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**Exposure Draft ED/2013/6: Leases**

Dear Sir/Madam,

Thank you for the opportunity to comment on your Exposure Draft ED/2013/6: Leases. The Volkswagen Group is one of the world's leading automobile manufacturers and the biggest carmaker in Europe. Our parent company, the VOLKSWAGEN AG is located in Wolfsburg, Germany. The group currently operates more than 100 production plants in Europe, the Americas, Asia and Africa. Around the world over 550,000 employees produce more than 37,000 vehicles or are involved in vehicle-related services each working day. The Volkswagen Group sells its vehicles in more than 153 countries. With our 100%-owned subsidiary Volkswagen Financial Services AG we are also the largest automobile financial services provider in Europe. As of December 31, 2012, our total balance sheet amounts to €309,644 million and our sales revenue amounts to €192,676 million. Volkswagen is affected by lease accounting in multiple ways: inter alia as lessor of vehicles with a total portfolio of approximately 2 million contracts as of December 31, 2012 in more than 40 countries worldwide in B2C and B2B leases, as lessor of ca. 10,000 tenements to employees and third persons and as lessee of a huge amount of different leased goods (e.g. office equipment, parking areas) all over the Group. On behalf of Volkswagen AG, Wolfsburg, we are pleased to provide you with remarks to the proposed Exposure Draft in response to your invitation to comment.

We have strong concerns regarding the distinction between lease contracts and service contracts and the complexity and the practicability of the proposed requirements.

#### **I. Distinction between lease contracts and service contracts**

We still don't see the difference between the right of using an asset and any other contractual right, for example long term delivery contracts or employee contracts. Therefore, we generally cannot agree to the right of use model as long as it is not clarified that there are no conceptual consequences for the accounting of any other executory contracts.

Because of the enormous different accounting consequences between a lease and a service contract the definition of a lease must be made in more detail. In our opinion the difference between a lease contract and a service contract as presented in the section of the ED "Identifying a lease" and in the Illustrative Examples (IE3) is not clear enough. Without such a clearer guidance there is a high probability, that certain preparers and users will lay out the definition of a lease in different ways, so that contracts with identical economic content could be accounted different. E.g. in example 1 (contract for rail cars) there is no economic difference if the transports are made with exactly specified rail cars (1A) or with a pool of rail cars (1B). The rights and obligations are similar from an economic point of view.

The proposals in the ED include guidance on how to separate lease- from non-lease components and allocate the total price. In our opinion from the perspective of a lessee it is normally not possible to determine a valid stand-alone price for each or all components. As a consequence estimations would be necessary. If there are no observable stand-alone prices a lessee has to capitalise the service component within a lease contract. This would lead to an overstatement of the right-of-use asset and the lease liability followed by negative consequences to the balance sheet ratios.

#### **II. Complexity and practicability of the proposed requirements**

Regarding the assessment of the lease term, we have strong concerns in order to the accounting of lease contracts with indefinite contract duration (e.g. parking area) and with the option for both sides to end the leasing within a short period (e.g. three months). At the determination of the lease term, options to extend the lease and options to terminate the lease are to be considered if there is a significant economic incentive to exercise such an option. And a reassessment of the lease term on a regular basis is required. In our view, this increases the costs of administration and accounting enormously and offers the opportunity for structuring financial statements. As a consequence the comparability of financial statements will be reduced.

The proposals in the ED require companies to classify a lease as either Type-A or Type-B, and apply a different subsequent measurement depending on how the lease is classified. According to the ED, a lease arrangement is a Type A lease when the underlying asset is not property, unless the lease term is for an insignificant part of the total economic life or the present value of the lease payments is insignificant relative to the fair value of the underlying asset at the commencement date

With such a new classification and no clear guidance in order to the criteria of the rebuttable presumption (“unless the lease term is for an insignificant part of the total economic life” or “the present value of the lease payments is insignificant relative to the fair value of the underlying asset at the commencement date”), there is again room for interpretation and judgement, which could lead to reduced comparability of financial statements and to restricted information for the users. One of the main criticism point of IAS 17 was the classification of lease contracts in Finance Lease and Operate Lease even this classification is accepted by preparers and users of financial statements and is based on the risk and rewards approach. In Finance Lease the financing of an asset is the main objective whereas in Operate Lease the main priority is the right of use of an asset followed by appropriate accounting procedures. The proposals in the ED only replace the classification from IAS 17 by another one. However the main aim of the standardsetters was to set priority to the property rights of an asset and even not the physical type of the asset. We refuse a classification in this complex way. If classification of lease arrangements cannot be avoided, we urge the IASB to demarcate clearly between Type A (= Movable Assets) and Type B (=Immovable Assets) without any further restrictions.

