



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

13 September 2013

Dear Mr Hoogervorst,

### **ED/2013/6 Leases**

Standard Chartered PLC (the “Group”) is an international banking group listed on the London, Hong Kong and Bombay stock exchanges. It operates in more than 70 countries, principally in Asia, Africa and the Middle East.

We welcome the opportunity to comment on the above Exposure Draft (“ED”) and appreciate the difficulty in reconciling disparate points of view on this critical and heavily debated area of financial reporting. Our detailed responses to the questions are set out in the attached Appendix.

We find the proposal to be a substantial improvement over past proposals on accounting for leases. We remain unconvinced that these complex proposals provide users with benefits that would justify the costs of implementation. If the IASB decides to move forward with these proposals, we have a number of concerns that we believe should be considered by the IASB (“the Board”) as part of their deliberations on this ED. These include:

- As lease accounting has not been at the centre of accounting failures is there a compelling reason in the form of benefits to users in order to adopt a new approach to accounting for leases when the costs of such a change will be substantial?
- The information that will be reflected on balance sheet under these proposals is generally provided under the existing standard as disclosures. Is there an incremental benefit from these proposals in terms of user information and if so could it not be better addressed through improved disclosure under the existing standard?
- Under these proposals reporting entities may structure transactions to retain off balance sheet reporting. In that case there may be no disclosure requirements and users will no longer be provided the same level of information on these transactions. Could these proposals actually result in a lower level of user information?
- Does accounting for a lease by a lessee as the purchase of a period of the life of a tangible asset reflect the economic reality of the transaction? The transaction is in

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Standard Chartered Bank is incorporated in England with limited liability by Royal Charter 1853 Reference Number ZC18

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Standard Chartered Bank is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and Prudential Regulation Authority



substance simply a rental of an asset and the inherent risk is the ability to recover the cost of using the asset not the asset risk itself.

- Has the impact on income taxes, capital charges and the costs to the parties to a lease been considered? While these are not relevant to the question of how a lease should be accounted for under IFRS, they are impacted by the accounting and should be considered as part of the analysis of costs and benefits of these proposals.

If these proposals do result in a new standard, given the significance of the changes involved, we believe that a minimum of three years will be needed from the date of publication of the final standard to the mandatory effective date as reporting entities, especially banks, will be faced at the same time with the adoption of IFRS 9 and the need to address tax, capital and valuation issues related to these proposals.

We provide our detailed responses to the questions posed in the ED in the attached appendix and will be pleased to provide any additional information or clarification of our comments if you so wish.

Yours sincerely,

A handwritten signature in black ink, appearing to read "T. Egan", written over a light blue horizontal line.

Thomas Egan  
Head, Group Accounting Policy & Advisory



## Appendix

The comments that follow assume that the Board will pursue the right-of-use model and should not be taken as an endorsement by us of that approach.

### Scope:

#### **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) Fulfillment of the contract depends on the use of an identified asset; and***
- b) The contract conveys the right to control the use of an 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 conclusion that does not reflect the economics of the transaction.***

The definition reasonably reflects what we would believe to be a lease and that the definition would largely be functional. We do have a few points with regard to the definition.

The ED excludes intangible assets for lessors in paragraph 4 and then states in paragraph 5 that lessees need not apply the standard to intangible assets. That suggests that a lessee may choose to apply this standard. If that is the case should it be a contract by contract policy choice or a policy choice for all intangible assets meeting the definition of a lease?

Another concern is the use of the term “goods and services”. It appears that leases are of tangible assets – ie, property, plant and equipment. The term “asset” should be used consistently so to avoid the suggestion that a supply contract for goods or services would meet the definition of a lease as the assets are not used for a time, but are consumed in their entirety. That leads to a further concern regarding whether “leases” include service contracts? There is little value in disclosing information around short term contracts related to car rentals, hotel stays or service apartment use, but these do appear to meet the definition in the ED. The ED excludes agreements over assets whereby the supplier has a right to substitute the specific asset, and it could be argued that in service contracts that right is always or almost always present, but this could be made clearer.

One more area of concern is the leasing of precious metals. Lease contracts are used to “lease” precious metals (for example, gold, platinum, palladium and silver) to clients of entities, including those of banks. These leases may involve the client converting gold into finished goods, as is the case with a jeweler, or consuming the commodity, such as using platinum as a catalyst to produce fertilizer. In each case, the client has a contractual obligation to return the commodity and the lessor bears price risk on the commodity.



