Leases

Exposure Draft ED/2013/6, issued by the International Accounting Standards Board (IASB)

Comments from ACCA
13 September 2013

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Further information about ACCA' s comments on the matters discussed here may be obtained from the following:

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ACCA welcomes the opportunity to comment on the above Exposure Draft (ED). Our Global Forum for Corporate Reporting has considered the proposals, and its views are reflected in the following general and specific comments.

GENERAL COMMENTS

Following extensive project work and consultations over several years, the IASB is again proposing a Right of Use (RoU) model for leasing. ACCA finds that it still cannot support a RoU model, including in the revised form proposed in the current ED. Consequently, we believe

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that the IASB should now abandon attempts to incorporate RoU methodology in a new Standard on leasing.

Whilst the current ED contains improvements compared to the previous one, and has some justification in accounting terms, ACCA believes that the current model under IAS 17 remains workable and preferable. Our concerns regarding the current ED centre on the complexity of the proposals for preparers, the overall lack of representation of economic reality given by the RoU model, and by comparison, the continuing validity of IAS 17 in practice. We do also acknowledge that there is currently an identified lack of information for users, particularly concerning the leases of which too many are 'off-balance sheet' under IAS 17.

We believe that the proposed changes in accounting methods for leases will result in additional complexity for preparers, especially those who currently hold a large number of operating leases. However, as indicated in our specific comments below, ACCA also believes that the proposals also do not reduce the need for judgement to a helpful level.

Furthermore, with respect to the issue of economic reality, ACCA believes that it is not necessarily appropriate for all leases to be recognised on the Statement of Financial Position. For example, it may be difficult to identify a financing element in certain leases currently accounted for as operating leases.

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In summary, ACCA believes that the IAS 17 model should be retained, although with additional disclosures, and possibly a lower threshold for the recognition of finance leases (as mentioned in our response to Questions 2 & 3 below).

In the responses below, ACCA will attempt to provide further detail on its preferences compared to the current proposals, by providing responses to each of the consultation questions on which the IASB seeks views. For example, comments on the current proposals for determining the length of a lease are also relevant to our preferred model for leasing, and disclosure requirements would have an equal or a greater importance.

Due to the differences between ACCA' s preferred approach and the current proposals, we conclude that a further ED will be needed from the IASB to gather views.

Finally we note that leases of intangible assets are still principally excluded from the scope of the proposed Standard. We draw attention to our responses to the previous ED issued by the IASB in 2010, and continue to question this exclusion, on the grounds that there is still insufficient rationale for it.

SPECIFIC COMMENTS

We now give our comments on the specific questions raised in the ED, as follows:

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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.

ACCA response

ACCA agrees that a definition of a lease needs to be set out, and we support the basic principles behind the definition, as stated

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above in the consultation question. We also agree that a certain amount of guidance is helpful. The level of detailed guidance given in paras 8 – 19 of the ED should reduce scope for divergence in practice. We are concerned that there should also be a reference to the use of wider judgement where necessary, when applying the guidance.

If the RoU model is not adopted and a less complex model is retained based on IAS 17, the question of whether an arrangement constitutes a lease has fewer accounting implications. However, for disclosure purposes, the distinction between a lease and a service agreement needs to be made clear through the definitions, as we are aware of differing opinions as to where the dividing line lies.

For example, there are differing views on whether more basic rental arrangements will be outside the proposed definition of a lease, due to the chance of substitutability. Consequently, it is unclear to what extent the proposals in the ED justify ACCA's concern that arrangements which currently qualify as operating leases will, in future, be subject to unnecessarily complex accounting as RoU arrangements, rather than service contracts.

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

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the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

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?

ACCA response

We are providing a response covering both Questions 2 and 3, as both deal with the 'consumption model' for leasing, and we believe that accounting should be consistent between lessor and lessee.

ACCA agrees that lease types should be assessed on objective criteria, such as the term of the lease compared to the economic life of the underlying asset.

However, with respect to this ED, we have a concern about the lack of guidance in it and in the Basis for Conclusions, about what constitutes 'insignificant' (and similarly, the concept of 'major'). Such lack of precision might give rise to uncertainty in practice and consequently, higher compliance costs (especially on the initial application of the revised Standard) and inconsistency

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between reporting entities. By contrast, the term 'substantially all', used in IAS 17 and also in this ED, is likely to be clearer for preparers and users.

In the light of our continuing support for IAS 17, we acknowledge certain amendments likely to be needed to this Standard. Firstly, IAS 17 has been criticised for setting the threshold at too high a level for a lease to be treated as a finance lease under the 'substantially all' principle. Secondly, a lease judged to have an immaterial financing element should automatically be treated as an operating lease. These changes can be debated through proposals in a further ED, as can disclosures on which we have provided comments in our response to Questions 5, 6 and 8 below.

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?

ACCA response

ACCA sees some merit in the classification requirements in paras 29 – 34, on the grounds of practicality and the generally differing character of property leases compared to others, from the point of

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view of the proportion of economic benefits consumed. We would also refer to the concerns we have expressed above about the terms 'insignificant' and 'major'.

Our thoughts in the preceding paragraph are consistent with our continued support for IAS 17 and our previous comments to the IASB, in the sense that we support a two-type model for leasing. However, we continue to support capitalisation in a 'lease/buy' situation, akin to a finance lease, but not for other leases which would mainly qualify currently as operating leases (such as a four-year lease of an office building).

The Type A / Type B lease distinction represents an attempt at a practical compromise, compared to previous proposals. However, we are concerned that under the Type B model, the apparent 'balancing figure' (the difference between interest and the rental cost) which would be presented in the Income Statement of the lessee represents too great a compromise. The addressing of this concern would appear to lead only to one outcome under the proposed RoU model - all leases would be recognised as the more complex Type A, even where there is no in-substance purchase. This outcome lends further support to the current model of IAS 17 which has two lease types, both of which are operating satisfactorily.

