



International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom
10 December, 2010

Re: Comments on Exposure Draft Leases

Dear Sir/Madam

FEHRCAREM would like to sincerely thank the International Accounting Standards Board (the "IASB" or "Board") for the opportunity to share our comments on Exposure Draft ED/2010/9, *Leases* (the "ED") published by you in August 2010.

Fehrcarem (Asociación Empresarial de Cadenas de Restauración Moderna) is a business organization integrated by the most important companies of the sector: McDonalds, The Eat Out Group, Telepizza, Areas, Grupo Vips, SSP, Grupo Rodilla, Gate Gourmet, etc. Our main mission is to represent and defend the companies' interests in front of the Spanish and European Institutions. In 2009 the turnover of our members was 4,103 Mill. € and the turnover of the sector was 8,954 Mill. € with 150.000 employees.

Further information about FEHRCAREM and its activities is available on our web site www.fehrcarem.es.

Our organization strongly supports the efforts of the IASB to improve International Financial Reporting Standards, in order to provide users of financial statements with information which is of better quality and of greater relevance, thereby aiding comparability.

We acknowledge that the current accounting model for leases has long been criticised for failing to meet the needs of users of financial statements. Therefore, we support the Board's objective to report relevant and representational faithful information to users of financial statements about the amounts, timing, and uncertainty cash flows arising from leases.

We do not believe that the current proposed ED fully meet this objective in a number of areas, which should be reconsidered by the Board members. These key areas include the measurement of more complex leases, scope exceptions, options to extend and contingent rentals, an in-depth study of the implications of the ED on the statement of comprehensive income, lessor accounting and transition. Moreover, its implementation would entail a substantial increase in costs and complexity for preparers. As a consequence of all these factors, the purpose of this letter is to express our disagreement with the aforementioned ED.

Nevertheless, in order to cooperate in improving the aforementioned standard prior to its definitive issue by the Board, we propose in this letter a number of solutions in each of these key areas, which we believe will enhance the benefits for users of the financial information, reduce income statement volatility (unjustified from our standpoint) that could arise as a



result of the current wording of the ED and, in many cases, also reduce the cost and complexity for preparers.

The IASB has received many comment letters on ED Leases and arranged meetings with companies due to concerns regarding the new standard. We believe that further development is required and that field tests should be performed on all the concerns and suggestions and on the Board's own considerations and, therefore, more time is required to make the final standard robust and ensure that it is supported by all users of financial statements.

We would be pleased to discuss our comments or answer any questions that the Technical Expert Group may have. Please contact our Secretary General, Juan Ignacio Diaz Bidart, (+34913529156; juan@fehrcarem.es or internacional@fehrcarem.es)

Yours faithfully,

A handwritten signature in black ink, appearing to read "Juan Ignacio Diaz Bidart", written over a horizontal line.

Juan Ignacio Diaz Bidart

Secretario General



APPENDIX – Response to questions in the Exposure Draft

The accounting model**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?*
- (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?*

We wish to manifest to you our concerns regarding certain aspects of the aforementioned ED which, in our opinion, may be not consistent with the conceptual framework established by the IASB itself. In this regard, we deem difficult to understand the change in the accounting treatment of the so-called right-of-use (ROU), as the definition of this ROU in the application guidance of the ED (B.4) is essentially the same that the one in the current standards (IFRIC 4.9) and the IFRS conceptual framework in which the criteria for the recognition of an asset in the financial statements are established remains unchanged.

It is said in the basis for conclusions on the ED (BC 7) that the proposals are consistent with the existing conceptual framework but none justification is offered for the aforementioned change of the treatment of an item which had not been previously considered as a recognizable asset. Although it is also said in the basis for conclusions on the ED that the consistency between the lease accounting model and the conceptual framework currently being developed would be possibly only once the framework project has advanced further, we deem it is an unwise approach to develop a conceptual framework to suit an already developed standard.

It is our conviction that the framework should be established in advance of any particular standard if the purpose is to develop a high quality complete and consistent set of rules and, in consequence, we do find the Board's approach rather troublesome, specially taking into account that the recognition and derecognition of assets has been a highly questioned point in the aftermath of the failure of some financial institutions.