Using the definition provided in the ED, these contracts appear to fall within the definition as the contract relates to use of a tangible asset.

Many of these contracts would be short-term and would fall out of the scope of the standard in terms of recognition and measurement, but would remain subject to disclosure requirements that would be of little relevance or use. It is likely that these contracts would then simply be amended to contain a clause that allows the supplier to substitute the fungible commodity and that would result in the contract falling out of scope.

The accounting prescribed in the ED does not reflect the economic reality of the transaction as price risk remains with the lessor and as the precious metal must be returned to the supplier in the state it was transferred, the transaction takes the form of a borrowing. Precious metals are viewed as currency when leased and that view is supported in terms of how the contracts are priced. For that reason, we believe that leases of precious metals should be explicitly scoped out of the standard.

### **The Accounting Model:**

#### **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 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 with the proposals related to lessee accounting as they do not appear to be consistent with the as the underlying principle of the right-of-use model that all leases give rise to the same assets and liabilities. If that principle is to be applied, then it would follow that they should be accounted for in the same way by all lessees.

The Boards' proposals treat all equipment leases as financing transactions, but a significant number of equipment leases are not financing transactions, but simply rental agreements. IAS 17 better reflects the economics of a lease contract that conveys a right to use an asset without taking asset risk and a contract that effectively is the financing of the purchase of the underlying asset.

We view the introduction of Type B leases as a compromise designed to accommodate certain reporting entities, while introducing complexity in applying the standard for others.

We believe that if a right-of-use model is adopted then all lease liabilities should be treated the same. This should be on a straight-line basis for all right-of-use assets and liabilities in order to provide for a matching of income and expense.



### **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 do not support changing the existing IAS 17 accounting model for lessors. The primary reason for revising the accounting for leases is the off-balance sheet treatment for lessees under operating leases. The proposed changes to lessor accounting would continue to result in recognition of either the underlying asset (Type B leases) or a lease receivable (Type A leases). The primary difference for lessors is that the current requirements under IAS 17 result in many leases being classified as operating leases, which does not result in any upfront profit recognition. The proposed standard would result in most non-property leases (which would include many leases currently classified as operating leases under IAS 17) being classified as Type A leases, resulting in the upfront recognition of profit or loss.

We do not support moving to an accounting model that results in upfront recognition of profit or loss for most non-property leases, particularly when the lessor has retained significant credit risk of the lessee. With the exception of recognizing a residual asset, if any, there is not a significant difference between the proposed lease accounting for lessor Type A leases and the proposed revenue recognition standards, both of which result in the upfront recognition of profit or loss. Therefore, we do not see a compelling conceptual basis for the proposed lessor accounting. If a transaction does not meet the standard for revenue recognition, it is unclear why it would effectively result in revenue recognition under the leasing standard. In addition, significant judgment will be necessary in determining the residual values, which will largely drive profit or loss recognition.

We do not believe that creating symmetry between lessor and lessee accounting is necessarily desirable. The current lessor accounting under IAS 17 is not a broken model, is well understood and generally provides useful information to users of financial statements. We support retaining the IAS 17 accounting model or at least retaining it for lessors with enhanced note disclosures regarding residual values.

### **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 paragraph 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?***

If the Board wishes to maintain a right-of-use model, classification should not be introduced into the standard as it creates complexity and the possibility that similar transactions are accounted for differently. If there is any form of classification, it should be based on IAS 17 principles and it should drive recognition rather than measurement.



The classification expedient proposed appears to be created to accommodate property and not to address an underlying economic principle. The classification approach also is complex and its application appears to be highly subjective. This will likely lead to significant diversity in practice while generating little useful information for users.

#### **Measurement:**

##### **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 these proposals if the Board decides to continue with a right-of-use model. In which case, we suggest that the Board use the “reasonably certain” threshold that is used in current guidance for the recognition of bargain purchase options instead of significant economic incentive.

##### **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 generally agree with the proposals around variable lease payments, but point to the complexity of these concepts and measurement as yet further reason for not adopting a right-of-use model. The increased complexity, resulting costs and the limited increase in useful information do not compel a change in accounting for leases.

