

Institute  
of Certified  
Public Accountants  
in Israel

ל ש כ ת  
רואי חשבון  
ב י ש ר א ל



1906/34089

September 30, 2013

International Accounting Standards Board  
30 Cannon Street  
London EC4M6XH  
United Kingdom

Dear Sir/Madam,

Re: **Exposure Draft – Leases**

We appreciate the opportunity to respond to the Exposure Draft "Leases" issued by the International Accounting Standards Board (IASB). This response represents the views of the Institute of Certified Public Accountants in Israel.

One of the main incentives to issue a new accounting standard that deals with leases was the lack of transparency in financial reporting of lessees. The fact that many leases were not recorded on-balance sheet, made it difficult for investors to appropriately assess the financial position of an entity, which resulted in many users making adjustments in order to capitalize a lessee's operating leases. Therefore, we agree with the concept that leases should be recognized on-balance sheet (rather than off-balance sheet), so that investors are provided with relevant information that will assist them in assessing an entity's overall obligations and its financial position. We also believe that such treatment is consistent with the definitions of an asset and a liability in the IASB's Conceptual Framework.

However, we expected that the IASB and the FASB ("the Boards") would establish a single model to be applied to all leases, since any non-single model will ultimately be subject to structuring opportunities and significant judgment in the classification of a lease (and, hence, will be more complicated to preparers and less understandable to users).

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Although the Boards have eventually decided to introduce a dual model, we agree that the proposed model reflects a reasonable and practical compromise that, on the one hand, is more operational than the 2010 ED (e.g., by reducing the complexity involved in estimating variable payments and extension options embedded in the lease) and, on the other hand, better reflects an entity's financial position in comparison to the current IAS 17's model.

Although we consent to the general concepts expressed in the ED and believe it strikes a fair balance between the relevance of information to users and the costs of applying its requirements, we ask the Boards to reconsider applying the Type A model by lessees to all leases. In our view, this suggestion comprises a better compromise because of the following reasons:

1. Lessees will apply a single model to all leases, thereby reducing significantly the costs and complications of applying a dual model. We also believe that using a single model would result in more coherent and understandable information to users.
2. The Type A model will be more understandable to users since it decouples the accounting treatment for the right-of-use (ROU) asset and the lease liability, in a way that faithfully represents the entity's rights and obligations arising from a lease. We expect that Type B leases would not be easily understood by investors since lessees subsequently measure the ROU asset as a 'plug number' which does not necessarily represent the rights held by the entity.

Moreover, the ED includes some deficiencies that need to be addressed by the Boards. These are discussed in detail in the appendix that is attached to this response letter.

Sincerely yours,



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Adir Inbar  
Chair of the Professional Council



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Arnon Ratzkovsky  
Chair of the Financial Reporting Standards  
Committee

## **Appendix – response to some questions included in the ED**

### **Question 6**

*Do you agree with the proposals on the measurements 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?*

### **Answer**

Some take the view that lease transactions are often in-substance sale or acquisition of the underlying asset or part of it. IAS 17 took that view with regard to finance leases, and the ED also takes this view with regard to some leases. For example, paragraph BC46 states that: "... For that reason, the lease payments made, and the right-of-use asset acquired, by the lessee would effectively incorporate the acquisition of the portion of the car that the lessee consumes during the lease term." Given that perspective, we would have expected the lease liability to be treated as any other financial liability that is financing an acquisition of an underlying asset. However, this is not the case, specifically with regard to the proposed accounting treatment for indexed lease payments (e.g. CPI-linked payments).

In accordance with paragraph 43 of the ED, a lessee shall recognize the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset, except for remeasurement that arises from a change in an index or a rate that is attributable to lease payments made during the current period – in that case it is recognized in profit or loss. However, if an entity, instead of leasing the asset, had borrowed the funds necessary to acquire the underlying asset from a third party (or had obtained long-term credit from the seller), then the resulting liability would have been a financial liability for which all of those changes in an index or a rate would be recognized entirely in profit or loss, even if they were accrued on the remainder of the financial liability to be settled in future periods. We believe that all financing costs, regardless of their form, have similar nature and therefore all of them shall be recognized in profit of loss rather than being capitalized partly to the ROU asset. Deviating from this basic principle will definitely cause lease arrangements to be tailored in a way that increases the capitalized part of financing costs (or vice versa in some cases).

Furthermore, as stated in paragraph BC183 "... respondents were of the view that lease payments denominated in a foreign currency are in effect another form of variable lease payments, and should be accounted for similarly to variable lease payments that are determined using an index...". We agree with those respondents that lease payments

denominated in a foreign currency are in effect another form of variable lease payments, and therefore these two types of variable payments shall be accounted for similarly. Our view is that both forms of payments shall be carried to profit or loss and not capitalized to the ROU asset. The only other alternative, not preferred by us, is capitalizing both kinds of payments to the ROU asset.

In this context, the Boards have also indicated that foreign exchange gains and losses should be recognized in profit or loss, as mentioned in paragraph BC184: "The boards decided that any foreign exchange gains and losses ... should be recognized in profit or loss. This is because this approach is consistent with existing requirements on foreign currency exchange differences...". We agree with the Boards in this matter and, as explained above, request the Boards to set the same treatment for CPI-linked (or other index-linked) payments.

Lastly, we believe that there should not be a difference between the accounting for the lessee's liability and the lessor's receivable in respect of financing costs. As explained in paragraph BC243, the lessor accounts for CPI-linked (or other index) changes, as well as for foreign currency changes, in profit or loss.

### **Question 8**

*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?*

We disagree with the Boards' decision to include a reconciliation of opening and closing balances of the lease liability (for the lessee) and of the lease receivable (for the lessor) and a 5-years maturity analysis. Since these liabilities and assets are similar in nature to financial assets or liabilities, and since such reconciliation is not required for financial assets and liabilities, we believe that it is also not necessary for lease liabilities and lease receivables. In our view, the disclosures required by IFRS 7 would meet the needs of users of financial statements while not posing an additional burden for preparers. We also believe that our proposal is in line with the IASB's recent efforts to tackle the disclosure overload in financial statements.

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