

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UK

Cc: EFRAG

Oslo, December 15th, 2010

Dear Sir/Madam

Exposure Draft, ED/2010/9 Leases

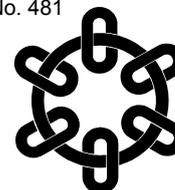
Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board) welcomes the opportunity to submit comments on the exposure draft Leases. While our detailed comments and basis for our conclusions are set out in the appendix to this letter, we would especially like to bring the following point of view to the attention of the IASB.

General remarks to the proposed model

We support the IASBs effort to develop a single approach to be applied to all leases, and believe that comparability (and hence usefulness) of financial statements will be enhanced if different treatments of operating leases and finance leases are replaced by an approach that applies the same principles to all leases. While we support the general concept of providing for the recognition in lessees statement of financial position of assets and liabilities arising from all lease contracts, we would strongly prefer a single approach to lessor accounting, and that the partial derecognition is applied to all leases.

Definition of a lease

We are not convinced that a sufficiently robust distinction has been drawn between leases and firmly committed executory contracts. Furthermore, we are very concerned that the current wording will result in similar contracts being accounted for differently, with structuring opportunities and reduced comparability as a result. Take for example two entities who need the same volume of a given service or product, entity A decides to contract for 50% output capacity in a large asset/plant (off-balance sheet) and entity B decides to contract for 100% output capacity of an asset/plant half the size (on-balance sheet). Furthermore, Entity B might have a choice of contracting the whole volume from one asset/plant or to spread the volume on more assets/plants. Whether entity B chooses to contract from one or more assets/plants, might be decisive for whether entity B will have to recognise the asset/plant on or off balance according to the current wording in paragraph B4(c).



We acknowledge that this is not a new issue and that the wording in paragraph B4 is mainly in line with IFRIC 4. However, clear, robust and carefully considered guidance on the distinction between off balance sheet executory contracts and lease contracts, becomes dramatically more important as the pressure on accounting guidance shift from the distinction between operating and finance leases to the distinction between leases and non-lease service contracts, and as the importance of this distinction moves from a disclosure issue to an off-balance versus on-balance issue.

Hence, we urge the Boards to perform a complete review and carefully elaborate on the fundamental distinction between leases and off balance sheet firmly committed executory contracts. As the main criticism to the existing IAS 17 has been related to off-balance sheet financing and the potential for structuring, the IASB should strive to achieve a conceptually sound and robust definition of what constitutes a lease before the new model is finalised.

Scope and exemptions

We agree with the scope exclusions and simplifications with the following qualifications:

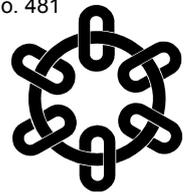
- We see no conceptual basis for excluding leases of intangible assets from the scope of the proposed standard.
- No general exemptions should be provided for short term leases. Rather than making exemptions and explicit rules, the proposed model should apply where assessed as material, utilising the existing guidance in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
- Both lessee and lessor should separately account for all service components, even when the service components are not distinct.

Application to complex leases

By the term complex lease we mean a lease contract that includes additional elements, such as options to extend or terminate the contract, options to purchase, residual guarantees, related service elements, etc.

We consider that the proposed model is well suited to account for complex leases, with the following qualifications:

- **Lease term:** We favour a component approach rather than the proposed “single asset” / “single liability” principle. Hence, we disagree with the proposed accounting for options to extend and terminate the lease. If the IASB decide to proceed with the single asset and single liability approach, the conceptual foundation behind this principle should be elaborated, especially with regards to how recognising an obligation under a renewal option, which otherwise would not meet the definition of an obligation under the framework, can be justified.

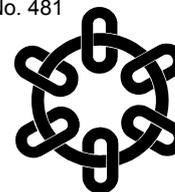


- **Purchase options:** We see no conceptual reason to treat options to purchase and options to extend or terminate a lease differently.
- **Contingent rentals that vary upon usage:** We disagree that contingent rentals that vary upon usage of the asset should be included when measuring the lessee liability or lessor receivable.
- **Contingent rentals that are contingent upon an index or rate:** Rentals that are contingent upon an index or rate should be recognised in profit or loss and not as an adjustment to the right-of-use asset / performance obligation.

Further explanations to our points of views and concerns to the exposure draft are laid out in our detailed comments to the questions in the order suggested by you in the appendix to this letter. Please do not hesitate to contact us if you would like to discuss any specific issues addressed in our response, or related issues, further.