We believe that the ED seems to have been developed on the conceptual premise that an asset is a bundle of rights. In our opinion, the logical implication of the said conceptual premise is that the lessor should derecognized part of the underlying asset and the lessee should recognized partially the same asset, or at least one of the same kind of the underlying (i.e. usually an item of property plant and equipment).

Moreover, we deem a worrisome approach to include in the financial statements not the assets that may fulfill the criteria for their recognition, but the rights of the issuer of the financial statements over the said assets, and believe that it can not be applied on a consistent basis (i. e. as the lessee recognizes the "right of use" trough the term of the lease instead of- partially- the leased item, the owner of an asset should recognize the "ownership"- or its economic effects such as the "right of use" trough the entire life of the asset, etc.- instead of the asset itself).

However, when evaluating specific aspects of the ED regarding the recognition of amortization and interest, additional concerns arises for preparers.

The application of the new standard for leases, as described in the ED, would have a significant impact on the statement of comprehensive income of issuers of financial statements. However, we consider that this matter has hardly been addressed in the analysis of the IASB, and therefore a more in-depth study of this area and its essential implications is required.

In order to assist in the consideration of the effect of the ED on the statement of comprehensive income, we set out below a brief summary of the most noteworthy matters.

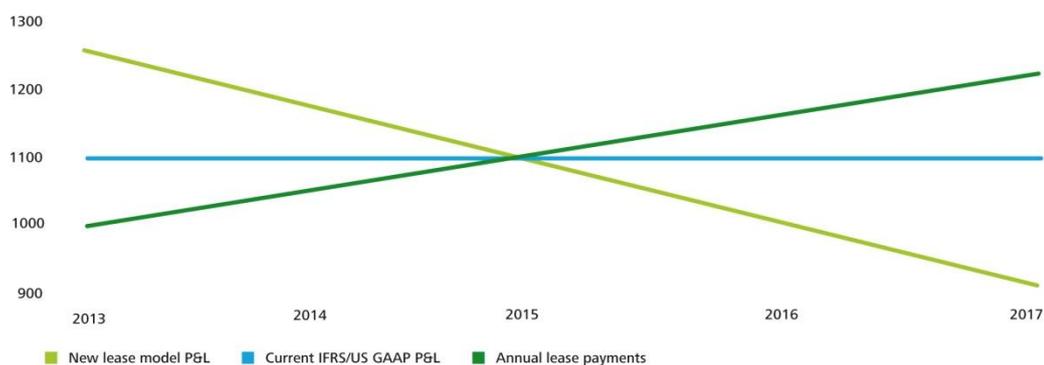
Under the current IAS 17, if the lease is classified as an operating lease, monthly lease payments are recognised in the statement of comprehensive income as an expense on a straight-line basis over the lease term. No asset or liability is recognised, except for the difference between the accumulated lease expense recognised on a straight-line basis and the actual amount paid.

Under the proposed model, the lessee would recognise a right-of-use asset and a corresponding obligation to pay rentals. The right-of-use asset would initially be measured at the present value of the future lease payments with a corresponding liability for the obligation to make lease payments, discounted using the lessee's incremental borrowing rate. The right-of-use asset would subsequently be amortised over the lease term, and the financial debt subsequently measured at amortised cost, with the corresponding charge to finance costs in the statement of comprehensive income.

The projected impact of this new accounting model on the lessee's statement of comprehensive income is that the sum of the amortisation of the right-of-use asset and the interest expense arising from the obligation to make future payments will exceed the rental expense recognised under the current IAS 17 during the first half of the lease but will subsequently be lower due mainly to:

- Amortisation of the right-of-use asset on a straight-line basis;
- Decreasing finance costs due to the measurement at amortised cost of the future lease payment obligations, as opposed to
- Rental expense recognised on a straight-line basis under the current IAS 17.

Chart 1. Expenses related to the lease



The analyses performed indicate that the new accounting model brings the lease expense forward to a considerable extent. This effect does not begin to reverse until approximately 55% of the lease term has elapsed and the expense is fully offset only at the end of the lease term.

This effect may have a highly considerable impact on profit before tax, entailing much lower returns on standard projects during more than the first half thereof, followed by higher returns. Consequently, under the new accounting model a project with a sustained cash-generating capacity over time would be heavily penalised in the statement of comprehensive income for a number of years, improving subsequently to reach a significantly higher rate than the actual performance of the project transactions, resulting in confused and counter-intuitive information that does not represent the reality of the business.

