objective seems to have been the primary driver behind the development of the right-of-use model. This model is based on a notion that an asset is a bundle of rights, one of them being the right-of-use; this is a new approach, which has never been debated on a conceptual level and we are not convinced that the focus on liability recognition has led to capturing the right population to which the right-of-use model should be applied. This is in the view the preparers and the auditors illustrated by the inconsistencies in the proposed application, in particular the use of two measurement bases and different accounting for lessors and lessees which will add to the perception of complexity.

They believe that the objectives of the project and what economic phenomena the IASB intended to depict in the primary financial statements need to be adequately explained in the Basis for Conclusions. If not, the right-of-use model will not be understandable and this will add to the feeling that this proposed IFRS is unduly complex.

Based on these observations, the preparers and the auditors agree with EFRAG recommendation that the IASB proceeds to finalise its project in steps:
1- To require without delay relevant disclosure on lease arrangements to ensure that users have access to the information they need; in this respect they suggest to capitalize the operating leases as defined in IAS 17 initially at the measurement principles of finance leases and subsequently at the carrying amounts of the related lease liabilities and to separately present them as ‘leased assets’.

2- To take advantage of the discussion on the conceptual framework to refine the definition of the right-of-use, distinguish this right from the other rights which are bundled in the asset, investigate whether the consumption of economic benefits of the underlying asset has a role to play, and refine the guidance to identify what activities convey the ability to direct the use of an asset and how this links with the business models of lessors (providing finance or managing assets). In this respect they suggest to consider in the conceptual framework discussions the specific characteristics of a lease arrangement comprising both the right to use the asset and the related obligations in one contract. Such discussion could in their view be concluded before completion of the conceptual framework project itself;

3- Finalise the accounting for leases, with the benefit of clarified objectives and a carefully identified lease population and the results of the current consultation.
‘
The comments are provided on the assumption that the IASB proceeds to issue a Lease Standard based on the proposals in the Exposure Draft. They are not intended to express unconditional support for the right-of-use model as explained above.

In the appendix the DASB respond to the questions raised in the Exposure Draft. As the users support the majority of the ED, the responses to the questions, predominately reflect the responses from the preparers and the auditors.

If you wish to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Hans de Munnik
Chairman Dutch Accounting Standards Board

Appendix: Response to questions in ‘‘Exposure Draft ED/2013/6 Leases’

Response to questions in ‘‘Exposure Draft ED/2013/6 Leases’

Q1 - 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.

Answer DASB:

We refer to the offer letter in respect of the different points of view of the DASB and the related assumptions.

The DASB is in favour of clear definitions and likes to avoid detailed examples and guidance in the illustrative examples.

The preparers and the auditors concur with the comments made by EFRAG and incorporated their response.

Identification of a lease
If all leases are recognised on the balance sheet, the preparers and the auditors believe that the definition of a lease must capture only those contracts that are not in-substance service arrangements. This is difficult to achieve because the provision of services often involves some use of assets, and a ‘service' is not a defined term in IFRSs.

The preparers and the auditors believe that applying the proposed criteria will require significant judgment, which may result in application issues. It may be difficult to assess ‘control’ when the asset is not in the physical possession of and is not directly managed by the lessee.

Interaction between definition of a lease and separation of components

The preparers and the auditors agree that a contract does not include a lease when the underlying asset is only a vehicle to benefit from consumables (such as the coffee consumables in Illustrative Example 2) or services provided only by the supplier. In this case, the essential component is the consumable or service, which does not qualify as an identified asset in a lease.
The preparers and the auditors are concerned about the changes in the identifying of a lease compared to IFRIC 4 Determining whether an Arrangement contains a Lease, in that it narrows the scope of the contracts that qualify as leases. Even though the Boards decided to retain the definition of a lease in IFRIC 4, they changed the application guidance supporting this definition to align the concept of control more closely with the control principle in the revenue recognition project and in IFRS 10 Consolidated Financial Statements. Most importantly, the Boards decided not to retain the provisions in IFRIC 4.9(c), which economically is the same as a lease. This may give the possibility of structuring agreements in such a way that lease accounting is avoided.
For more complex contracts with significant service elements (e.g. power purchase, IT outsourcing, time charters, drilling contracts), the identification of a lease based on the control concept still leaves room for interpretation and, if not further improved, would likely result in diversity in practice.

The preparers and the auditors believe that paragraphs 19 and 20 of the ED may confuse preparers, as the condition in paragraph 20a (the asset being dependent from other resources that are readily available to the lessee) appears to be very similar to the condition in paragraph 19a. However, we understand that the two conditions are used to assess two very different issues: paragraph 19 to assess if the contract includes a lease and paragraph 20 to assess whether the lease contract (already identified in accordance with paragraph 19) includes only one or more lease components.