Yours faithfully,

Erlend Kvaal
Chairman of the Technical Committee on IFRS of Norsk RegnskapsStiftelse



The accounting model

The exposure draft proposes a new accounting model for leases in which:

- a) a lessee would recognise an asset (the right-of-use asset) representing its right to use an underlying asset during the lease term, and a liability to make lease payments (paragraphs 10 and BC5–BC12). The lessee would amortise the right-of-use asset over the expected lease term or the useful life of the underlying asset if shorter. The lessee would incur interest expense on the liability to make lease payments.*
- b) a lessor would apply either a performance obligation approach or a derecognition approach to account for the assets and liabilities arising from a lease depending on whether the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected term of the lease (paragraphs 28, 29 and BC23–BC27).*

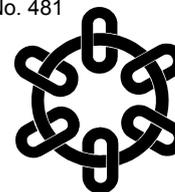
Question 1: Lessees

- a) Do you agree that a lessee should recognise a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?*

This question is answered under the presumption of a simple lease without contingent rentals, options to purchase the leased item or options to extend or terminate the lease. Our comments to complex leases follow in our answers to subsequent questions.

We support the efforts to replace the model in IAS 17 with a model that better addresses the major concerns with this model that have been raised over the years. We think the suggested model of recognising a right-of-use asset and a liability to make lease payments could increase comparability for financial statement users and reduce structuring opportunities currently resulting in unrecognised financing. Furthermore, we believe the right of use asset would reflect the risks the lessee has undertaken and the obligations that the lessee has incurred.

However, we believe the suggested model needs to be developed further in order to provide a sufficiently sound principle based accounting for leases that could provide users with better information. The fundamental criterion behind the suggested model is the disaggregation of an asset into a number of rights and that the transfer of a few of these rights, namely the rights specifically related to the use of the asset for a certain period of time, completes the (lessor's) performance obligation at the time the asset is transferred from the lessor to the lessee. Although we do not disagree with this criterion, we believe this way of looking at a transfer of only the right of use of an asset for a period of time, but not other risks and rewards related to the asset, is a fundamental change to the interpretation of the existing asset and liability definitions and the framework. A conceptually sound principle-based way of



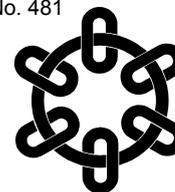
looking at lease assets and liabilities would most likely have an impact on other assets and liabilities that could potentially be treated in a similar way. Hence, we recommend that before a new interpretation of the asset recognition model is introduced in the standard for lease accounting, a broader assessment of the consequences should be performed, in particular with regards to the potential for antithetic views or interpretations by analogy to issues outside the intended scope of the standard.

We note that less complexity has been an objective for developing a new leasing standard, but we are not convinced that the suggested model is less complex than the existing IAS 17. We are also concerned that the problems with the existing standards are not sufficiently addressed. One of the main criticisms of the existing model is that operating leases and finance leases are treated differently. We appreciate that this bright line assessment will be taken out. However, we are very concerned that some service contracts that involve the use of an asset will be subject to a different accounting treatment than other almost identical service contracts. Furthermore, we are not convinced by the arguments in the ED that the potential for structuring will be reduced if the suggestions are implemented. Hence, we suggest that more work to assess consequences of the proposed standard is performed. We particularly think it is important that a thorough evaluation of the users' assessment of the suggested changes is performed before a final standard is issued. Mainly to avoid the risk of preparers incurring significant implementation costs on a standard that might only marginally improve the information to users'. As a follow up to these assessments, we urge the Boards to perform a complete review and carefully elaborate on the fundamental distinction between leases and off balance sheet firmly committed executory contracts. As the main criticism to the existing IAS 17 has been related to off-balance sheet financing and the potential for structuring, the IASB should strive to achieve a conceptually sound and robust definition of what constitutes a lease before the new model is finalised.

- b) *Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?*

Given the current distinction between tangible and intangible assets, we are of the opinion that the right-of-use assets are intangible in nature and should be measured consistently with the guidance in *IAS 38 Intangible Assets*.

We agree that interest should be recognised for liabilities measured at their present values. We believe that the Boards should aim to account for financial liabilities as consistently as possible across different standards. This would also contribute to the objective of reducing complexities in accounting for financial instruments, and to reduce the incentives for structuring contracts in or out of scope (ref. paragraph 8) of the proposed standard.



Question 2: Lessors

Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term, and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?

Do you agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

This question is answered under the presumption of a simple lease without contingent rentals, options to purchase the leased item or options to extend or terminate the lease. Our comments to complex leases follow in our answers to subsequent questions.

