

International Accounting Standards Board
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Financial Accounting Standards Board
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13 September 2013

Dear Sirs,

Thank you for the opportunity to provide comments on the revised Exposure Draft for lease accounting, dated May 2013.

CHP Consulting (“CHP”) provides software solutions and consultancy services to major asset finance organizations worldwide. ALFA Systems, our flagship software solution, provides integrated lifecycle support for the pricing, sale, administration and accounting of a wide variety of finance products. Our clients’ lease portfolios range from high-value complex “big-ticket” leases to hundreds of thousands of small-ticket contracts and full-service operating leases.

Based on our knowledge of our clients’ usage of both ALFA Systems and other legacy or incumbent systems, CHP is well qualified to comment on how the proposals set out in the Exposure Draft will be applied by preparers in a practical way.

CHP welcomes the revised Exposure Draft as a significant improvement over the first Exposure Draft (2010), eliminating much of the complexity and subjectivity of the original proposals. We are supportive of the overall approach of lessee capitalization of all leases, but we do not support the lease classification between property and non-property based on the consumption of the underlying asset. We believe that many equipment leases are taken out for operational rather than financial reasons including, for example, many aircraft, ship and rail car leases, and fully maintained car leases (“contract hire”). For these leases, which would generally be classified as Type A, a straight-line recognition of lease expense is more appropriate for lessees and more consistent with the economic reality of the contract. We suggest, assuming the Boards persist with a dual model, that the classification is based around the existing criteria in IAS17.

While we recognize the improvements over the 2010 ED, we consider that the proposals remain complex and are concerned that a lack of consensus amongst users of financial statements undermines the cost-benefit of the proposals. We believe that a stronger cost-benefit case is required, and that greater consensus needs to be achieved during the forthcoming re-deliberation period before the Boards should proceed to issuing a Final Standard.

In response to the specific questions set out in the Exposure Draft, our views are as follows.

Question 1: Identifying a lease

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 that a lease should be dependent on the use of and the right to control a specified asset. However, the concept of right to control seems open to interpretation and similar transactions are likely to be classified and accounted for differently. Illustrative examples 2 & 3 determine that contracts are classified differently dependent on whether there are other suppliers of consumables. Consequently the same contract may be classified differently if a new supplier enters the market. We propose that the classification should be based on the nature of the contract.

With reference to the practical application of separating the components of a contract, we observe that it is not uncommon for contract hire lessors to price a gross “rental” for the lease and service component of the contract. Separate allocation for each of the components of the contract might not be stored at contract level within their lease administration systems.

Questions 2-4: lessee accounting, lessor accounting, and classification of leases

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?

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?

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?

As set out in our opening comments, we agree that the recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases. However, we disagree that this should be dependent on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset. We believe that many leases are entered into for operational reasons; and that in these cases the cost, residual and economic life of the asset is not material to the lessee.

We disagree that the principle of consumption should be applied dependent on whether the underlying asset is property or not property. We also think that the term “insignificant” introduces new uncertainty, and therefore potentially reduced comparability for users. We suggest that the risks and rewards based approach in IAS17 would be a preferable classification.

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?

We broadly agree with definition of lease term; it is a notable improvement on the 2010 ED. We agree with the Boards’ view that the existing concepts of “reasonably assured” and “reasonably certain” work well in

practice, and therefore we suggest that this terminology is retained instead of the proposed “significant economic incentive”.

We are concerned that the requirement to reassess the lease term based on a change in relevant factors could be very time consuming for both lessees and lessors with large portfolios. For some entities it could also require significant lease administration software changes to differentiate between periodic reassessment and the lessee electing to exercise an option that had not been included in the assessment of the lease term (or *vice versa*). We propose that reassessment should only be required where a significant change in factors impacts an entity’s whole lease portfolio.

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 Boards’ basis for conclusions that the cost and complexity of the proposals in the 2010 ED outweighed the benefits, and welcome the changes in the revised exposure draft. We observe that leases linked to money-market rates (LIBOR) will require regular and frequent reassessment, which may be a particular burden for lessees, when the actual changes to the linked rate are likely to be small.

We are unclear how leases that contain tax variation clauses (for example a change in the corporation tax rate or the asset tax depreciation rate) should be treated; these are normally known significantly in advance. We would like to see further guidance and examples for these.

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 welcome the modified retrospective approach as a practical way to reduce the transition burden while allowing restatement from original lease commencement.

For lessors transitioning from operating leases to Type A leases, we do not agree that lessors must account for securitized receivables as secured borrowings. We suggest that a lessor should have the option to account for the transaction as a sale of receivables.

For lessors transitioning from finance leases, we are concerned that the requirement to not account for the residual asset will cause a prolonged dual-accounting model. Lessors will be required to account for existing finance leases separately from new Type A leases. This dual accounting will continue until the expiry of the last of the existing finance leases. For lessors with high-value leases, this could be a long period of time.

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 have specific comments about the disclosure requirements, although we note that the increase in requirements suggests that the proposed standards do not meet the needs of the users.

Other Comments: Lessor Accounting

We have the following additional comments about the proposed lessor accounting for Type A leases.

As illustrated by example 19, initial direct costs are included in the lease receivable, and as a consequence the lessor must impute the interest rate on the lease receivable, which will be different from the interest rate on the residual asset. This differs from current GAAP where a single rate of interest income is recognized on the net investment in the lease. The effect of this is to slightly defer the total interest earnings over the term of the lease. For the majority of leases the initial direct costs are insignificant compared to the total earnings, and so we believe that the systems changes required to support two rates are not cost-justifiable.

Where a lessor has a residual value guarantee from a third party, we believe this should be recognized as a financial, as opposed to a physical, asset.

Thank you for your time in considering our comments.

Yours faithfully,

Ralph Neuff

Director