Deutsche Post DHL

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Corporate Accounting and Reporting

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International Accounting Standards Board
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Your reference
Our reference
Phone
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Date September 13th, 2013
Subject **Exposure Draft ED/2013/6 Leases**

Dear Sir / Madam,

We are pleased to have the opportunity to comment on the above mentioned Exposure Draft issued by the International Accounting Standards Board (IASB). In this letter we would like to set out our general comments on the Exposure Draft. The appendix of this letter provides you with our detailed comments on specific issues raised in the Exposure Draft.

We welcome the long-lasting initiatives made by the IASB in order to improve the accounting for leases and believe that IAS 17 could benefit from the proposals and some of the proposed changes. We appreciate the thorough analysis and development of the very detailed proposed concepts. However, we do have some major reservations on the proposed changes of accounting for leases. In summary, our key issues are as follows:

1. With respect to the general approach chosen for changing lease accounting, we still have serious concerns with the proposed right-of-use concept and share the concerns raised by EFRAG in their Draft Comment Letter dated July 8, 2013 that such a concept has never been

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debated on a conceptual level. We are not convinced that the distinction between lease contracts and service contracts in BC20-23 is conclusive and final. We still have concerns why a lease contract leads to right-of-use assets while in other contracts where both parties have partially performed their obligations to an equal extent (executory contracts as defined in IAS 37) this is not the case. We still miss a thorough conceptual analysis of other types of executory contracts with respect to potentially resulting rights-of-use assets and related obligations coming out of these contracts. We therefore support EFRAG's recommendation not to change IAS 17 but to bring improvement to the existing limitations with relevant disclosure of leases.

2. With respect to the proposals of ED/2013/6, we perceive the proposals as being far too complex. Especially the introduction of the distinction of type-A-leases and type-B-leases is a withdrawal of one of the original objectives for improvement of lease accounting, which was the introduction of a single accounting model for leases. In addition, distinction of type-A-leases and type-B-leases re-introduces key elements of today's distinction between finance leases and operating leases – but only in P&L. Therefore, if IASB decides to stick to the general concept chosen for lease accounting (i.e. right-of-use-concept), we recommend to reduce complexity and standardize the concepts by at least eliminating the notion of type-B-leases completely and solely concentrate on all leases being accounted for as is proposed for type A leases in combination with a reasonable distinction to short-term leases.

3. Another follow-up complexity of the different accounting models chosen for lessees and lessor lies within technical consolidation of intercompany leases. In a situation where one entity of a group has a lease-in from the market and leases this asset out group-internally to one or more other group entities, and where all group entities follow the full set of IFRS (before being consolidated), the different accounting approaches for (a) the entity who holds the external lease-in (lessee), (b) the same entity being the intercompany lessor and (c) for the intercompany lessee(s) lead to the fact that a faithful presentation of the group's statement of financial position will not be given as these intercompany transactions will not be subject to the consolidation procedures normally applied under the rules of IFRS 10.B86(c). This result will be in place for each group-internal lease where all classification and measurement decisions are taken identically by lessee(s) and lessor(s) and where the lease-in rate is identical to the intercompany lease rent; it will be even more complex in cases where those classification and measurement decisions are not taken identically and/or where the entity holding the external lease-in increases the rate for the intercompany lease-out by a certain margin. Obviously, this problem can be resolved by

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defining an appropriate accounting policy for intercompany leases. However, we wonder whether it makes sense to correct an overcomplicated accounting model by additionally implementing complex internal accounting policy guidelines.

