Deutsches Rechnungslegungs Standards Committee e.V.
Accounting Standards Committee of Germany
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Berlin, 13 September 2013

Dear Hans,

IASB ED/2013/6 *Leases*

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to provide our views on the IASB's ED/2013/6 (the 'Re-ED'). We appreciate the opportunity to provide our view.

In our responses to the Discussion Paper DP/2009/1, as well as to the first Exposure Draft ED/2010/9, we were generally supportive of the right-of-use approach, mainly as it appeared to be a conceptually sound and consistent approach. However, we also noted that the introduction of the right-of-use approach as proposed in both the DP and the original ED would cause significant measurement as well as other practical problems. We acknowledge that in the Re-ED the IASB has addressed a number of these concerns, many of which we agree with.

In our comment letter on the first ED, we stated that, in order for the new approach to be conceptually superior to the current literature, we would prefer a single model (and preferably one to be applied consistently by both the lessee and the lessor). We understand that many constituents did not agree with advancing with a single model,

mostly because such an approach would treat all leases as purchases of an asset rather than a service. The resulting 'frontloading' effect in the statement of profit or loss, i.e. the combined effect of unwinding the interest on the lease liability using the effective interest rate method and a linear amortisation of the right of use, caused the Boards to propose an alternative approach.

We understand that the resulting approach proposed in the Re-ED is a compromise, and if the vast majority of the IASB's constituents reported their consent, we would not object to that approach being implemented (subject to a number of specific suggestions for changes laid out in more detail in Appendix 1). That is not to say that we can put ourselves wholeheartedly behind the new proposal. Having redeliberated and reflected on the current proposals and bounced them off previous positions held by the DRSC, our preferred route of action would be as follows:

- Advance with the new approach for lessees only, i.e. do not fundamentally change the current accounting for lessors. If a right-of-use approach was to be implemented for lessors also, detach it and move it forward as a separate project.
- Finalise the proposals for lessees only if the resulting recognition, measurement, presentation and disclosure addresses the concern raised by users, which were the key reason why this project had been undertaken in the first place (please refer to Appendix 2 of this letter, where we describe how the IASB should approach the issue as to whether users consider their concerns to be properly addressed by the proposals of the Re-ED; we consider this to be a critical issue since indications have been made public lately that users oppose the leases proposal).

We provide our line of reasoning more fully in Appendix 1 to this cover letter. Briefly:

- Lessees: We understand that the main driver for undertaking the leases project was the concern raised by users that lease liabilities of legacy operating leases do not show up on the face of the statement of financial position. We believe that concern to be valid, and we also concur that a right-of-use approach seems to be the most promising and convincing answer to address this concern. We acknowledge the conceptual issues that are associated with such an approach (e.g. carving out a particular right from the bundle that make up an asset and recognising it separately whilst not doing the same for other individual rights; shifting the unit of account when considering what is actually taken control of – i.e. control the use of an asset

vs. control the asset; etc.), but we believe that they can be addressed appropriately. Hence, although our preferred route for lessees would be to apply a Type A lease accounting to all leases alike, we would not object to implementing the currently proposed model, subject to

(1) this proposal indeed being the solution sought by users in addressing their concerns and not giving rise to yet another round of different adjustments; and

(2) our specifically identified issues being addressed when finalising the proposals.

- Lessors: As stated above, the DRSC has always been a proponent of a model that would treat all leases alike, and preferably symmetrically (if one party is acquiring something, the other must be giving up something). Having considered the latest proposal, though, we come to the conclusion that the right-of-use approach seems to give rise to significantly more issues for lessors than for lessees. Our biggest concern relates to the fact that, in the majority of cases, the lessor has not lost control *of the asset*: He has lost control *of some rights to use the asset*. We come to the conclusion that it would be more decision-useful to actually continue showing the leased asset on the face of the lessor's statement of financial position rather than splitting it into a receivable and a residual asset (giving rise to yet another set of issues, e.g. the unwinding of the interest on the residual). Theoretically, if the lessor were to fair value the leased asset, the transfer of the rights to use the asset would be reflected fully in the measurement of the leased asset. We acknowledge that mandating a fair value approach for all leases rather than only for leased property is neither feasible at this stage, nor has it been conceptually thought through and thoroughly tested. It is for these reasons that we believe that the IASB should not progress with its proposal of introducing a Type A lease for lessors. Rather, we are of the opinion that the IASB should not only retain the accounting for Type B leases (which is, in substance, the current accounting model for operating leases), but also the accounting for legacy finance leases in IAS 17 – the main reason being that control of the asset is passed, if, and only if, the lease constitutes in substance a purchase.