Unfortunately, it seems that the new accounting model for leases would not contribute to presenting transactions fairly because by altering the pattern of returns over time to a growth rate that does not coincide with the actual revenue generated by the projects, it breaks the fundamental income and expense matching principle.

In our view, various approaches could be adopted with respect to the recognition of the amortisation expense of a right-of-use asset that could be analysed in order to make the new model a better reflection of the pattern of returns over the life of projects operated under leases. These approaches could include a different distribution over time of the amortisation expense and finance costs to cover the entire lease term (such as an increasing amortisation model, which could be justified by the fact that the expected returns on the project also increase over time).

In this regard, an increasing distribution over time of the amortisation of right-of-use assets could have a net effect on the statement of comprehensive income similar to the application of the so-called “linked-approach”, without the fundamental disadvantage that gave rise to the tentative rejection of this approach by the IASB in its Discussion Paper (DP/2009/1), i.e. that the liability recognised by the lessee did not accrue interest. In addition to distributing the lease expense in order to reflect the consumption of benefits, it retains the benefits of the approach, which were also recognised by the IASB: a) it is simpler for lessees to apply; b) it aligns the statement of comprehensive income and the tax treatment of leases; and c) it reflects the way in which lease contracts are priced.

Another argument in favour of the increasing amortisation of right-of-use assets is the way in which amortisation is calculated. If we assume that in a contract between independent parties the future lease payments will essentially be equivalent to the use that the lessee expects to obtain from the underlying asset, the net present value of the rentals is also equal to the discounted value of the benefits that the lessee expects to obtain from the subject-matter of the contract. The value of the right-of-use asset decreases over time as it is used in the process to produce goods and services – which may reasonably be assumed to occur on a straight-line basis over the lease term – but increases due to the reduction in the discount rate applied to the future cash flows. In short, increasing amortisation better reflects the time pattern of the repeated use of the right-of-use asset.

Another alternative would be for the IASB to analyse in depth in what category of liability the obligation to pay rentals would fall. If this liability were considered to be a non-financial liability, the amortised cost method should not be used, as would be the case of a deferred tax liability. In this case, all the adverse effects described above would be mitigated.

Question 2: Lessors

- (a) *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?*
- (b) *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?*

Please refer to our response to Question 1 for a general view of our understanding of the ED model, from the lessor perspective also. Moreover, in any case, we cannot understand the reasoning for supporting the performance obligation model for lessors. This alternative implies significant risk that should be avoided at all cost.

One of the main risks derived from the performance obligation approach is that of double counting of the same asset, given that the lessor continues recognising the whole asset but also recognises a lease receivable.

The second risk is that still a distinction similar to that required under IAS 17 concerning the distinction between finance and operating leases is required under this new model, which would again let accounting records subject to accounting arbitrage due to its difficult application.

As a result, and bearing in mind our concerns expressed in our response to Question 1 about the accounting model, we support the partial derecognition approach for lessors.

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 profit or loss, 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 BC41–BC46.)

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

In our opinion, an adequate definition of the scope of the standard is critical to ensuring that the objectives thereof are achieved. In this regard, it is of utmost importance to determine which type of lease contracts must be covered by the new standard, and under which assumptions certain contracts may be excluded.

Also, in order to ensure that the application of the new standard does not become unnecessarily costly for the issuers of financial statements, there are certain aspects of the contracts which, in our opinion, must be taken into consideration in order to determine the application of the new standard to them. These aspects, in general, relate to the fact that the aforementioned contracts may or may not be significant in economic terms for the reader of the financial statements, compared with the cost and effort required to prepare them based on the requirements of the ED.

Certain of these aspects are as follows:

- a) Lease term: one of the factors that may serve as an indicator that the true objective of the lessee is not to take control of the asset or assume the risks and rewards of ownership is the term of the lease. We believe that the standard should include a clear definition of what should be considered to be a short-term lease.

In this regard, we consider that, probably, the time horizon of twelve months indicated in the ED could be reasonable, provided that other factors are taken into consideration such as the aforementioned relatedness of the leased asset to the lessee's core business, since it is habitual practice to arrange leases for a term of around 24 months (or even longer) for assets unrelated to the core business. The exclusion of such leases from the scope of the standard would not, in our opinion, significantly impair the information offered to users of the financial statements, although it would lessen the administrative workload arising from applying the standard for the lessees.