4. We additionally seriously doubt that all the proposed changes would be for the benefit of the users of financial statements represented by the major capital market participants like rating agencies and analysts/investors.
   Long-lasting tradition of the rating agencies shows that they even under today's regime of IAS 17 include future lease obligations into their rating models – and obviously have the information necessary to do that.
   In addition to that, we performed a series of interviews with analysts covering DPDHL and discussed the cornerstones of the proposed accounting rules for leases with them. The bottom lines of the discussions were that, while leasing mostly is a general topic being considered when following our company, accounting for leases is not a specific factor in evaluating our company. In general, information provided today under the regime of IAS 17 was assessed to be an adequate source for the information needs of the analysts (although some more information linked to underlying business models were mentioned to be always nice to have). Therefore, while in the opinion of the analysts interviewed it might be of some limited use to include leased assets and the corresponding financial liabilities in the statement of financial position, the currently proposed rules for P&L-treatement were clearly rejected as they make analysis unnecessarily complicated. Therefore, they did not come to the conclusion that changing lease accounting in the currently proposed way would be of benefit for their work as being representatives of the "capital market". In their view, staying with current lease accounting and improving (not necessarily extending) disclosures would be a better way to serve their needs.
   Finally, analysts pointed out that the business models (where leasing is used) and cash flow of leases does not change; as a direct consequence of this, they – of course – do neither expect their general view on DPDHL to change nor expect a notable change in valuation of our company. Based on this, we seriously doubt that proposed changes for lease accounting would improve the relevance or decision usefulness of the information provided. Having this in mind, we seriously doubt that an acceptable balance between implementation costs for companies and the benefits provided to the capital markets (cost-benefit constraint) would be met if the changes in lease accounting proposed in ED/2013/6 Leases would come into practice.

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We would be pleased to discuss our comments with you at your convenience. If you have any questions, please feel free to contact:

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Yours sincerely,

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Enclosures

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 with the definition and the proposed requirements, because we feel that with the adjustments made in comparison to existing requirements in IFRIC 4 (e.g. clarification on substitutability; focussing on control-concept) the requirements have been made more clear.

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 do not 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. Knowing that it is laid down as rebuttable presumptions (in paragraphs 29-30 of the ED), we do not see any conceptually acceptable reason why leases of property should differ from leases of other assets. Instead we propose to only implement the distinction between short-term leases and regular (type-A-) leases.

Basically, we understand that there is a distinction between a "borrowing" and a "regular lease". In our view, a "borrowing" only lasts for a relatively short period of time (being "short" in absolute terms, not in relative terms). By applying the usual threshold of IAS 1 for definition of "short-term" (or "current") of 12 months (more precise: "normal operating cycle") it is possible to distinguish short-term (out-of-scope-) leases from in-scope leases.

In our view, it is also not correct to distinguish between leases where a financing component can be identified (type-A-leases) and leases where a financing component cannot be identified (type-B-leases). In our view, all leases, regardless of whether being of short-term nature or not, and regardless of underlying asset, have a financing component. This is simply due to the fact that, in our view, a lessor in any case will calculate a margin into the lease charges based on his own financing needs of the asset leased to the lessee – also regardless of whether that lease is of short-term nature or not, and regardless of the underlying asset.

Transferring these two arguments to leases, we would have a situation where all leases with a maturity exceeding one year would be qualified to having a financing component embedded. Consequently, interest cost (the financing component) of these leases should be shown in financial result.

In contrast, for leases with a maturity of less than one year, the fact that they also have an inherent financing component is overruled by the current / non-current distinction, leading to the result that for reasons of simplicity these leases do not need to be shown in full detail. Consequently these leases would finally have to be qualified as what is referred to as short-term leases (in line with the proposed treatment).

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?

Considering our answer to question 2, we will give our opinion on question 3 only with respect to lessor accounting for type-A-leases as we recommend not to follow the distinction between type-A- and type-B-leases for both parties of a lease agreement.

Within lessor accounting for type-A-leases we have the following two concerns.

Firstly, we do not understand what the residual asset purports to represent. From technical and pure computational perspective, we understand how this asset comes into place. However, we fail to understand what the economic substance of that asset is. In one way of understanding, it can be interpreted as being some kind of discounted value of economic benefits (more precise: the rights to use those economic benefits) over which the lessor will have control starting at some point in future, i.e. after the lease term. In another way of understanding, this is the residual bundle of property rights related to the asset that rests with the lessor over the lease term, as only the right to use is leased-out to the lessee while e.g. rights to transfer legal title and rights to make changes to the asset itself are not leased-out to the lessee and, consequently, stay with the lessor. We recommend to investigate further and explain more precisely if it is appropriate to combine all these fractions of the underlying asset into such a residual asset.