Please find our detailed comments on the questions raised in the ED, and also two comments on additional issues not covered by the questions, in Appendix 1 to this

letter. If you would like to discuss our views further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President

Appendix 1 – Answers to the questions of the exposure draft

The following comments and remarks are provided under the assumption that the IASB proceeds with issuing a Standard based on the proposals in the Re-ED, unless stated differently in the individual answers. These comments are not meant to express unconditional support to the issuance of a standard.

Additionally, with respect to our preferred route as we describe it in the cover letter, detailed comments are provided in the following as well.

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.

Overall, we agree with the definition of a lease and the proposed requirements for how an entity would determine whether a contract contains a lease. With respect to selected details, however, we would like to suggest the following changes.

With respect to IFRIC 4 we welcome that the IASB decided to change the proposed application guidance supporting the definition of a lease in order to align the concept of control more closely with the control principle inherent in other parts of the literature (e.g. IFRS 10 and the forthcoming standard on revenue recognition). Additionally, we appreciate the IASB having addressed practice issues that were raised concerning the definition of a lease in IFRIC 4. We consider the revised requirements more practicable and allowing for a clearer distinction between a lease and a service than the original proposals contained in ED/2010/9.

According to paragraph 8 of the Re-ED, fulfilment of a contract does not depend on the use of an identified asset if the supplier has the substantive right to substitute the asset throughout the term of the contract. With respect to paragraph 9(b) of the Re-ED, we consider this requirement not to be sufficiently specified so that significantly divergent interpretations are likely to emerge. We ask the IASB to further specify in the application guidance whether there are barriers that would prevent the supplier from substituting alternative assets in place of the asset during the term of the contract in case of customised assets (e.g. multi-functioning devices meeting entity-specific security standards) and car fleet management agreements. Other issues we do not consider to be sufficiently clear include the following:

- Is there a need to consider the likelihood as to whether a substitution of the asset will happen or does only the legal possibility need to be considered?
- Do cost-related barriers need to be considered in relation to the payments for that specific lease or in absolute terms? And
- Can there be changes during the lease term as to whether a supplier's right to substitute is substantive?

Other concerns we have with respect to paragraphs 13-17 of the Re-ED and relating to control are as follows:

- In case an underlying asset is leased (jointly) by more than one entity and the designated use is agreed to be based on equal time periods – for instance, an airplane that is leased jointly by three parties who use it in turn –, the question arises whether there is *ability to direct the use* by 'a customer'. We note that some hold the view that, in line with paragraph 11 of the Re-ED, all three entities are entitled to a capacity portion of the asset, so that an asset cannot be identified and, thus, there is no lease in the meaning of the Re-ED. We wonder whether this was the intended outcome and request that the IASB addresses this issue.
- In case it is contractually agreed that the underlying asset may only be used by the lessee, but not by his / her related parties and not be subcontracted, does the lessor retain control over the underlying asset, or is this agreement to be considered a protective right of the lessor? A clarification would be helpful in this regard.