- b) Relation of the assets to the core business of the lessee: in general the leases taken out for assets not used in the lessee's core business are aimed solely at obtaining the use of such assets for a given period of time, or even the provision of a service, although rarely may it be considered that objective of the lease is to take control of the asset or acquire the risks and rewards of its ownership.

This is the case of the contracts entered into for the lease of administrative or back office equipment, such as computer hardware, reproprinting equipment, vehicles, etc.

In the case of leases for this purpose, the IASB should provide an exact definition of which assets are considered to be related to the lessee's core business and those which are not.

In our opinion, in accordance with the criteria set out above, the leases that were excluded from the scope of this standard could be accounted for in accordance with the current IAS 17.

Additionally, we believe that allowing the chance to opt on a lease-by-lease basis obstructs the aim of comparability of financial statements, and, therefore we support that such optional treatment is to be applied for all leases meeting similar characteristics in terms of nature of the asset, lease term, etc.

Definition of a lease

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?*
- (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?*
- (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?*

We believe that the criteria included in the ED to identify a lease give excessive weight to physical delivery or access to the asset, while it should be important to identify the business purpose of the transaction. In other words, when the lessee is mainly interested in receiving a service and is indifferent as to the specific asset used, the transaction should be treated as a service arrangement (please see our response to Question 3 Short-term leases when discussing the relation of the asset with the core business of the lessee).

Our view is that the criteria to identify a lease and for distinguishing leases and sales/purchases should be defined by reference to the scope criteria in paragraphs 25 and applicable guidance in the Revenue Recognition ED, in order to avoid any inconsistency.

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 can't see any reason to exclude intangible assets from the scope of the standard. However, we consider that it is important to once again bear in mind the aforementioned criteria (please refer to our response to Question 3: Short-term leases) as potential exclusions (both *short-term* and *non-core* distinction), since they should also be applied to intangible assets.

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 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?

We believe that there is an actual need to clearly define the treatment of leases which also include the provision of services. We consider that, based on the analysis of each lease, it is reasonable for the lessee and the lessor to recognise them in accordance with their predominant components.

On the other hand, in the case that the IASB was to request for further distinction to be performed, we consider that only the lessor, based on the best information available, could recognise separately the various components of the lease, based on the standard applicable to each. However, also in this case is of significant importance to bare in mind the criteria suggested in response to Questions 3 and 5 above regarding the scope of the standard, in order to avoid unnecessary administrative complexity.

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?

We disagree. We believe there should be no difference in the accounting treatment between a purchase option and a lease extension option as they both can be used by a lessee to provide some level of control over the asset beyond the initial lease term. One can view a contract that contains renewal options for the whole of the useful economic life of an asset as no different in substance to a purchase option. We are concerned that if the final standard contains guidance regarding purchase options that would result in very different accounting from that for renewal options, this could result in significant structuring opportunities. We believe that there should be consistent accounting between purchase options and extension options included in a lease contract. We believe, consistent with our proposals for lease extension options, that purchase options should be included if it is virtually certain they will be exercised. See our response to question 8 regarding our detailed views on how lease extension options and hence purchase options should be reflected.

Measurement

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 agree that options should not be separated from the underlying lease contract. However, we believe conceptually that payments that would become due if an option were to be exercised should only be recognised where the definition of a liability is met in the case of lessees and the definition of an asset is met in the case of lessors. We believe an option is fundamentally different from an asset and liability. Also, there are certain observations that we consider to be of particular significance in order to consider this matter:

- Rentals payable in an extension period do not meet the definition of a liability based on the conceptual framework;
- Rentals receivable in an extension period do not meet the definition of an asset based on the conceptual framework;
- The lessee may not have reliable information at every reporting date about future market rentals for the specific asset and, therefore, be unable to assess if the option to extend is favourable or not;
- The lessor may not be aware of lessee's decisions that may impact the likelihood of the renewals; and
- Including these amounts in the measurement of future payments increases volatility and may reduce comparability.

As a result of the foregoing, we disagree with Boards' proposal and we believe that it is ill advised to include rentals from optional extension periods in the recognition of lease contracts, which actually means determining the lease term as the first rental period, before any option to extend.

Also, we disagree with the proposal that the lease term should be 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. We believe that the proposal would result in entities recognising assets and liabilities associated with extensions option periods that do not meet the definitions in the conceptual framework. Instead we believe that the lease term should include only those extensions periods in respect of which the exercise of an extension option is virtually certain.