The preparers and the auditors believe that the IASB should reconsider the wording of paragraphs 19 and 20 to make sure that they are relevant only to the specified issue that they are intended to solve.

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?

Answer DASB:

We refer to the offer letter in respect of the different points of view of the DASB and the related assumptions.

Yes, the preparers and the auditors agree. They believe that for comparability reasons it is important that in-substance purchases (current finance leases) and regular purchases are accounted for in a similar way. The preparers and the auditors realize that where exactly the distinction between operating lease and finance lease should be made is arbitrary. The proposed right-of-use model could have avoided the arbitrary distinction by introducing a single recognition, measurement and presentation method. The introduction of the “the Single Lease Expense” - approach is not consistent with a right-of-use model.

The preparers and the auditors don’t support different recognition, measurement and presentation methods for lessees and lessors depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset.

The preparers and the auditors are of the opinion that conceptually it would be more appropriate to apply one model for all leases and both for lessees and lessors consistently.

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?

Answer DASB

We refer to the offer letter in respect of the different points of view of the DASB and the related assumptions.

As explained in Question 2, the preparers and the auditors are of the opinion that conceptually it would be more appropriate to apply one model for all leases and both for lessees and lessors consistently.
The preparers and the auditors agree with the following comment from EFRAG:
If the IASB confirmed recognition of Type-B leases by the lessee, the preparers and the auditors would question the proposed Type-B accounting for lessors. While recognition and derecognition requirements are not always symmetrical in IFRSs, by choosing a right-of-use model for Type-B leases, the Board would take the view that the unit of account is the right to use the underlying asset and that it is transferred to the lessee at the commencement date. In this model, the logical implication is that the lessor should reflect this transfer and derecognise a portion of the asset.

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?

Answer DASB

We refer to the offer letter in respect of the different points of view of the DASB and the related assumptions.

The preparers and the auditors concur with the comments made by EFRAG and incorporated their response.

The preparers and the auditors reject the proposed criteria and presumptions for the classification of leases

While the preparers and the auditors could support different recognition requirements for Type-A and Type-B leases, the way a lease is classified should be the same for all underlying assets, regardless of their nature.

Paragraph 42 of the Basis for Conclusions states that a single lease expense would provide better information about leases for which the lessee pays only for the use of the underlying asset and is expected to consume only an insignificant amount of the economic benefits embedded in the underlying asset. The distinction is based on the expected level of consumption, not on the nature of the underlying asset. The preparers and the auditors do not see why this should be introduced in the Standard.

As acknowledged in paragraph 50 of the Basis for Conclusions, the presumptions may not always result in conclusions that are consistent with the principle, and the preparers and the auditors do not think that this is appropriate.

The preparers and the auditors are also not persuaded that a lessee consumes more than an insignificant portion of the economic benefits of a real estate only if the duration of the lease term is for most of the economic life of the asset.

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?

Answer DASB

DASB supports that lease payments due under options should be recognised under certain circumstances (similar to IAS 17: when it is reasonably certain that the lessee will exercise the option, such as bargain option). Not recognising options most likely to be exercised distorts the depiction of performance of the entity. When the terms are advantageous to the holder, the value of the option is likely to have been incorporated in the payments for the initial term, which will then be more expensive than the payments for the optional period. Excluding the payments for the optional periods then results in recognising a higher cost of the lease in the first non-cancellable period.
Similarly, excluding these payments from the measurement of the lease receivable by the lessor may result in overstating the carrying amount of the residual asset. If exercising the option is highly likely, the payments that the lessor will obtain in the optional period may be lower than the corresponding portion of the underlying asset's cost allocated to the residual.

DASB welcomes that the Board has accepted EFRAG's recommendation that the lease term should not be based on the longest term more likely than not to occur, as was suggested in the 2010 ED. However, DASB recommends maintaining the current notion of 'reasonably certain' in IAS 17.

DASB believes that the current practice of accounting for lease options works well. In paragraph 140 of the Basis for Conclusions, the Board agrees with this assessment and notes that applying the concept of 'significant economic incentive' would provide a threshold that is similar to the concepts of 'reasonably certain' in existing IFRS.

DASB therefore thinks it would be advisable to maintain the current definition, which is well understood by preparers and users. Replacing it with 'significant economic incentive' may lead to a view that the Board is introducing a completely new threshold, which is not the case. The analysis of economic factors developed by the Board in paragraph B5 is indeed useful, but we recommend presenting it as application guidance to help assess when the exercise is reasonably certain.

It is important to emphasize that an entity needs to consider all economic factors relevant to that assessment. The fact that an option is in the money should not be conclusive in isolation. For this reason, DASB recommends revising Illustrative Example 16 which as it stands may suggest that an entity has a significant incentive to exercise a purchase option only because the exercise price is lower than the current market value of the underlying asset. The example should remind constituents that all relevant factors need to be considered to reach that conclusion.