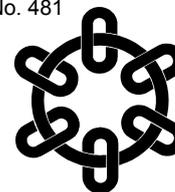
We do not support a hybrid approach, and would strongly prefer one single approach to lessor accounting.

We acknowledge that both the performance obligation and the derecognition approach has its distinct advantages and disadvantages. Our concern with the derecognition approach primarily relates to the pattern of revenue recognition subsequent to initial recognition, caused by the residual asset being measured at cost:

- a) We share the concerns expressed by Stephen Cooper in AV 11, pointing out that unless interest is accreted on the residual asset (time value of money), the profitability of the lessor is underestimated (back loaded) during the period of the lease, with a catch-up arising when the asset is sold or used in a subsequent period. This is a consequence of historic cost measurement that we find challenging to justify, especially for leases with residual value guarantee from third parties (residual value guarantee from unrelated third parties are not regarded as lease payments according to paragraph 35(b)), where the lessor in substance is left only with credit risk.

Hence, provided that the IASB decides to proceed with the partial derecognition approach, either as part of the hybrid approach or applied to all leases, we encourage the IASB to take a fresh look at the accounting for the residual asset, as measuring the residual asset at cost will systematically result in back loading of revenue. We question whether this pattern of revenue recognition will provide a true and fair view of the economic substance of the transaction, and hence provide financial statements that are relevant to the decision-making needs of users.

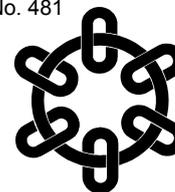
Also note that we regard the residual value guarantee to be a separate distinct asset. Thus, the residual value guarantee should be accounted for separately from the lessor receivable.



- b) We note that the mechanics of the derecognition approach result in increased gains over the life of an asset, where the model is applied to short term leases of assets with long economic life. For example, a two year repeated lease (no options to extend or terminate) of an asset with an expected economic life of 50 years, will result in increased gains at each date of commencement of a new two year lease. We understand that this is some of the basis/reason for why the IASB decided to proceed with a hybrid approach. However, we find no trace of this argument in the basis for conclusion of the exposure draft. Note that it is hard for constituents (often with limited time to spend on the comment letters) to form a strong opinion on proposals from the IASB unless the board explicitly states the arguments for their conclusions.

However, despite the above mentioned concerns, we would still prefer the partial derecognition approach (BC 21) applied to all leases. Our preference for the partial derecognition approach is mainly based on the following arguments:

- a) **The performance obligation approach seems conceptually inconsistent with the lessee approach:** Under the performance obligation approach, lessors should recognise revenue when the lessor permits the lessee to use the underlying asset over the lease term. Hence, the obligation is satisfied continuously during the lease term. However, it is argued that the lease ceases to be an executory contract after the date of commencement of the lease. If the lessee has an obligation of the full term of the lease when it obtains initial access to the asset, it follows that from that moment, the lessor has completed the execution of its part of the transaction. Hence, recognising revenue continuously during the lease term under the performance obligation approach seems inconsistent with the fundamental rationale for recognising the right-of-use asset (lessee has an unconditional obligation to pay for the right-of-use asset over the full lease term as soon as the lessor has provided access to the leased item) at the lessee statement of financial position.
- b) **The performance obligation approach seems conceptually inconsistent with the proposed revenue recognition approach:** The fundamental rationale for recognising the right-of-use asset in the lessee statement of financial position rest on the fact that the lessee has obtained control of the transferred asset for the full term of the lease, and the lessor has completed the execution of its part of the transaction at commencement of the lease. Hence, recognising revenue continuously (deferred revenue recognition) during the lease term under the performance obligation approach seems inconsistent with the revenue recognition approach proposed in ED/2010/6 *Revenue from Contracts with Customers* (paragraph 25). Hence, in our view, for the proposed standard on revenue recognition and the proposed standard on lease accounting to be consistent on when to recognise revenue, the partial derecognition approach would have to be applied to all leases. Thus, any hybrid approach to lease accounting would result in a pattern of revenue recognition which would be inconsistent with the proposed model in ED/2010/6 *Revenue from Contracts with Customers*, independently of where and how the



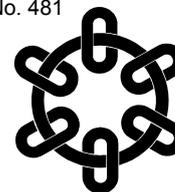
distinction between the partial derecognition and the performance obligation approach is drawn.