The ED proposes an exemption for short-term leases. Our previous responses to the IASB supported the existence of an exemption, but commented that the definition of short-term appears arbitrary,

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and we recommend that the IASB reconsiders the strict maximum term of 12 months for such leases. For example, two or three year leases may not in fact give rise to material assets or liabilities under the proposed RoU model, or the IAS 17 model which we prefer.

Finally, we would also question the concern that the subdivision of a single lease between the assets which it covers is always unduly burdensome and artificial. Consequently, we suggest that such division should be permitted, where practical and relevant to users of the financial statements.

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?

ACCA response

Under the IAS 17 model preferred by ACCA, proposals to determine the lease term are now primarily of significance in establishing an appropriate structure for disclosures.

ACCA continues to support the recognition of the minimum non-cancellable period, along with any related residual value guarantees. Options to cancel or to extend would be covered through disclosure only. We do not concur with the view that the

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disclosure approach would potentially misrepresent the assets and liabilities arising from a lease, and believe that appropriate disclosures will meet the information needs of users of the financial statements.

We believe that in most cases, an option is not the result of an artificial manipulation of the lease term to benefit the parties to the lease, but represents an opportunity to defer the making of a decision until a future date.

As expressed in our response to the IASB's earlier Exposure Draft in 2010, ACCA believes that a requirement to assess the likelihood of taking up renewal or cancellation options adds complexity. The assessment of whether there is a 'significant economic incentive' for the lessee to take up the option is not, in our view, sufficiently precisely set out to provide certainty around the lease period which should be recognised.

Whilst it is proposed that both lessor and lessee should recognise the same lease period, ACCA believes that there is a risk that the complexity referred to above could result in disagreement between the two parties on what the lease term should be. If this arises, it is unclear how such a disagreement would be resolved.

Furthermore, the proposals run some of the risks of a method based on probabilities (which might result in the recognition of assets and liabilities which do not meet the definitions in the Conceptual Framework). The financial statements could, as a result,

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show liabilities which an entity may not incur, and lease terms to which the lessee may not commit. Lessors might account for income which they have yet to control, which is not in accordance with the principles for revenue recognition.

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?

ACCA response

These proposals are of significance in establishing an appropriate structure for disclosures, under the model preferred by ACCA.

ACCA considers that the IASB's amended proposals represent a useful and necessary simplification, compared to the 2010 ED. They address the concerns which we raised at the time, and particularly that variable payments might appear to be fixed costs as a result of the proposals. Disclosure requirements can provide the necessary information on the variable lease payments which are not recognised.

Question 7: transition

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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?

ACCA response

If IAS 17 is amended, as preferred by ACCA, the transition process will be more straightforward than if the current ED is adopted. Full retrospective application should then be feasible, without the need for a modified retrospective approach.

We would have welcomed the opportunity to comment on a possible effective date for the new Standard, and whether early implementation is likely to be permissible. At this stage of the project on leases, we hoped that the IASB would be able to give an indication on these matters.

For the RoU model proposed by the IASB, a modified retrospective approach has the advantage of practicality (by reducing the burden of transition on preparers). The revised approach also reduces the 'front-loading' of lease charges on transition which would otherwise have occurred. Under the RoU model, we would

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also concur that full retrospective application should be available for entities which are able to apply it (for example, because they have few leases), and wish to do so.

With respect to leases which are finance leases under IAS 17, the proposed lack of transition relief under the proposed RoU model may prove to be a burden for a first-time adopter of IFRS. This might be mitigated: for example, if a preparer' s national GAAP follows IAS 17 principles in respect of finance leases, it would be feasible for that entity to enjoy the transition relief which would be available to the existing adopters of IFRS.

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?

ACCA response

We believe that certain principles on disclosure apply to both to the IAS 17 model which we prefer, and the RoU approach proposed by the IASB. In particular, ACCA welcomes a framework for lease

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disclosure which is sufficient and informative, but not excessive, and which avoids duplication.

Specifically, ACCA supports the providing of scope for an entity to determine the level of aggregation of disclosures. We would also recommend that disclosures specific to leases should not be required where they duplicate information already in the financial statements, and suggest that the IASB reviews the proposed specific disclosures with this aim in mind.

We believe that disclosure questions will be an important aspect of the new consultation needed by the IASB, based on amending the current IAS 17 model. Where there are alternative ways of presenting information, there should be consultation on the most appropriate way of providing the disclosures required. For example, if the non-cancellable period of a lease is an important factor for disclosure purposes, consideration would be needed of the effect of part-way break clauses, and associated penalties, on the disclosures concerning the length of this period and the commitments during it.

In addition, a need has been identified for increased disclosure around operating leases under the current IAS 17 model, and there needs to be consultation on this matter in particular with users of financial statements.

A revised Standard should also clearly set out reduced disclosures appropriate for short-term leases.

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Turning to certain proposals in the ED, we would question whether all of the disclosures set out in para BC210 cannot be required on cost / benefit grounds. For example, an entity will already have the information to make the disclosures under headings (a), (c) and (d). The information in (a) – discount rates - and (c) – options to purchase – may well be useful for users of the financial statements. However, in order to avoid excessive disclosure, the information could be required in a summary form.

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?

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The model favoured by ACCA, which is based on changes to IAS 17, would not necessitate the proposed amendments to IAS 40.

As a general point, we welcome the greater inclusion in the proposed Standard on leasing of provisions relating to the leasing of investment properties, thereby removing some of these requirements from IAS 40.

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