The accounting of Type A leases leads to a front-loaded recognition of lease expense at the lessee although there is economically considered a constant receipt of a service over a period of time (for example, lease of a car with a lease term of two years which will be usually renewed). In our view, a front-loaded recognition of lease expense at the lessee doesn't represent the economical content of such lease contracts.

We expect difficulties in complying the requirements with Type B leases. We cannot comprehend why the right-of-use asset at the lessee should be amortised progressively just to get lease costs, which are straight-line over the lease term. In this context we see difficulties to calculate the amortisation for the purpose of the reconciliation of opening to closing balances and to present the amortisation together with the unwinding of the discount on the lease liability in the statement of profit or loss. For the cash flow statement payments arising from Type B leases are shown completely within operating activities according to the

ED. Up to now we report the cash flow from operating activities using the indirect method (IAS 7.18). For the consideration of lease payments in the cash flow from operating activities we would need to use the direct method respectively a combination of both methods. We think that this would be very burdensome for us.

Furthermore, the proposals in the ED require comprehensive additional qualitative and quantitative disclosure requirements that will cost additional data resources and interfaces as well as tremendous manual work. In our opinion the costs and efforts to implement the extensive disclosure requirements extremely outweigh the benefit of the users. If every leasing contract is on balance sheet, why are there so much additional information necessary in the notes?

The requirement of a – even modified – retrospective approach of the standard as proposed in the ED leads to a heavy burden for preparers. There is often no sufficient information about the lease objects available. A retrospective adoption causes enormous cost, too. We don't think that this is justified by a better comparability.

### **III. Conclusion**

The ED fails the original goal of the IASB to reduce complexity and to increase comparability in lease accounting. The ED implements estimates and judgemental decisions caused by a lot of indefinite legal terms that affect for example the identification of a lease, the classification of a identified lease contract and the assessment of the lease term. This would lead to reduced comparability of financial statements and to restricted information for the users. Furthermore, the proposed requirements to reassess certain key estimates and judgements cause volatility to assets and liabilities.

The requirements of the ED adds a lot of complexity, the administration and accounting costs for the preparers will increase significantly without a corresponding increase in additional useful information for the users.

We expect that the implementation of the requirements proposed in the ED will last at least three years.

For reducing the complexity and avoiding the impracticability of lease accounting as proposed in the ED we suggest, that the retrospective application will be replaced by a prospective application. In addition, we refuse the proposed classification. We prefer one accounting rule for all lease arrangements. If classification of lease arrangements cannot be

avoided, than clear guidance of how to classify a lease needs to be provided and a simplified accounting rule for Type B leases should be implemented. And, we strongly recommend to extend the short-term exemption to three years.

Nonetheless, we generally believe that existing IAS 17 provides well known information for users of financial statements and is generally accepted by lessors as well as by lessees. As a consequence the IASB should cancel the whole leasing project and retain current IAS 17. Alternatively it would be possible to expand the current notes in IAS 17.

Further details are included below in our responses to the questions of the Board.

Best Regards,

Dr. Ingrun-Ulla Bartölke

## Questions of the Board

### 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.

In accordance with the Illustrative Examples (IE3) concerning the identifying of a lease, we have difficulties to see the difference between the right of using an asset and service contracts. For the decision if a contract contains a lease, the customer needs to assess if there are economic barriers that prevents the supplier from replacing the equipment for fulfilment of the contract. This information is normally not available at the customer. Because of the different accounting consequences between a lease and a service contract the definition of a lease must be made in more detail.

### 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?

According to the ED, a lease arrangement is a Type A lease when the underlying asset is not property, unless the lease term is for an insignificant part of the total economic life or the present value of the lease payments is insignificant relative to the fair value of the underlying asset at the commencement date. We suggest to demarcate clearly between Type A and Type B, so that Movable Assets are always Type A and Immovable Assets are always Type B without any restrictions.