- c) **The performance obligation approach double counts for the same asset:** We agree with those who believe that the performance obligation approach double counts for same asset. This issue is particularly problematic when applied to leases where the lessor has transferred significant benefits and risks associated with the underlying asset.
- d) **Complexity:** Reducing complexity is one of the arguments for replacing the current model in IAS 17. However, it seems clear the complexity of the proposed model is enhanced compared to IAS 17. Two different models for lessor accounting contribute to the increased complexity proposed in the exposure draft.
- e) **The performance obligation approach will not provide decision useful information where significant risks and benefits are transferred to the lessee:** The performance obligation approach will not give rise to gains at commencement of the lease, and the transferred asset will remain recognised on the lessors balance sheet. We do not believe that this outcome will reflect the substance of the transaction, where significant benefits and risks are transferred to the lessee. Hence, we do not believe that the performance obligation applied to all leases will provide decision useful information.
- f) **Not concerned about revenue from service:** We are aware that some oppose the derecognition model due to concerns that the lessor could recognise revenue for services that have not yet been delivered to the lessee, and that the lessor would recognise gain for all lease transactions at commencement of the lease. However, we believe the requirement to separate service components even when the service component is not distinct, will mitigate this concern.
- g) **Not concerned about gain initially:** We are aware that some oppose the derecognition model due to concerns that the lessor would recognise gain for all lease transactions at commencement of the lease. However, recognising a gain at commencement of a lease is conceptually consistent with the derecognition model (also, see comment b) above).

Based on an overall assessment, we would express our strong preference for one single approach to lessor accounting. Furthermore, we strongly prefer the partial derecognition approach to be applied to all leases.

Question 3: Short-term leases

The exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is twelve months or less:



- a) *At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognise lease payments in profit or loss over the lease term (paragraph 64).*
- b) *At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognise assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit or loss over the lease term (paragraph 65).*

(See also paragraphs BC 41-BC 46)

Do you agree that the lessee or lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

No, we disagree. We believe that all material leases will be of interest to users of financial statements. Furthermore, from a conceptual point of view, similar contracts should be accounted for consistently. An exemption for short term leases, however defined, would be inconsistent with the fundamental approach of accounting for the assets and liabilities under the proposed model. Thus, we believe that no general exemptions should be provided for short term leases. Rather than making exemptions or explicit rules, the proposed model should apply where assessed as material, utilising the existing guidance in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

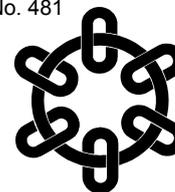
However, that being said, we have received a considerable amount of feedback from financial statement preparers, expressing their deep concern with the cost that would be required to achieve compliance with the proposed standard, questioning the cost and benefits of the proposals. Hence, we encourage the IASB to keep this in mind when elaborating on potential simplifications and cost benefit considerations.

Definition of a lease

The exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1–B4 and BC29–BC32). The exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59–BC62) and on distinguishing a lease from a service contract (paragraphs B1–B4 and BC29–BC32).

Question 4

- a) *Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?*

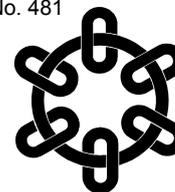


We believe the proposed accounting for leases raises fundamental questions on the distinction between leases and firmly committed executory contracts, and how to account for firmly committed executory contracts in general. Executory contracts and leases are in many instances similar contracts, and often it is difficult to make the distinction between the two. Currently operating leases and firmly committed executory contracts outside the scope of IAS 39 or IAS 37 are all off balance sheet and preparers can deal with similar contracts by providing the same types of disclosures for both in order for the users to understand the entities' commitments.

We would support a model which results in consistent accounting for similar contracts with similar characteristics. For this aim to be achieved, a clear, robust and carefully considered distinction between leases and off balance sheet firmly committed executory contracts will be needed. However, we do not believe that the current wording in B4 achieves this aim. Rather, we believe that letter (c) of paragraph B4 might result in arbitrary differences in accounting between two entities who need the same volumes of a given service or product. For example, entity A may (more or less incidentally) decide to contract for 50% output capacity in an asset/plant (off-balance sheet), while entity B may decide to contract for 100% output capacity of an asset/plant of half the size (on-balance sheet). Furthermore, entity B might have a choice of contracting the whole volume from one asset/plant or to contract from two different assets/plants of the same size. Hence, whether entity B chooses to contract from one or two plants, might be decisive for whether entity B will have to recognise the asset on or off balance according to the proposed wording in paragraph B4(c). Thus, applied to certain contracts, we believe that the current wording in B4(c) might result in similar contracts accounted for differently, with reduced comparability and structuring opportunities (contradictory to the purpose with replacing IAS 17) as a result.

