EFFAS THE EUROPEAN FEDERATION OF FINANCIAL ANALYSTS SOCIETIES

IASB – International Accounting Standards Board
IFRS – International Financial Reporting Standard

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Exposure Draft: Leases

Comments by the European Federation of Financial Analysts Societies (EFFAS) Financial Accounting Commission – FAC

Dear Madam, dear Sir,

The European Federation of Financial Analysts' Societies is the European organization of national analysts' societies. It comprises 27 members representing more than 16,000 analysts and investors in the areas of equity and bond research, asset management as well as investment advice. EFFAS Commission on Financial Accounting represents the views of investment professionals in the field of financial reporting.

The Financial Accounting Commission is pleased to share with you the views of European analysts regarding *Leases.* We would like, also, to take this opportunity to underline that introducing simplicity in future documents in contrast with the complexity of the ED will certainly contribute to a more homogenous understanding of the standard. Given the technicalities of the subject clear examples are useful for users.

Question 1 – Definition – Identifying a lease

The 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 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.

Response: For analysts is important to understand an issuers lease activity. We think that lessees by signing a lease contract are committed to future payments of rentals which in turn increase their financial risks. Thus, leases giving rise to a financial liability should be incorporated onto the balance sheet.

For practical purposes we accept that leases for a shorter period than 12 months are excluded although capacity contract such as optical fiber leases and intangible leases could on the other hand be recognized.

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?

Response: Lessee accounting should reflect the right to consume an asset and to settle the related liability. As noted in the ED, paragraph 42, Type A leases give rise to separation between interest payments on the underlying assets and the amortization. For Type B leases the ED proposes to combine interest payments and amortization. It is in relation to this that some members contend that they do not see any need for accounting differences implying that they do not agree with the dual-*approach*. The Commission would like to see a consistent accounting standard applied for both Type A and Type B leases. The lessee expecting to consume only a portion of the economic benefit is not a factor of major concern. The comparability of financial information between issuers is however critical for analysts work.

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?

Response: We agree that the lessor accounting for Type A and Type B can differ to reflect the consumption of the underlying asset.

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?

Response: We think that a *dual approach* will be useful to the extent that the lessee and the lessor accounting permits a more comprehensive understanding of the impact of the contract on both. The classification in itself will only provide a better basis for valuation on the grounds that a specific breakdown on the accounting lines is provided to permit a better understanding of risks and rewards. Lease payments should be allocated to both interest and depreciation even for Type B leases becoming therefore an obligation of the lessee to the lessor.

Although FAC by and large supports the proposal, divergent opinions between members about the merits of the *dual approach* were voiced. A contentious aspect was as to understand why at least a part of a lease expense is not classified as interest payments. Although this could be valid for contracts with a fairly short life more questionable is for contract with a longer life. We believe that the ED does not explain the reason for introducing the dual model and we think that it is important to see the interest element and consequently that the only time a lease payment will be an operating cost in its entirety is for short-term leases.

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?

Response: We agree.

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?

Response: We agree.

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 additional transition issues the boards should consider? If yes, what are they and why?

Response: A full retrospective approach would be desirable although we are not sure about companies being able to make it. Comparability should be a key aspect in determining the transition.

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 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?

Response: We agree.

Best regards,

EFFAS Commission on
Financial Accounting

EFFAS Commission on Financial Accounting

EFFAS was established in 1962 as an association for nationally-based investment professionals in Europe. Headquartered in Frankfurt am Main, EFFAS comprises 27 member organisations representing more than 16,000 investment professionals. The Commission on Financial Accounting is a standing commission of EFFAS aiming at proposing and commenting on financial issues from an analyst standpoint. FAC members are Javier de Frutos (Chairman, IEAF-Spain), Jacques de Greling (Vice-Chairman- SFAF, France), Friedrich Spandl (ÖVFA, Austria), Henning Strom (NFF, Norway), Ivano Mattei (AIAF, Italy), Taras Koval (USFA, Ukraine), Jérôme Vial (SFAA, Switzerland) and Rolf Rundfelt (SFF, Sweden).

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