After identifying single (lease) components in a contract in accordance with paragraph 20 of the Re-ED, a lessee shall allocate the consideration in the contract as detailed in (a) – (b) of that paragraph. The wording "observable stand-alone price" is

used in this guidance and further elaborated in paragraph 24 of the Re-ED, and the term *stand-alone price* is defined in Appendix A to the Re-ED. We consider it necessary to further specify the phrase "observable stand-alone price" since there are circumstances in which it would otherwise remain unclear whether observable stand-alone prices are available. Consider the following example: If globally unique production facilities are leased for the first time along with the required workforce to run these operations, there would not be observable stand-alone prices in terms of paragraph 24 of the Re-ED (since there is no project history with traceable pricing), so that the purchaser would be required to account for the transaction as a single lease component in line with paragraph 23(c) of the Re-ED, which does not appear to make much sense, economically speaking. Therefore it should be further clarified what specific requirements must be met in order to have 'observable' stand-alone prices (in particular whether it would be sufficient for first-time lease transactions to derive such prices of comparable constellations).

Another area of concern relates to the fact that minor differences in the specific circumstances may lead to quite different accounting consequences, although the transactions are economically similar. We believe that similar transactions should be accounted for alike. We ask the IASB to reconsider this issue since the examples No. 1 – 4 in the *Illustrative Examples* section of the Re-ED demonstrate that similar transactions are not accounted for alike:

- Example 1 – Contract for rail cars: although the customer has the right to use railcars for five years in all three subcases, there are different accounting requirements,
- Example 4 – Contract for fibre-optic cable: although the customer has the right to use defined capacity portions of fibres within a larger cable in both subcases, there are different accounting requirements.

Since the accounting requirements proposed are quite complex, it would be costly for lessees and lessors to implement and to apply the requirements in the future, if all leased small sized equipment and small parts would be within the scope of the future leases standard. Therefore, we suggest to the IASB to seek appropriate solutions for such equipment, e.g. personal computers, fax and copy machines, printers, coffee machines, notwithstanding the general materiality thresholds to be applied.

In addition to the above, we would like to raise the following drafting points:

- In paragraphs 6 – 24 of the Re-ED the terms *supplier* and *customer* are used. For the benefit of clarity we consider it preferable to only use the terms *lessor* and *lessee* throughout the document and to avoid language that seems to stem from the revenue standard.
- The three examples of decisions that could most significantly affect the economic benefits to be derived from the use of an asset listed in paragraph 14 (at the end of (b)) of the Re-ED should be connected by an *or* instead of an *and*.

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?

From a conceptual point of view, we do not agree with the proposed lessee accounting model. However, since the model is a compromise, we would not object to that approach (subject to some changes as detailed below) if the vast majority of users of financial statements prepared in accordance with IFRSs reported their consent to the approach being implemented.

Conceptually, our view has not changed vis-à-vis the one we provided in our comment letter to ED/2010/9. We continue to believe that a single measurement model is the conceptually correct and appropriate way to account for all leases. Our reasoning is based on the fact that the lessee's right to use the underlying asset meets the definition of an asset and that the lessee's obligation to make lease payments meets the definition of a liability. Hence:

- the right-of-use asset should subsequently be measured at cost, less accumulated amortisation and any impairment (similarly to other non-financial assets); and
- the lease liability should subsequently be measured in line with the effective interest method (similarly to other financial liabilities).

On this basis and as stated in the cover letter we have a lot of sympathy for the specific requirements proposed for Type A leases with respect to recognition,

measurement and presentation of expenses and cash flows, while, conceptually, we do not agree with the specific accounting requirements proposed for Type B leases.

With respect to Type B leases we consider many knock-on questions currently to be unanswered, e.g.:

- Shall an amortisation pattern be introduced to IFRSs that would typically increase over the lease term and that does not portray truly and fairly the actual pattern of consumption of the economic benefits embodied in the asset, but merely serves the purpose of allocating the single lease cost on a straight-line basis over the lease term?
- Is the single lease expense model, based on a measurement linking the carrying amount of the right-of-use asset with the interest charge calculated on the lease liability consistent with IFRSs and the Framework?

In its original ED the IASB proposed a single measurement model to be applied to all types of lease arrangement (notwithstanding exceptions for short-term leases). As stated at the outset, we were supportive of that view. However, many constituents have voiced concerns claiming that not all leases were the same. Specifically, they criticised the frontloading of expenses in those lease arrangements that were not considered to be a financing transaction. We acknowledge that the IASB has tried to alleviate these concerns by now proposing to differentiate between two types of leases depending on whether the asset leased is property or not (i.e. Type A or Type B). As stated in the cover letter, we acknowledge that the proposals as detailed in the Re-ED are a compromise.