Nonetheless we prefer one accounting rule for all lease arrangements and refuse the new classification of lease arrangements in this way. In our view it does not make any sense 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.

In order to Type B leases we cannot understand why the expenses consisting of the unwinding of the discount on the lease liability and the amortisation of the right-of-use asset are presented as lease costs in the statement of profit or loss. Besides, we cannot comprehend why the right-of-use asset should be amortised progressively just to become lease costs, which are straight-line over the lease term.

### **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 refer to our comments on question 2.

### **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?

With the introduction of a new classification and no clear guidance in order to the criteria of the rebuttable presumption ("unless the lease term is for an insignificant part of the total economic life" or "the present value of the lease payments is insignificant relative to the fair value of the underlying asset at the commencement date"), there is again room for interpretation and judgement. In our view there is a high probability, that certain preparers and users will interpretate these criteria in different ways, so that identical lease contracts could be accounted different. This would lead to additional workload for the preparers, reduced comparability of financial statements and to restricted information for the users.

As above already described we refuse the new classification of lease arrangements in this way. If classification of lease arrangements cannot be avoided, we suggest to demarcate clearly between Type A (= Movable Assets) and Type B (=Immovable Assets) without any restrictions.

#### **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?

According to the ED, when determining the lease term, options to extend the lease and options to terminate the lease are to be considered only if there is a significant economic incentive to exercise such an option. In our view, this indefinite legal term leads to subjective judgements with a lot of room for interpretation.

Additionally a reassessment of the lease term on a regular basis heavily increases the costs of administrating and accounting of leasing contracts and gives space for structuring financial statements. As a consequence the comparability of financial statements will be reduced.

Furthermore, we have strong concerns in how to account for lease contracts with indefinite contract duration (e.g. parking area) and with the option for both sides to end the leasing within a short period (e.g. three months).

We recommend using as lease term the agreed contractual term in the lease contract or the period till the contract can be cancelled.

#### **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 agree with the simplifications made in comparison to the ED /2010/9. Lease payments that depend on an index or rate (such as the Consumer Price Index or market interest rate)

are included in the measurement of lease liabilities, because the lessee is not able to avoid such payments.

#### **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?

As mentioned above the Volkswagen Group acts as lessor in more than 40 countries with a total contract volume of approx. 2 million. In every country individual contract management systems are in place. Every system needs to be adjusted to fulfil the new complex requirements of the ED on a contract by contract basis.

From a lessee point of view a retrospective application is very extensive as the data needed for an on-balance accounting e.g. the calculation for the distinction between leasing and service component was not archived. Currently there is no inventory register in place that is able to handle the right-of-use assets on a single contract basis which is necessary to gather the necessary accounting information (e.g. additions, depreciations, impairment expense) on a contract by contract basis.

The retrospective approach intensifies the complexity of the implementation of the new requirements for preparers without significant increase in useful information for the users. We ask the board that the retrospective application requirement will be replaced by prospective application.

#### **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 do not agree as the required disclosures are inappropriate and too burdensome for preparers and users. There is no necessity for such extended disclosures, if all of the lease contracts are on balance. In our opinion the costs to implement the extensive disclosure requirements and to fulfil them regularly in subsequent periods extremely outweigh the benefit of the users.

**Question 9, 10, 11: FASB-only**

n/a

**Question 12: 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 scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

Under the current IAS 40 a property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property if the property would otherwise meet the definition of an investment property and the lessee uses the fair value model for the asset recognised. This classification alternative is available on a property-by-property basis. When this classification alternative is selected, any interest so classified is included in the disclosure required by IAS 40.74-78 (IAS 40.6). When this classification alternative is not selected, the lessee does not need to provide these disclosure requirements. Under the proposed requirements a right-of-use asset arising from a lease of property would be within scope of IAS 40 if the leased property meets the definition of investment property. That mean, that the disclosure requirements (e.g. the fair value) of IAS 40 would apply to a right-of-use asset even if it is measured at cost.

We don't agree to that proposal because the slightly improved benefit for the user doesn't justify the additional workload for the preparers.