#### **Transition:**

##### **Question 7: Transition**

***Paragraphs C2-C22 state that a lessee and a lessor would recognize 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 transition issues the boards should consider? If yes, what are they and why?***

This approach seems reasonable, but there should be an assessment of how this would work under actual scenarios. Adoption of these proposals will take considerable time and effort. For banks, the proposed accounting would have a significant consequential impact on regulatory capital and risk-weighted assets. Therefore, we believe that the effective date should be no earlier than three years from the issuance of the final standard.

#### **Disclosure:**

##### **Question 8: Disclosure**

***Paragraphs 58 – 67 and 98 – 100 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments; reconciliation 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 consider the disclosure requirements set out in the ED to be too extensive.

Of particular concern are the reconciliation requirements in paragraphs 61 and 64 that effectively are the disclosure requirements for owned assets. An entity that leases an asset is not in the same position nor exposed to the same risks as an actual owner of that asset. These requirements should be removed in the final standard.

The ED is also appears to require the same disclosures for short term leases as for all others by only exempting them from the recognition and measurement requirements. We therefore encourage the Board to clarify the disclosure requirements for short term leases and provide that all or the majority of disclosure requirements do not apply to short term leases.

Specifically, we would want the final standard to make it clear that the disclosures only apply to significant information. Many leases have considerable covenants and restrictions, but some are not significant in terms of financial impact and many are contingent on events that are no probable or even reasonably possible at the balance sheet date.

While quantitative disclosures especially movement schedules should be required to include all leases the qualitative disclosures should be limited to financial significant leases. For example, the requirements of 60a could be reworded to state:

A lessee shall disclose the following information about the nature of its financially significant leases, including:

- (i) a general description of those financially significant leases;
- (ii) the basis, and financially significant terms and conditions, on which variable lease payments are determined;
- (iii) the existence, and financially significant terms and conditions, of exercisable options to extend or terminate the lease. A lessee shall provide narrative disclosure about the exercisable options that are recognised as part of the right-of-use asset and lease liability and those that are not;
- (iv) the existence, and financially significant terms and conditions, of residual value guarantees provided by the lessee; and
- (v) the financially significant restrictions or covenants imposed by leases, for example those relating to dividends or incurring additional financial obligations.

### **IAS 40 Investment Property**

#### ***Question 9: 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?***

We would agree with these proposals if a right-of-use model were to be adopted.

**Other Comments:**

- While we agree that a lease agreement does result in an obligation that meets the definition of a liability, we find that this is true of other executory contracts that are accounted for off-balance sheet. For example, own use contracts for commodities under IAS 39. The right-of-use model serves to create accounting that does not reflect the economic substance of the transaction. First, the lessor does not sell a “time portion” of the asset as this approach reflects. It simply rents the asset for a payment or series of rental payments. This is not a sale as asset risks are not transferred. The asset recognized by the lessee is also not reflective of economic reality as control usually includes a right to sell the asset. A leased asset may only be used or, if allowed, sub-leased. It appears that in order to achieve the objective of balance sheet recognition for leases, the Board may be bending some of the underlying principles of accounting. We would not encourage this unless the outcomes were true to the economic substance of the transaction. It does not appear to be the case here.
- We would like clarity over the language in ED paragraph 18.

A customer’s ability to derive the benefits from use of an asset refers to its right to obtain substantially all of the potential economic benefits from use of the asset throughout the term of the contract. A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, consuming, holding or sub-leasing the asset. The economic benefits from use of an asset include its primary output and by-products in the form of products and services. Those economic benefits also include other economic benefits from use of the asset that could be realised from a commercial transaction with a third party.

This suggests that if the lessor retained some benefits that the contract would not qualify as a lease. Therefore would a profit participation clause or a variable payment clause tied to revenue or profit result in the contract not qualifying as a lease?

- As these proposals would introduce a new type of asset, the “right-of-use asset”, we believe that it should be made clear that this asset is not an intangible asset, but rather that it would be considered as a portion of the underlying asset. This is significant to capital treatment and in terms of reporting this information outside of the financial statements.
- With regard to short term leases, we are concerned that the concept of “significant economic incentive” is not included in the definition of short term leases. As drafted, an entity that would have an option to extend a short term lease would be precluded from the exemption regardless of the significance of the incentive.
- We are concerned that the proposals may result in accounting treatment that does not reflect the economic substance of the transactions with regard to some sub-leasing arrangements, especially those undertaken within a Group. Consideration should be given as to whether the intermediate lease(s) should be netted for accounting purposes.