The Boards' aim was to provide users with information about the amounts, timing and uncertainty of cash flows, but we believe that this aim with respect to extension options would be better achieved through disclosures than through recognition on the statement of financial position.

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?

In view of the habitual term of leases for an entity's strategic assets, in order to comply with the provisions of the ED, issuers of financial statements will be obliged to make estimates of the various financial aggregates for protracted periods such as 15 or even 30 years, for example.

In the same way as other international standards, such as IAS 36, consider that the forecasts of future events made more than five years in advance may not be sufficiently reliable to support an impairment test and the impact thereof, if any, on the financial statements, it also seems logical to affirm that, in the case at hand, managing uncertainty would be no easier. Accordingly, in accordance with IAS 36.35, and due to the volatility of certain industries, the projections prepared by the issuers of financial statements in order to verify the existence of impairment has been limited to a maximum period of five years. Bearing this in mind, the current version of the new ED may give rise to an inconsistent approach to estimating future financial performance (IAS 36 only five years, compared to the new ED on leases that establishes the full term of the lease). This could even have a contradictory effect, since, depending on the circumstances, the issuers of financial statements could be obliged to recognise impairment losses for a cash generating unit with the related rights of use as a result of using financial projections at five years, whereas the right-of-use asset itself had been recognised on the basis of the full lease term.

In practice, the preparation of long-term projections is not very reliable. The element of uncertainty over such timeframes is highly significant and there are no sufficient means of mitigating such uncertainty to a reasonable extent.

We should also consider the nature of the contingent rent that we are dealing with. We can make a distinction between payments of various types:

- Contingent rent that is linked to the use of an asset (such as mileage), which is under the control of the lessee, since the latter decides to what extent to use it;
- Lease payments that are contingent on the performance of the asset are less under the control of the lessee, and are similar to a profit-sharing agreement;
- Lease payments that are contingent on an index or other variable are totally outside the control of the lessee (such as a price index).

It seems clear that the contingent rent that is linked to the use of an asset and those contingents on an asset's future performance do not meet the definition of obligation until the time when the asset is used or its performance is obtained, respectively. Similarly, the rent contingent on an index, although it could be considered to be obligatory, is difficult to determine and, therefore, the most reasonable approach would be to disclose it in the notes to the financial statements, but not take it into consideration in accounts, since once more they would be based on estimates that were difficult to verify and volatility would increase.

We the undersigned are convinced that the limitation on the use of estimates of future events and the simplification of the way in which such estimates are made is critical to the success of the new standard on leases.

To this end, based on the considerations set out above, we believe that the best alternative is to exclude contingent rent from the calculation of future lease payments, although the existence thereof should be disclosed in the notes to the financial statements.

Accordingly, the users of the financial statements would receive relevant information, and only the contingent rent already paid would have an impact on the financial statements, which would be in line with IAS 37: "A contingent liability also arises in the extremely rare case where there is a liability that cannot be recognised because it cannot be measured reliably. Disclosures are required for the contingent liability."

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?

The proposed new accounting model requires certain estimates to be performed at lease agreement inception and reassessed at each reporting date. Given the characteristics of the agreements entered into by preparers, these estimates refer mainly to the following matters:

- Duration of the lease agreement, conditional upon the exercise of options to extend it; and
- Future value of the drivers of contingent rentals, which are usually Gross sales and Gross operating profit (GOP).

In both cases, given the common duration of the lease agreements entered into by preparers, when seeking to comply with the ED, we will all be obliged to perform estimates of future decisions to be made by management (regarding the exercise of options to extend) and of several financial aggregates (when estimating contingent rentals) 15 or even 30 years in advance.

Therefore, at inception of the lease agreement, estimates should be performed of the future exercise of options to extend and of the future contingent rentals; and both kinds of estimates should be reassessed at each reporting date.

As indicated above, taking into consideration how uncertainty impacts the global economy, performing such estimates would be extremely complex and, moreover, their reassessment at each reporting date would introduce a significant volatility to the accounting records; in addition, this would probably make it very difficult to compare the financial information from different industry players and it will contribute for a great confusion by users and investor, therefore less reliance on such information.