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?

Answer DASB

DASB concurs with the comments made by EFRAG and incorporated their response.

DASB welcomes the IASB's decision to exclude usage and performance-based variable lease payments from the measurement of the lease liability and lease receivable.

DASB supports inclusion of variable payments based on an index or rate, but are concerned that the notion of 'in-substance fixed payments' is not fully clear. The IASB has not provided a principle to identify in-substance fixed payments so the application of this notion will be based mostly on the Illustrative Examples.

Examples cannot replace principles-based requirements and may be interpreted in different ways. Example 17 requires recognition of an amount that is due irrespective of the level of sales. In our view, this amount would qualify as a fixed payment. If this is the only type of payment that the IASB wants to capture, there is no need to introduce a notion of in-substance fixed payments.

DASB fully agrees that variable lease payments should not be recognised only because they are highly probable. Example 18 is quite useful in making clear that if payments are based on future sales, no payment is recognised regardless of the fact that the entity will certainly generate sales in future.

There are other types of clauses that could qualify as in-substance fixed, for instance when the contingency is not genuine, or a significant payment is triggered by an extremely low threshold. If these are the payments that the IASB intends to capture, then it needs to provide a clear principle - in our view example 17 would not provide a robust basis to require the inclusion of these payments in the measurement of the liability.

The issue of variable payments is surfacing in other projects; for instance contingent consideration is addressed in the revenue recognition project and the IFRS Interpretation Committee is currently discussing contingent payments on the acquisition of tangible and intangible assets. DASB recommends that the IASB should reach consistent conclusions on the treatment of contingent and variable payments across different projects.

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 that the boards should consider? If yes, what are they and why?

Answer DASB

DASB concurs with the comments made by EFRAG and incorporated their response.

In general terms, DASB is in favour of full retrospective application. However, lease arrangements may have long durations and lessees may not have the information to apply new requirements fully retrospectively. DASB agrees with granting practical reliefs that lead to the reduction of implementation costs.

DASB also agrees with the proposal to carry forward the amounts recognised before the transition date for leases previously classified as finance leases. This will avoid that expenses already charged in the lessee's profit and loss are recognised for a second time after adopting the new Standard.

Paragraph C4 of the ED requires that an entity adjusts equity at the beginning of the earliest comparative period presented. However, paragraph C8 of the ED requires the use of the lessee's incremental borrowing rate at the effective date. DASB believes that it would be more consistent to require the use of the lessee's incremental borrowing rate at the beginning of the earliest comparative period.

DASB also believes that entities should not be required to recognise lease liabilities and right-of-use assets for leases previously classified as operating leases, if the term has ended before the end of the period in which the new Standard is applied.

Question 8: disclosures

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 change do you propose and why?

Answer DASB

DASB concurs with the comments made by EFRAG and incorporated their response.

DASB welcomes the requirement in paragraphs 59 and 99 of the Exposure Draft that an entity should consider how much emphasis to place on each requirement to satisfy the objectives. The list of requirements is extensive and DASB believes that it should be clearly stated that not each of them will be needed in all situations.

Presentation requirements in the ED will allow lessees to present the impact of leases in different lines of the statement of financial position, statement of comprehensive income and statement of cash flow. This is partly the effect of the dual measurement approach (which DASB does not support as mentioned in the discussion above) but also of the exemption allowed for short-term leases.

DASB thinks that users would benefit from a requirement to disclose in one location comprehensive information about total rights and obligations and related income and cash flow effects inherent in lease contracts of which the entity is part of.

DASB recommends providing a better explanation of why entities should provide reconciliations of balances for Type-B leases, or why separate reconciliations for Type-A and Type-B liabilities are necessary although their measurement is the same.

Questions 9, 10 and 11 in the ED are for FASB only.

Question 12: consequential amendment 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?

Answer DASB

DASB concurs with the comments made by EFRAG (view A) and incorporated their response.

DASB is concerned that the guidance in IAS 40 and IFRS 13 *Fair Value Measurement* should be amended to assist preparers in dealing with options. Under the current requirements, IAS 40 is usually applied only to interest in investment property held under a finance lease. As noted in paragraph 312 of the Basis for Conclusions of the ED, finance leases typically do not include variable lease payments or unrecognised optional lease payment. So currently the application of fair value model does not usually need to deal with these components.

This issue would become more important following the proposed amendment, because existing operating leases of investment property are more likely to include options or variable payments. Applying IAS 40 measurement requirements would involve measuring the market value of the options. As noted in paragraph 137 in the Basis for Conclusions, options may be difficult to be measured reliably.