Based on the outcome of a field test we carried out (together with EFRAG and other European National Standard Setters), German companies consider the proposed lessee accounting to be complex and expect it to be costly, both in terms of implementation and ongoing application. Therefore, it is crucially important to ensure that the benefits that would arise from the proposals in the Re-ED substantially exceed the costs that are expected for implementing and applying the proposed new requirements on an ongoing basis. If the vast majority of the users of IFRS financial statements reported their consent, we would not object to that approach being implemented for lessees (subject to some specific suggestions for changes laid out in more detail in the following). Thus, while we do not put ourselves wholeheartedly behind these proposals, we would accept the IASB advancing with the new approach for lessees only, subject to users supporting the approach.

In Appendix 2 of this letter we describe how the IASB should approach the issue as to whether users consider their concerns to be properly addressed by the proposals of the Re-ED and whether users support it. We consider this to be a critical issue for the project since indications have been made public lately that users oppose the leases proposal.

Specific issues suggested for change

We do not support the proposed guidance of paragraph 33 of the Re-ED: "... if a lease component contains both land and a building, an entity shall regard the economic life of the building to be the economic life of the underlying asset when applying the classification criteria in paragraph 30" of the Re-ED. This guidance may lead to inappropriate classifications, e.g. when the land takes centre stage of the lease and the building is subordinated.

According to paragraph 56(b) of the Re-ED, for Type B leases a lessee shall present the unwinding of the discount on the lease liability *together with* the amortisation on the right-of-use asset in the statement of profit or loss and other comprehensive income (referred to in ED/2013/6.BC42 as *single lease expense* approach). Many companies present their net income by clearly distinguishing operating income and expenses from interest income and expenses. Such a segregation of income and expenses would be distorted, if the proposed presentation of the single lease expense for Type B leases were to be introduced. This is why we propose that the IASB should allow reporting entities to either follow the approach as described above or to present the two components separately as part of the operating expenses and as interest expense, respectively.

According to paragraph 56 of the Re-ED and relating to both, Type A and B leases, a lessee shall present expenses from such leases in the statement of profit or loss and other comprehensive income and would not be allowed to alternatively disclose that information in the notes. We do not believe that such an apodictic requirement is appropriate. We are of the opinion that the presentation requirements outlined in IAS 1 are sufficient (specifically IAS 1.85, which requires the presentation of additional line items, headings and subtotals in the statement of comprehensive income and the separate income statement (if presented), when such presentation is relevant to an understanding of the entity's financial performance).

We also wonder how the requirements in paragraph 56 of the Re-ED reconcile with an entity's presentation of expenses recognised in profit or loss using a classification based on their function within the entity (IAS 1.99).

As far as the presentation in the statement of cash flows is concerned, we favour an approach whereby a lessee follows the general presentation requirements in IAS 7, which we consider to be sufficient (specifically IAS 7.11, which requires an entity to present its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business). In this context, we specifically do not support the proposed requirement in paragraph 57(a) of the Re-ED to classify repayments of the principal portion of the lease liability arising from Type A leases within financing activities.

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 do not agree.

A model that would treat all leases alike, and preferably symmetrically, has always been supported by the DRSC. However, the lessor accounting proposed in the Re-ED leads us to the conclusion that the right-of-use approach seems to give rise to significantly more issues for lessors than for lessees. The lessor not losing control *of the asset* but *of some rights to use the asset* (which is true for the majority of cases, i.e. the cases in which the lease does not in substance constitute a purchase), is our biggest concern. In the absence of a convincing and comprehensive alternative, this concern leads us to conclude that it would be more decision useful to actually continue showing the leased asset on the face of the lessor's statement of financial position rather than splitting it into a receivable and a residual asset (giving rise to yet another set of issues, e.g. the unwinding of the interest on the residual).