Secondly, we do not understand why such a computational plug in the balance sheet can generate interest income. Again, we understand technically and from a pure computational perspective that this unwinding of discount is based on the concept of present value chosen for lessor accounting of type-A-leases. Again, we fail to understand what the economic substance of that item is. We recommend to provide explanation how such a residual asset (whatever its economic substance is) can earn interest income throughout the lease term without the economic benefits being under control of the lessor during that lease term.

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?

As stated in our comment on question 2 we in general do not support the proposal to classify leases as either type-A-leases or type-B-leases and that such classification should be based on the volume of consumption.

With respect to the distinction requirements proposed, we have several concerns:

Firstly, we do not understand why two of the major principles of IAS 17 for distinguishing finance leases from operating leases are re-introduced for distinction of type-A-leases from type-B-leases.

Secondly, we have concerns with respect to the present value-related requirement as laid down in par. 29(b) and 30(b). While par. 29(b) mentions the threshold "insignificant" relative to fair value of the underlying asset, par. 30(b) mentions the threshold "substantially all" of the fair value of the underlying asset. We do not understand how this requirement will be assessed if the portion of the fair value is clearly more than insignificant but not substantially all. In our view, it does not make sense to define one requirement for distinction but at the same time defining two different thresholds leaving a lot of room in between these two thresholds.

Thirdly, the same criticism applies to the economic life-related requirement: While par. 29(a) mentions an "insignificant part", par. 30(a) refers to "major part". How would this requirement be assessed if the lease term is for a part of the economic life that is more than insignificant but not major part? In addition, with respect to the economic life-related requirement and having considered paragraphs BC124/125, we cannot completely follow why par. 29(a) is based on the "total economic life", while par. 30(a) is based on the "remaining economic life".

In addition, interpretation of current IAS 17 on how to interpret the present value-test and the useful life-test for distinction of operating leases vs. finance leases is derived from U.S. GAAP. However, as U.S. GAAP also is expected to move to proposed new rules for lease accounting, the source of this interpretation will not be in place anymore in future. If the boards stick to the distinction of type-A-leases and type-B-leases, which we do not recommend (see our arguments in question 2), we recommend to clarify terminology in order to contribute to a clear basis for interpretation of the underlying principles for preparers and users in order to avoid diversity in practice.

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 agree with the proposals including the reassessment approach. We appreciate the idea of considering all kinds of economic incentives (asset-, contract- company- and market-based aspects), which seems for us to be by far more reliable to users of financial statements than the proposals made earlier.

With regards to distinguishing short-term leases from leases in scope of the ED, and together with BC 298 we often see agreements, that have a very short or no non-cancellable lease period (in some cases only the term, during which the lessee has to give notice on cancellation), but which do automatically extend for another period (e.g. year, quarter) if no cancellation is actively proclaimed. Our current understanding is that these kinds of leases do contain a multiple of options to extend the contract. Therefore this contract would be excluded from the option to be scoped out because it is "short-term", but would be treated as regular leases, being subject to assess any significant economic incentives to extend. We would appreciate clarification of treatment of such kinds of contracts in the final standard (or at least in the basis for conclusions) in order to provide clear guidance for all preparers.

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 new proposals.

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 agree with the proposal to introduce the modified retrospective approach. Nevertheless we would like to point out the tremendous implementation effort required to arrange the transition for each and every lease item, when applying either the modified or full retrospective approach. Therefore we recommend the boards to consider the transition necessities thoroughly when determining the final effective date.

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 agree with the proposal of increasing volume of disclosures accompanying increased complexity in statement of financial position and income statement (driven by right-of-use-accounting and type-A- vs. type-B-distinction).

As already explained in our cover letter, we are convinced that increased volume and changed content of disclosures is justifiable if recognition and measurement is unchanged compared to IAS 17. We also would accept an increased volume of disclosures in a set of rules where leases are shown on-balance in general but distinction between type-A-leases and type-B-leases is not necessary.