



Indian Banks' Association

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board (IASB)
30 Cannon Street
London
EC4M 6XH
UK

IBA/C&I/2013/7847
September 13, 2013

Dear Sir,

Comment letter on Exposure Draft ED/2013/6 Leases

We refer to the ED released by you on 16 May 2013 relating to Leases.

2. We are grateful for the opportunity to respond to the ED issued by the IASB. We have consulted within the members of the Indian Banks' Association in respect of this ED. We append our response to the matters on which specific comment is requested. The comments represent the views of our members.

• **Question 1 – Identifying a lease**

This revised ED 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.

We agree with the definition and the proposed requirements. In fact, the new proposals are beneficial as certain power purchase agreements (PPAs) that are identified as leases under IFRIC4 (existing IFRS requirements) may not meet the definition of a lease under this ED. This is because the ED's approach to control has a greater focus on the lessee's ability to direct the use of the underlying asset than IFRIC 4. As per IFRIC 4, the lessor could not treat the power plants as assets in their balance sheet and such assets were treated as owned by the lessees. This impacts the Fixed Asset Coverage Ratio and Earnings Before Interest Tax Depreciation and Amortization, affecting the ability of lessor to raise capital. So an agreement under which lessee agrees to purchase all of the electricity from a power plant but does not control the operations of the power plant might be a lease under IFRIC 4 but not under this ED.

- **Question 2 – lessee accounting**

Do you agree that the recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

We agree with the proposals. However, the proposals do not define what is significant or insignificant in the context of the total economic life of the underlying asset which may lead to inconsistencies in practice. Further, we refer to the illustrative example 12 – Equipment lease classification given by IASB, which indicates that lease term which is 16.67% ($2/12 \times 100$) of the economic life and present value of the lease payments which is 27.83% ($16700/60000 \times 100$) of the fair value of the underlying asset would not be deemed to be insignificant. However, it is not clear how much lower than these percentages the consumption needs to be to satisfy the insignificant criteria.

For ready reference, the example is quoted herewith.

A lessee enters into a two-year lease of an item of equipment, which has a total economic life of 12 years. The lease payments are CU 9,000 per year, the present value of which is CU 16,700 calculated using the rate the lessor charges the lessee. The fair value of the equipment at the commencement date is CU 60,000.

The lessee determines that the lease is a Type A lease because of the following:

- the underlying asset is not property;
- the lease term is for more than an insignificant part of the total economic life of the equipment; and
- the present value of the lease payments is more than insignificant relative to the fair value of the equipment at the commencement date.

- **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 agree with the proposals. Please refer to our response to Question 2 above.

- **Question 4 – Classification of leases**

Is measuring the loss allowance (or a provision) at an amount equal to 12-month expected credit losses operational? If not, why not and how do you believe the portion recognized from initial recognition should be determined?

We agree with the proposals. However, the proposals do not define ‘major part’, ‘insignificant part’ of the economic life, ‘substantially all’ and ‘insignificant relative to’ for the purposes of evaluating the lease classification tests. These thresholds would be key to the lease classification and need to be defined. Moreover, the terminologies used for the classification of Type A and Type B leases should be simplified.

- **Question 5 – Lease term**

Do you agree with the proposed requirement to recognize a loss allowance (or a provision) at an amount equal to lifetime expected credit losses on the basis of a significant increase in credit risk since initial recognition? If not, why not and what alternative would you prefer?

We agree with the proposals on lease term (i.e. non-cancellable period and notice period), including the reassessment but clarifications are required in following two cases as to what will be the lease term:

- A lease that runs from the date of signing until further notice and in which both the lessee and lessor have the right to cancel with one month’s notice. There is no initial non-cancellable period in this case.
- A 3 year lease contract in which initial 11 months are non-cancellable period with 1 month notice period for lessor and 3 month notice period for lessee.

- **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 proposals on the measurements of variable lease payments but we are of the view that some more guidance should be provided by IASB regarding discount rate as the calculation of property yield is not clear and will lead to inconsistencies.

The proposals would introduce volatility to assets and liabilities for lessees, and for lessors in Type A leases, due to the proposed requirements to reassess certain key estimates and judgments at each reporting date.

- **Question 7 - Transition**

- a) **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?**
- b) **Are there any additional transition issues the boards should consider? If yes, what are they and why?**

We agree with the proposals.

- **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 recognized 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 agree with the proposals.

3. If you have any questions regarding our submission, please do not hesitate to contact me at +91 22 22174002 or email me at sshukla@iba.org.in or mishra@iba.org.in.

With kind regards

Yours sincerely

Sangeet Shukla
Senior Advisor