In addition, we believe that the asymmetrical accounting treatment for Type A and Type B leases would result in reduced comparability for users of financial statements as different accounting treatments would be applied to like transactions.

Thus, we believe that the IASB should not progress with its proposal of introducing Type A lease accounting for lessors. Rather, we are of the opinion that the IASB should not only retain the accounting for Type B leases (which is, in substance, the current accounting model for operating leases), but also the accounting for legacy finance leases in IAS 17 – the main reason being that control of the asset is passed, if, and only if, the lease constitutes in substance a purchase.

Mainly due to practical considerations, we have concerns regarding the proposed initial and subsequent measurement of the residual asset in case of Type A leases. If a lessor reflected an expectation of variable lease payments in determining the rate the lessor charges the lessee and those payments were not included in the lease receivable (which is likely to be the case not only in a few instances), in accordance with paragraphs 71 et seq. of the Re-ED, the lessor shall include in the initial measurement of the residual asset the present value of variable lease payments expected to be earned during the lease term, discounted using the rate the lessor charges the lessee. In accordance with paragraphs 83 and B19-B21 of the Re-ED, after the commencement date a lessor shall derecognise a portion of the carrying amount of the residual asset in each period and recognise a corresponding expense in profit or loss. Although we consider this proposal to be theoretically correct, we consider it too complex to apply for most likely little benefit.

The Re-ED further proposes that a lessor should unwind the discount embedded in the initial measurement of the gross residual asset over the lease term and recognise the unwinding of the discount as interest income. We do not support this approach since the measurement basis proposed for the residual asset is different from the measurement basis typically applied to other non-financial assets measured at cost, i.e. an entity does not usually adjust the subsequent measurement of a non-financial asset for the effects of the time value of money when the non-financial asset is measured on a cost basis (paragraph BC249 of the Re-ED). We consider the proposed accretion of the residual asset to be in conflict with general accounting principles, since subsequent increases in carrying values of non-financial assets are possible only in case of reversing impairment losses or fair value measurement.

In any case (i.e. whether or not the IASB follows our proposal), we support that lessors shall not be permitted to apply the lease accounting proposals to leases of intangible assets. Though excluding all intangible assets - and licences in particular – from the proposed new standard on leases for lessors represents a setback

compared to the scope of IAS 17, which excludes only some intangible assets from its scope (though for both lessors and lessees), and we agree with the IASB's statement in paragraph BC81 of the Re-ED that there is no conceptual reason not to permit lessors to apply the lease accounting proposals to leases of intangible assets, we understand that it is the Board's intention that, for lessors, leases of intangible assets shall not be within the scope of the proposed new standard until a separate and comprehensive review of the accounting for intangible assets has been performed. We support this approach and recommend reviewing and addressing any issues in the context of leases of intangible assets as soon as possible.

In case the IASB does not follow our proposal to solely implement the proposed accounting for Type B leases, we believe a specific issue needs to be addressed which would arise in certain head-lease/sub-lease constellations. If both the head- and the sub-lease are determined to be Type B leases, a lease receivable for the sub-lease could not be recognised while a lease liability for the head-lease must be recognised. This is why we suggest the IASB establish an exception for such scenarios, according to which the reporting entity should be required to apply a 'receivable and residual' approach to the sub-lease.

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?

Conceptually, we disagree with the proposed classification of leases since it contradicts one of the overarching goals of the project, which is to create a *single* lease accounting model. However, if the vast majority of the IASB's constituents reported their consent to the classification model (along with the specific accounting requirement proposed on that basis), we would not object to the approach being implemented for lessees considering our comments as detailed in the answer to question 2. On the other hand, and as laid out in more detail in our answer to question 3, we would not agree to this principle being implemented as the basis for lessor accounting.

From a conceptual point of view we prefer a lessee to account for all leases (except for short-term leases) according to the proposals in the Re-ED as Type A leases.

Doing so would significantly reduce complexity and avoid structuring opportunities. Further, the proposed approach to base the classification on the lessee's expected pattern of consumption of the economic benefits embedded in the underlying asset is in conflict with the principles underlying the proposed right-of-use model – according to that model the *right* is the unit of account to look at, not the underlying asset.

