Finance

Jim Coyle
Group Financial Controller

LLOYDS BANKING GROUP

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Comment Letter No. 436

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

Lloyds Banking Group plc
25 Gresham Street
London, EC2V 7HN

020 7356 1770 direct
jim.coyle@lloydsbanking.com

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Dear Mr Hoogervorst

Exposure Draft ED/2013/6 'Leases'
Lloyds Banking Group plc welcomes the opportunity to comment on the proposals contained within the above Exposure Draft (ED).

We believe the ED is an improvement addressing many of the operational and conceptual concerns that were highlighted in the responses to the 2010 Exposure Draft. We do, however, have a number of concerns and would ask that the IASB address the following matters in the final published standard.

We would ask the Board to more clearly set out the principles that underpin lease classification. We believe that determining lease classification based primarily on whether the underlying asset is property or non-property does not give appropriate prominence to the IASB's underlying principle that lease classification should be determined based on the amount of consumption of the underlying asset rather than the type of underlying asset.

Depending on the extent of comparative information presented, as drafted, the transitional rules could require listed entities to assess leases that exist many years before the effective date and could require considerable effort even before a final standard has been published. Consequently, we would ask the Board to amend the transition requirements to only require recognition and measurement of leases within the scope of the ED that exist at the beginning of the immediately preceding period and to further limit the requirement for restated comparative information to the immediately preceding period. This would be consistent with the relief provided in IFRS 10.

In respect of lessors, we are pleased that the IASB has removed the performance obligation approach which we believed was conceptually flawed. However, we note that the revised approach to lessor accounting in the ED is a considerable change from existing lessor requirements and will result in considerable operational burden to both implement and maintain. We would therefore ask the Board to conduct further outreach to minimise the operational burden and to ensure the benefits of the proposals outweigh the operational cost for preparers.

Our comments on the specific questions in the ED are given in the appendix to this letter. These comments should be read in the light of our overall comments above.

Yours sincerely

James Coyle

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APPENDIX

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 requirement 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 of a lease as set out in the 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?

There are a wide variety of leases with different economics where it is appropriate to introduce a dual approach to recognition and measurement of lease income and expenses using the principle of consumption of the underlying asset to distinguish between lease types. Specifically, we agree that it is appropriate that for Type B leases, where the lessee is in substance paying for use of the asset, rather than consuming the asset, that the income statement profile should be constant in each period and should not distinguish between amortisation of the asset and a financing component. Conversely, where the lessee is in effect purchasing all or part of the asset that it consumes (Type A) it is appropriate to recognise the amortisation of the asset over time and interest on the lease liability. Therefore we accept that differing amortisation profiles for right of use assets, depending on the lease classification, will appropriately reflect the substance of lease arrangements.

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?

As noted in our response to Q2, it is appropriate to distinguish the recognition and measurement of lease income and expenses depending on the consumption of the underlying asset. We therefore believe that as lease classification aims to distinguish between the underlying lease economics of the lease transaction, it is appropriate that the approach to determining lease classification should be the same for lessors and lessees.

We note that the balance sheet treatment of Type B leases results in the lessor continuing to recognise the underlying assets in full on the balance sheet while the lessee also recognises an asset reflecting the right to use (but not consume) the underlying asset. Another approach that seeks to achieve symmetry with lessees would be for the lessor of a Type B lease to derecognise the portion of the asset equivalent to the right of use asset recognised by the lessee. However, we accept that such an outcome would be inconsistent with the underlying economics of a Type B lease, which the ED is seeking to reflect, where the lessor in effect seeks to obtain a return on its asset as opposed to enabling the lessor to consume part of the asset. Consequently, we believe that the proposed approach for lessors appropriately reflects the substance of lease arrangements.

However, we are concerned that the proposed approach will introduce a significant implementation and ongoing operational burden for lessors in complying with the new requirements; including changes to leasing systems on implementation and introducing ongoing requirements for additional data, processes and controls to enable regular reassessment and we would ask the Board to ensure these implications are minimised.

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?

We agree with the introduction of a distinction between types of leases to reflect differing consumption of the economic benefits embedded in the underlying asset.

However, we believe that determining lease classification based primarily on whether the underlying asset is property or non-property does not give appropriate prominence to the IASB's underlying principle that lease classification should be determined based on the amount of consumption of the underlying asset rather than the type of underlying asset. We therefore believe that paragraphs 29 and 30 should be amended to better explain the overriding consumption principle that should be used to distinguish between Type A and Type B lease classifications and seek to remove the existing rules based distinction of property and non-property.

Question 5: lease term
Do you agree with the proposal 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?

In principle, we agree with the proposal on lease term and we believe it represents a more conceptually appropriate and operational proposal than was contained in the 2010 Exposure Draft. However, we note that determining whether the lessee has a 'significant economic incentive' is a new concept and will require considerable judgement in assessing and weighing up the factors in paragraph B5. We believe this could be addressed by retaining the current notion of 'reasonably certain' used in IAS 17 which the Basis for Conclusions, paragraph 140, notes works well. We would also welcome additional application guidance from the IASB to address the common leasing business practice where 'informal extensions' are granted beyond the contractual period.

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 proposal to include in the measurement of lease assets and liabilities variable lease payments that depend on an index or a rate. However, we do not believe the benefit of performing reassessments would outweigh the costs for preparers.

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?

The ED requires retrospective treatment of leases that exist at the beginning of the earliest comparative period presented. It further provides relief to minimise the operational burden through permitting the use of hindsight in assessing the lease classification and lease term, etc.

Depending on the extent of comparative information presented, the transitional rules as currently drafted will require entities to mobilise resources to capture the necessary information in advance of the publication of a final standard, and in some cases, this could include leases which will have terminated before the effective date of the new standard.

Therefore, in order to minimise the operational burden of transition, we would ask the Board to amend the transition requirements, to only require recognition and measurement of leases within the scope of the ED that exist at the beginning of the immediately preceding period and therefore to limit the requirement for restated comparative information to the immediately preceding period. A similar relief was granted for IFRS 10 'Consolidated Financial Statements' and we believe it provides an appropriate trade off between minimising the operational burden of compliance while still providing useful information.

We would also ask the Board to grant relief from providing information as required by IAS 8 paragraph 28(f) for the year when the new leasing standard is first applied in order to remove the need to continue to maintain accounting systems to account for leases under IAS 17.

Question 8: disclosure
Paragraphs 58-67 and 98-109 set out the disclosure requirements for a lessee and a lessor. Those proposal 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 agree with the disclosure principles set out in paragraphs 58 – 67 for lessees and 98 – 109 for lessors. However, we are concerned with the level of detailed information required for disclosure in the reconciliation of the balance sheet obligations arising from leasing transactions. The preparation of such detailed information to perform the reconciliation may not be aligned with internal management information used in operating the business therefore would require investment in development of data and systems solely to meet the requirements of the ED.

Questions 9-11- Non-public entities (FASB only)

Not applicable.

Question 12 (IASB only): consequential amendments to IAS 40

The IASB is proposing amendment to other IFRSs as a result of the proposals in this revised Exposure Draft, including amendment 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 form 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?

We agree with this approach as we believe it appropriately reflects the business model related to such assets.