Thus, we urge the Board to perform a complete review and carefully elaborate on the fundamental distinction between leases and off balance sheet firmly committed executory contracts. As the main criticism to the existing IAS 17 has been directed at off-balance sheet financing and the potential for structuring, the IASB should strive to achieve a conceptually sound and robust definition of what constitutes a lease before the new model is finalised. As part of the reassessment of what constitutes a lease, we also strongly encourage the IASB to consider providing explicit guidance on the unit of account, an issue often encountered in practise.

As mentioned above, it would be necessary to take users' concerns into consideration as an important input to the assessment of what constitutes a lease. Also, note that we have received strong concerns from financial statement preparers that the costs of applying the rules in B4(c) to contracts with significantly shorter duration than the economic life of the assets involved (current operating lease contracts) might be very high. Some also think the structuring risks in this area (off-balance sheet "lease" arrangements or similar) are better solved as part of the consolidation / SIC 12 project, and not as part of the standard for leases. We encourage the IASB to keep this in mind when elaborating on the final wording in the proposed standard.



Lastly, note that we believe there is a flaw in the description in the last part of the sentence in B2 (b) (if a lessor can substitute another asset for the underlying asset but rarely does so in practice). It cannot have been the intention that the lessee's assessment rests on what the lessor has been doing and what he may be doing in practice. In our opinion it would be sufficient that the lessee makes an objective assessment as to whether it is possible and whether it is economically feasible for the lessor to substitute the asset.

b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?

We generally agree with the criteria in paragraphs B9 and B10. However, we believe bargain purchase options should be considered consistently independent upon whether they are free standing or embedded in a lease contract. In this regard we would like the IASB to elaborate on when a bargain purchase option would result in a purchase or sale of the underlying asset, including more guidance on the term "trivial amount" in B8(a).

c) Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

No, we think the guidance needs to be significantly expanded and clarified. Please see our comments to question 4a) above.

Scope

Question 5: Scope exclusions

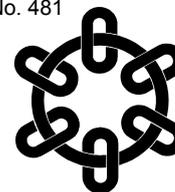
The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33–BC46).

Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and why?

We agree with one qualification. We see no conceptual basis for excluding leases of intangible assets from the scope of the proposed IFRS.

Question 6: Contracts that contain service components and lease components

The exposure draft proposes that lessees and lessors should apply the proposals in Revenue from Contracts with Customers to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B5–B8 and BC47–BC54). If the service component in a contract that contains service components and lease components is not distinct:



- a. *the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.*
- b. *the IASB proposes that:*
 - i. *a lessee should apply the lease accounting requirements to the combined contract.*
 - ii. *a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.*
 - iii. *a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements, and the service component in accordance with the proposals in the Revenue from Contracts with Customers.*

Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

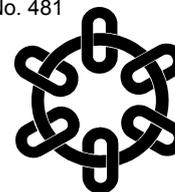
No, we do not agree. We believe in general that the fundamental qualitative characteristics of relevance and faithful representation require that both the lessor and the lessee separately account for all service components. Hence, we agree with the IASB that this is necessary to prevent lessors from applying the derecognition approach to recognise revenue for services that have not yet been delivered to the lessee. However, we disagree that lessees and lessors applying the performance obligation approach should recognise assets and liabilities for service elements where neither party have performed. Such an outcome would be inconsistent with how other executory contracts are accounted for. Hence, we see no conceptual reason for granting an exemption for such elements. Thus, we believe the proposed exemption will provide less relevant and faithful information, and reduced comparability compared to a general requirement to separate service elements.

Question 7: Purchase options

The exposure draft proposes that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraphs 8, BC63 and BC64).

Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?

General comment:



We see no conceptual reason to treat options to purchase and options to extend or terminate a lease differently. Hence, we believe that the same approach should be applied consistently to options to extend or terminate the lease term.

Preferred approach:

We do not support the “single asset”/“single liability” principle in the DP/ED. Rather, we support a component approach where all options (both options to purchase the underlying asset and options to extend or terminate the lease term) is separately accounted for. Our view is mainly based on the following arguments.

- A component approach would give rise to consistent accounting between different elements in the lease standard (option to extend, terminate and purchase) and between standards (non-financial options).
- A component approach would not give rise to liabilities or assets which do not meet the liability and asset definitions in the framework.
- Also, we share the concern expressed by Stephen Cooper in paragraph AV 2 that reflecting options as the gross cash flows resulting from exercise would overstate leverage and not reflect the economic flexibility that options provide.