The dual accounting model may further lead to the situation that two leases with identical lease terms are accounted for differently, only because property is the underlying asset in one case (e.g. lease of land) and non-property is the underlying asset in the other case (e.g. a ship).

Having recognised the right-of-use asset separately from the lease liability at the commencement date, a lessee should subsequently measure the right-of-use asset independently of the lease liability (this is not the case for the proposed Type B lease accounting).

Also, the proposed classification of leases does not find our support since we believe that the classification is based on two criteria that are not mutually exclusive. The conflicting criteria are as follows:

(1) property or non-property; and
(2) consumption of the underlying asset.

However, since we understand that the proposed principle is a compromise addressing mainly constituents' concerns, we would not object to the approach as described at the outset if the vast majority of users reported their consent to the principle underlying the classification of leases.

In case the IASB maintains the classification, we propose to consider the following simplification for the lessee accounting: classify all non-property as Type A leases and maintain the proposed classification guidance for property leases so that they either may be classified as Type A or as Type B leases.

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?

Overall we agree with the proposals and consider the proposed guidance in the Re-ED to be plausible, intuitive and much more practicable than the proposals in ED/2010/9.

We would nonetheless flag what appears to be a drafting issue: According to paragraphs 44 and 79 of the Re-ED, the lessee and the lessor shall reassess lease payments / receivables if there is *a change* in the lease term, as described in paragraph 27 of the Re-ED. Our concern relates to the fact that paragraph 27 requires an entity to reassess the lease term if there is a change in relevant factors, as described in paragraph B6 of the Re-ED, that would result in the lessee having or no longer having a significant economic incentive either to exercise an option to extend the lease or not to exercise an option to terminate the lease. This guidance could be read in a way that an entity would need to perform the reassessment based on *any* change in relevant factors, possibly resulting in the lessee having or no longer having a significant economic incentive. This may be burdensome and onerous. Therefore, we suggest the IASB revisit and clarify the guidance and limit the reassessment to such instances in which there are sufficiently substantial changes.

For simplification purposes we propose to exempt leases from the requirement to be reassessed its lease term in accordance with paragraphs 44 and 79 of the Re-ED in case the lease rates to be paid for periods covered by an option to extend the lease or an option not to terminate the lease are based on current market conditions for the individual optional periods. We hold this view since it appears to make no difference as to whether a lessee would

- end a current lease without exercising an option to extend this lease or not to terminate this lease (based on lease rates which are in line with current market conditions) and enter into a new lease agreement (which would also be assumed to be based on lease rates which are in line with current market conditions), or
- exercise the option to extend or not to terminate the existing lease at the lease rates as described above.

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?

Overall, we agree with the proposed guidance in the Re-ED and consider it much more practicable than the proposals made in ED/2010/9.

However, according to paragraphs 44(d) and 79(c) of the Re-ED for subsequent measurement purposes, an entity is required to reassess the lease payments if there is a change in an index or a rate used to determine lease payments during the reporting period: The entity shall determine the revised lease payments using the index or rate as at the end of the reporting period. We consider this requirement to be burdensome, since (in most cases) it requires entities to continuously adjust the discounted amount of the best estimate of the value – even though this means only replacing one estimated amount with another, without getting to a final number. This is why we suggest to the IASB to ease this requirement.

Another issue of concern is that the term *variable lease payments that are in-substance fixed payments* (paragraphs 39(c) and 70(c) of the Re-ED) remains unclear, even taking into consideration the examples provided in the *Illustrative Examples* section to the Re-ED. Without further specification it appears to be obvious that significantly divergent interpretations will emerge. While we note the IASB's intention not to provide further requirements (see paragraph BC153 of the Re-ED), we nevertheless ask the IASB to further clarify the term and specifically clarify which understanding of the term is in line with its intention / principle. The IASB states in the BC to the Re-ED that an entity must include variable lease payments that are in-substance fixed lease payments in the measurement of lease assets and liabilities because those payments are unavoidable and, thus, economically are indistinguishable from fixed lease payments. We wonder whether variable lease payments are to be determined as in-substance fixed lease payments based on

- quantitative information (i.e. probability-based),
- qualitative information, i.e. usage or performance based lease payments
  a) are generally avoidable by the lessee, and are therefore never in-substance fixed, or
  b) will – based on past experience – be triggered with a very high level of probability, and are therefore in-substance fixed to this extent.

If the IASB is merely concerned about potential structuring opportunities, we prefer the IASB clearly expresses this view.

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?

We did not identify any additional transition issues the IASB should consider.

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 generally agree with the proposed objectives (paragraphs 58 and 98 of the Re-ED) and approaches that an entity should consider the level of detail necessary (paragraphs 59 and 99 of the Re-ED) to satisfy the disclosure requirements as detailed in paragraphs 60 – 67 and 100 – 109 of the Re-ED.

However, we have concerns that there is a tendency that converting these objectives into concrete disclosure requirements always results in additional disclosure requirements which appears to be especially true for the Re-ED. We wonder why a proposal for a lease accounting model supposed to be superior to the current IAS 17 model needs that many additional disclosures. It appears that the extent of the disclosures required relates to the complexity of the proposed accounting requirements (the more complex the requirements are, the more detailed explanations need to be provided in the notes). We expect that the disclosures – although justifiable on an individual

basis – will cause considerable efforts and costs for the reporting entities to comply with.

Considering the fact that optionality is not completely considered in the amounts recognised in the statement of financial position (e.g. lessees will not recognise lease liabilities stemming from lease payments which are performance- or usage-based variable lease payments (not in-substance fixed)), users would like to obtain the information necessary to perform their own calculations in this respect in order to determine – e.g. for lessees – the hidden leverage and to adjust the financial statements to portray the lease liabilities considering all relevant optionality as deemed necessary.

Thus, we consider it critically important that users provide an evaluation of the proposed requirements of the Re-ED and whether they still would need to make adjustments to the financial statements in case the requirements were implemented (with respect to how the IASB should approach users on this issue, please refer to our comments in Appendix 2).

FASB-only: **questions 9 – 11**

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?

No, we do not 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. This is because we prefer to differentiate between ‘investment property’ that is an entity’s own property and other rights, which we consider not to be ‘investment property’, i.e. any right-of-

use assets arising from a lease of property, even if the underlying asset meets the definition of 'investment property'. This view is further supported by the fact that these right-of-use assets are normally not held for capital appreciation and the fair value could not be realised through a sales transaction. We believe that the fact that these assets are regularly held to earn rentals be better portrayed by the recognition of a right-of-use asset (ED/2013/6.37), measured initially as required by ED/2013/6.40 and subsequently by ED/2013/6.41(b) with the proposed requirement of ED/2013/6.52 (application of IAS 40) to be cancelled.

Other issues

In paragraphs 118 – 120 of the Re-ED short term leases are discussed, and a definition is provided in Appendix A of the Re-ED. However, the specific issue of cancellable leases is not addressed in the Re-ED itself but in paragraphs BC107 et seq. Because of its importance – not only for our jurisdiction, but for most of continental Europe – we consider it necessary to address this issue in the mandatory part of the standard.

We further note the following perceived inconsistency with respect to the lease term. On the one hand lessees and lessors may elect, as an accounting policy, not to apply to short-term leases (as defined in Appendix A of the Re-ED) the requirements of the Re-ED with respect to the lease term, the classification of leases, recognition, measurement and presentation. However, if based on the requirements of paragraphs 25 et seq. of the Re-ED the lease term of a non-short-term lease is 12 months or less (since there is no *significant economic incentive* to exercise options to extend or not to exercise options to terminate the lease), the relief as described above for short term leases is not available. The same is the case in Example 11 of the *Illustrative Examples* to ED/2013/6 (IE6 – Short term lease). We ask the IASB to address this issue, since it appears to make sense to provide the relief as it is available for short-term leases also for non-short-term leases with a lease term of 12 months or less.