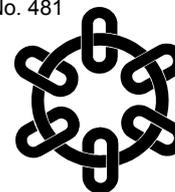
Based on the wording of paragraph 15, we assume that initially, the purchase option will have to be separated from the lease payments (“component approach”) and subsequently measured at cost. If this is the intention of the IASB, we believe the standard should state more explicitly that the value of the purchase option should be separately accounted for, that the purchase option should be measured at fair value initially and subsequently, and if it is not within the scope of IAS 39, it should be measured at cost (and reviewed for impairment) and presented as a net asset. When exercised, the option premium should be included as part of the purchase price of the underlying asset. Hence, we agree with the suggested solution to the accounting for options to purchase the leased item. However, we believe the same approach should be applied consistently to all options to purchase the leased item and options to terminate or extend the lease term.

Comment, provided that the IASB decide to proceed with the proposed approach

We see no conceptual reason to treat options to purchase and options to extend or terminate a lease differently. Hence, if the IASB decides to adopt a single asset/single liability approach, both options to purchase the leased item and options to extend or terminate the lease should be accounted for consistently.

Measurement

The exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that:



- a. *assumes the longest possible term that is more likely than not to occur, taking into account the effect of any options to extend or terminate the lease (paragraphs 13, 34, 51, B16–B20 and BC114–BC120).*
- b. *includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21 and BC121–BC131). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be measured reliably.*
- c. *is updated when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments, including expected payments under term option penalties and residual value guarantees, since the previous reporting period (paragraphs 17, 39, 56 and BC132–BC135).*

Question 8: Lease term

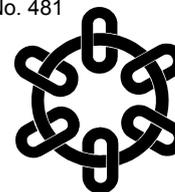
Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

We do not support the “single asset”/“single liability” principle in the DP/ED, which in our view results in recognising liabilities which do not meet the definition of a liability in the framework, overstated leverage and reduced usefulness of information. Rather, we propose a component approach with separate accounting for both options to purchase underlying asset and options to extend or terminate the lease term. We believe a component approach would ensure consistent accounting between different elements in the lease standard (option to purchase leased item and options to extend and terminate the lease) and between standards (non-financial options). Furthermore, a component approach would not give rise to liabilities which do not meet the liability-definition in the framework.

Also, we believe that options to extend or terminate the lease create rights and obligations by contract, which are not inherent in the lease. Hence, we find gross accounting for such options inconsistent with the proposed lease model.

Question 9: Lease payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?



Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be measured reliably? Why or why not?

Should all contingent rentals be included in measuring the liability?

We support the alternative view expressed by Stephen Cooper, that contingent rental agreements that vary upon usage of the asset provide the lessee with additional flexibility, and reflecting them in the measure of the lessee's liability does not provide relevant information about the underlying economics of the transaction.

Furthermore, we believe that contingent rentals that are linked to the usage of an asset are under the control of the lessee. Hence, it could be argued that these elements do not meet the definition of a current obligation as the obligation results from a future decision of the lessee. However, we believe that rentals that are contingent on factors outside control of the lessee (such as price indexes and residual value guarantees) meet the definition of an unconditional obligation where the uncertainty only relates to the measurement of the amount to be paid.

Hence, provided that the contingent component is outside control of the lessee, we agree with the proposal to include contingent rent and expected payments (term option penalties and residual value guarantees) specified in the lease in the measurement of assets and liabilities arising from lease. However, we do not agree that contingent rentals under the control of the lessee, such as rentals that vary with usage of the asset, should be included in measuring the liability.

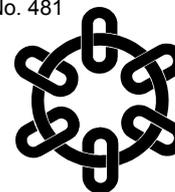
Exemption for lessors: We agree that a lessor should include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments only if they can be measured reliably. However, the IASB should ensure that the wording in the new leasing standard is consistent, including guidance on when contingent payments can be measured reliably, with the proposed revenue recognition standard (see paragraph 38-41 in ED/2010/6 *Revenue from Contracts with Customers*).

How to measure contingent rentals?

We agree that contingent rentals and expected payments under residual value guarantees should be measured using an expected outcome technique, and that contingent rentals that depend on an index or rate should be measured based on readily available forward rates. Furthermore, we accept and support an exemption allowing indices or prevailing rates or indices to be applied if forward rates or indices are not readily available.

Question 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a



significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

Reassessment or not

We agree as a simplification, that lessees and lessors should be required to remeasure assets and liabilities arising under a lease only “*if facts or circumstances indicate that there would be a significant change in the liability since the previous reporting period*”. However, we believe that reassessment at each reporting date should be the starting point. Hence, reassessment only if facts and circumstances indicate that there would be a significant change in the liability since the previous reporting date, should be optional and not required.