Appendix 2 – How the IASB should explore whether the proposal for lessee accounting is the solution sought by users in addressing their concerns

Objective

The IASB initiated the *Leases* project to improve the financial reporting of leasing activities under IFRS in the light of criticisms that the existing accounting model for leases fails to meet the needs of users of financial statements. Many users often adjust the financial statements to capitalise a lessee's operating leases. However, the information available in the notes to the financial statements is often insufficient for users to make reliable adjustments to a lessee's financial statement. The adjustments made can vary significantly depending on the assumptions made by different users.

The IASB decided to address those criticisms by developing a new approach to lease accounting that requires an entity to recognise assets and liabilities for the rights and obligations created by leases. The new approach would require a lessee to recognise assets and liabilities for all leases with a maximum possible term (including any options to extend) of more than 12 months. This approach should result in a more faithful representation of a lessee's financial position and, together with enhanced disclosures, greater transparency of a lessee's financial leverage.

Based on this reasoning provided by the Board as to why existing lease accounting needs to change (please refer to paragraph BC3 et seq. of the Re-ED), it is obvious that the implementation of a new approach would only be meaningful if users based on the new approach will not need to adjust the financial statements with respect to the leases information, anymore.

We consider the explicit confirmation by users to be of paramount importance, such that they, based on the proposed approach, could rely on the financial lease information provided and need not continue adjusting financial statements for the effect of an entity's lease commitments and claims (e.g. to split up the single lease expense for Type B leases or to consider differently the effect of options or contingent lease rate agreements as compared to how the lessee actually considered them in the course of recognition and measurement). In other words, users should confirm that they would use the information as it will be provided in the

financial statements and would not readjust the information presented on the balance sheet before performing their own calculations to determine lease liabilities. The proposed requirements in the Re-ED must be considered by users to be a significant improvement over the existing accounting guidance for leases. In order to explore whether the proposal for lessee accounting is indeed the solution sought by users in addressing their concerns, the IASB should observe the following.

Group of individuals and organisations to consult with

We consider the key target group to be existing and potential investors, lenders and other creditors, who regularly make decisions about providing resources to the entity. Also, analysts of financial statements should be part of that consultation process – namely buy-side analysts.

Process to be observed for the consultation

The IASB should meet with senior management of users familiar with the proposed requirements as detailed in the Re-ED in order to gain a thorough understanding of the position users take on the issue. The meetings shall be set up as ‘one-on-one’ or small group meetings, since we consider that the discussion on that basis would allow the IASB to receive personal, open and candid feedback.

What needs to be validated is whether the users intend to unwind the accounting numbers in the balance sheet as required by the Re-ED and then do their own analysis or, do (more than marginal) analyses and modifications on top of the proposed accounting construct. Specifically, users should be asked whether they support:

- how lessees amortise the right-of-use asset of Type B leases, for which the amortisation charge typically would increase over the lease term,
- how lessees recognise the lease expense in profit or loss for Type B leases, which is a single lease expense, combining the unwinding of the discount on the lease liability with the amortisation of the right-of-use asset,
- how optionality is considered in the amounts recognised in the statement of financial positions, which will not include variable lease payments being performance- or usage-based (hidden leverage).

Securing benefits that would arise from the proposals to substantially exceed the expected costs

In paragraphs BC344 et seq. the IASB concludes, that on the basis of the information obtained about the effects of the proposals in the Re-ED, the IASB is of the view that the benefits that would arise from the proposals substantially exceed the expected costs.

However, significant concerns were raised lately that users – post implementation of the proposals – would continue adjusting financial statements for the effect of an entity's lease commitments and claims. This is why we consider additional in-depth analyses to be of paramount importance in order to find out whether the benefits of users substantially exceed the expected costs of preparers, the latter of which were confirmed in the course of the field test we carried out (together with EFRAG and other European National Standard Setters) to be high / significant, both for implementation and first time application as well as on an ongoing basis.

As done in the course of the effects analyses mentioned by the IASB in paragraphs BC329 et seqq., the additional in-depth analyses we are asking for should be done for both, the proposed new lessee and lessor accounting requirements.