How to account for changes in the lessee liability and lessor receivable under the right-of-use and the performance obligation approach?

We agree that changes in the liability / receivable due to changes in the lease term should be adjusted towards the right-of-use asset / performance obligation (provided that the IASB decide to proceed with the single asset/single liability approach).

Furthermore, we agree that change in the liability / receivable due to contingent rentals related to the current or previous periods should be recognised in profit or loss.

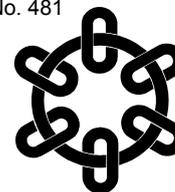
We also agree that changes in the financial liability / receivable, due to contingent rentals relating to future periods which vary with usage of the leased item should be recognised in the right-of-use asset / performance obligation (provided that the IASB decided to include contingent rentals that vary with usage or performance of the leased item when measuring the lease liability / receivable). However, we believe that changes in the liability / receivable due to changes in rentals that are contingent on an index or rate should be recognised in profit or loss.

How to account for changes in the lessor receivable under the derecognition approach?

We agree that rentals that are contingent on an index or rate should be recognised in profit or loss. However, remeasurement due to changes in contingent rentals based on usage arises when it is expected that the lessee will acquire more or less of the right-of-use asset. This is not different from a reassessment of the lease term that is treated as a new recognition (derecognition) event. Hence, we believe the residual asset should be reassessed in these circumstances.

Sale and leaseback

The exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the



underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents the sale of the underlying asset, the leaseback would also meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66–67, B31 and BC160–BC167).

Question 11

Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?

We do not support the performance obligation approach to lessor accounting. Hence, we believe that the derecognition approach should be applied to all leases.

Presentation

The exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25–27, 42–45, 60–63 and BC142–BC159).

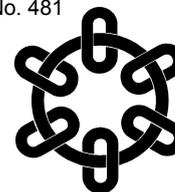
Question 12: Statement of financial position

Question 12 is answered under the presumption that the Board decide to proceed with a hybrid approach to lessor accounting.

- a) *Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment or investment property as appropriate, but separately from assets that the lessee does not lease (paragraphs 25 and BC143–BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?*

We do not agree in general that a lessee should present liabilities to make lease payments separately from other financial liabilities and the right-of-use assets separately from assets that the lessee does not lease. Rather, we believe the lessee should apply the current guidance in IAS 1, and present the lease liability and right-of-use asset separately at the face of the statement of financial position when such presentation is relevant to an understanding of the entity's financial position (IAS 1.69). However, this information should be disclosed in the notes independently of how the information is presented at the balance sheet.

- b) *Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?*



We agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling a net lease asset or lease liability (linked presentation). However, this should only be mandatory at the face of the statement of financial position when such presentation is relevant to an understanding of the entity's financial position (IAS 1.69). However, this information should be disclosed in the notes independently of how the information is presented at the balance sheet.

- c) *Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?*

No, we do not agree in general that the lessor should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment. Rather, we believe the the lessor should apply the current guidance in IAS 1, and present the rights to receive lease payments and the residual asset separately at the face of the statement of financial position, when such presentation is relevant to an understanding of the entity's financial position (IAS 1.69). However, this information should be disclosed in the notes independently of how the information is presented at the balance sheet.

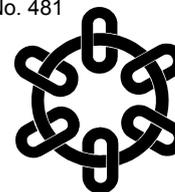
- d) *Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?*

No, we do not agree in general that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position. We believe that the lessor in a sublease should account for the lease and sublease in line with our answers to question a-c above. However, this information should be disclosed in the notes independently of how the information is presented in the balance sheet.

Question 13: Statement of comprehensive income

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

We do not agree in general that lease income and lease expense should be presented separately from other income and expenses in profit or loss. Rather, we



believe that the lessor should apply the guidance in IAS 1, and present lease income and lease expense separately at the face of the income statement when such presentation is relevant to an understanding of the entity's financial performance (IAS 1.83). However, lease income and lease expense should be disclosed in the notes independently of how the information is presented at the face of the income statement.

Question 14: Statement of cash flows

Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

We agree that cash flows arising from leases should be presented separately in the statement of cash flow. We believe that a statement of cash flow that gives information on how the operations are financed and a split between lease and other transactions will provide useful information for investors and analysts.

Disclosure

Question 15

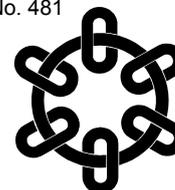
Do you agree that lessees and lessors should disclose quantitative and qualitative information that:

- a) identifies and explains the amounts recognised in the financial statements arising from leases; and*
- b) describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows*

(paragraphs 70–86 and BC168–BC183)? Why or why not? If not, how would you amend the objectives and why?

We agree that lessee and lessor should disclose quantitative and qualitative information that identifies and explains the amounts recognised, and describes how leases may affect the future cash flows. However, disclosure requirements for both lessee and lessor include information that might be business sensitive. We urge the Board to reconsider the need of such information. Furthermore, the disclosures seem extensive. It will be very demanding to provide all the requested information, even if there are some limitations under paragraph 71. Extensive disclosure requirements might increase risk of errors due to complexity and also reduce the readability and relevance of the disclosures to financial statement users.

That being said, we would like to draw the attention of the IASB to one issue which is not directly related to the exposure draft. We believe that information about the amounts, timing and uncertainty (including maturity analysis) of cash flows locked up in firmly committed contracts is of great importance to financial statement users and



analysts in particular. We acknowledge that such disclosures are currently required by different standards, depending on the specific scope of the standard (for example IFRS 7.39, IAS 17.35 and IAS 16.74(c)). Furthermore, we acknowledge and support that such information is proposed for contracts scoped under the proposed revenue recognition (paragraph 78) and the proposed lease standard (paragraph 86). However, we believe this information is just as important to unrecognised firmly committed executory contracts which are not encompassed by any of these standards, such as firmly committed executory supply contracts. It is very difficult for the user of financial statement to form a picture of the total cash flows tied up in various firm commitments when the total picture is incomplete and where such information is spread around in several standards and different disclosures. As we see it, this is a weak point of the current IFRSs, and we ask the IASB to consider a more generalised approach to disclosure requirements on expected cash flows from firmly committed contracts.

Transition

Question 16

- a) The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186– BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?
- b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?
- c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

We agree with the proposal to use a simplified retrospective approach. We do not think that full retrospective application of lease should be permitted. Different application methods will reduce comparability between companies. The effect of different application approach might be significant since operating lease will be recognised in the statement of financial position under the proposed standard.

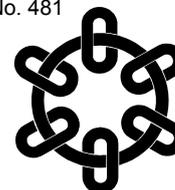
Benefits and costs

Question 17

Paragraphs BC200–BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?

Benefits

We support the IASBs effort to develop a single principle based approach to be applied to all leases, and believe that comparability (and hence usefulness) of



financial statements will be significantly enhanced if different treatments of operating leases and finance leases are replaced by a uniform approach to all leases.

However, we strongly believe the IASB should have a second look at the fundamental distinction between leases and off balance sheet firmly committed contracts, to avoid replacing one arbitrary distinction with another. Furthermore, as laid out in our comment letter and the answers to the specific questions above, we still have significant concerns to certain aspects of the suggested model (in particular to lessor accounting and accounting for complex leases), which in our view will compromise some of the benefits of the suggested model unless the IASB reconsider some of the current proposals.

Costs

There is little doubt that the exposure draft as currently drafted will result in significant costs to a large number of financial statement preparers. We have, in particular, received the following concerns from financial statement preparers on the costs involved with the proposals:

- Accounting for complex leases and reassessment of options and contingent rentals, will be costly and complex to a number of industries such as the retail industry, which often enter into a large number of long term contracts both as lessee and lessor, and where the contracts normally contain both contingent rentals (often based on revenue) and a number of extension or termination options in each contract.
- To certain industries, such as shipping and telecom, the complexity and costs of separating service elements from lease contracts might be large.
- Two different models to lessor accounting will increase the complexity of the proposed accounting for leases.
- The disclosure requirements seem extensive.

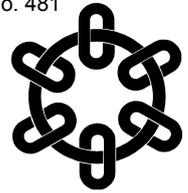
While we see clear overall benefits of the proposed model, we acknowledge that the cost of complying with the proposed requirements seems extensive to certain industries. Hence, we encourage the IASB to consider and elaborate on alternatives which could reduce the complexity of the proposals without compromising the overall benefits of the model. Furthermore, the IASB should take the complexity and the far reaching consequences of the proposals into consideration when setting the effective date for the proposed standard.

Other comments

Question 18

Do you have any other comments on the proposals?

Foreign exchange



We assume that the lease liability / lessor receivable based on a currency different from functional currency of the lessee/ lessor, would be regarded as a monetary item according to IAS 21, and that foreign exchange differences on this monetary item should be recognised directly in profit or loss and not in the right-of-use asset or performance obligation. We recommend a consequential amendment to IAS 21 to clarify this issue.