Sale and leaseback

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 believe with the IASB's treatment for lessees in a sale/leaseback transaction, according to which if the transfer meets the definition of a sale, the seller/lessee will derecognise the asset and will recognise the lease based on the proposals in the ED; and if the transfer does not meet the definition of a sale, the seller/lessee will not derecognise the asset and will recognise a financial liability.

As for the performance obligation approach, please refer to our response to Question 2 regarding our support to only one partial derecognition model for lessors, and not the performance obligation approach.

Presentation

Question 12: Statement of financial position

(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?

(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?

(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?

(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?

Please refer to our response to Questions 1 and 2 above for our opinion about presentation of lease contracts in the financial statements and our considerations on the recognition of assets and liabilities from them derived. We believe there is sufficient guidance in IAS1 for IFRS preparers. We believe that an entity should decide whether separate presentation is necessary in the primary statements or whether it is adequate to provide the information in notes based upon materiality.

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?

Please refer to our response to Questions 1 and 2 above for our opinion about presentation of lease contracts in the financial statements and our considerations on the recognition of assets and liabilities from them derived. We believe there is sufficient guidance in IAS1 for IFRS preparers. We believe that an entity should decide whether separate presentation is necessary in the primary statements or whether it is adequate to provide the information in notes based upon materiality.

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?

In our opinion, in most cases such information is not that relevant to be presented separately in the Statement of cash flows, and it could just be disclosed in the notes instead.

Additionally, we believe that only an actual acquisition of assets should be presented as a cash flow transaction in the Statement of Cash Flows. Since it cannot be asserted that the ultimate purpose of all leases is to acquire assets (take control of the asset and assume the risk and rewards associated therewith), it would be confusing to treat all of them as purchase transactions financed by the lessor. Therefore, in order to prevent arbitrariness arising from the application of rules regarding the existence of indications of a purchase transaction, as under the current IAS 17 concerning the distinction between finance and operating leases, the separate effect of the cash flows from investing activities which are offset by the cash flows from financing activities for the same asset which, in reality, was merely held under a lease, should not be recognised in the Statement of cash flows.

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?*

Based on the considerations set out in our responses to Questions 7, 8 and 9 above, we believe that there are certain aspects of the rental agreements which should be excluded from the measurement of the initial Right-of-use asset and liability to pay rentals recorded at inception of the contracts. This aspects, such as options to extend, contingent rents and purchase options, would incorporate to accounting records a significant amount of uncertainty and volatility due to reassessment at every reporting date (please refer to our response to Question 10 above), and therefore, in our opinion, they should be subject to disclosure instead.

Transition

Question 16

- (a) The exposure draft proposes that lessees and lessors should recognize 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?*

Since, according to the ED, the new accounting model for leases would be applicable to all leases outstanding at the date of first-time application, the right-of-use asset and the liability that reflects the obligation to pay rentals would be recognised at the present value of remaining payments, using the lessee's incremental borrowing rate.

As indicated above, the time pattern of the lease expense is significantly modified under the new accounting model, bringing forward the recognition of the expense.

Let us take the example of an entity that carries on a series of projects under leases of which the portion of the lease term elapsed varies, i.e. the progress of the leases is distributed more or less uniformly over time in the entity's portfolio.

In this case, under the first-time application model put forward in the ED, regardless of the point in time of the leases at the transition date, the right-of-use asset and the obligation to pay rentals would be calculated on the basis of the remaining payments, i.e. a new time pattern for returns would begin for each lease in which returns would be artificially penalised for over half of the remaining lease and would not be linked in any way to the actual pattern of project returns.

However, if the new standard were applied full retrospectively for the first time, for the hypothetical entity described above with a balanced portfolio in terms of the lease term elapsed, such first-time application would situate the various leases at different points in time with respect to the pattern of returns, i.e. certain leases would be in the first stage of bringing forward expenses whereas others would be reversing the amount brought forward.

Consequently, we believe that it would be appropriate to establish as the basic scenario the full retrospective application of the new standard. There are no conceptual reasons to prohibit when entities have the relevant information available.

However, we understand that only in the case of an entity that has not available the relevant information to apply full retrospective approach, the IASB could allow simplified retrospective as an option for transition.

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?

In the absence of the Boards making significant improvements to the ED, we do not agree that the benefits would outweigh the cost. Whilst we appreciate the Boards addressing some of the significant criticisms of the current model (e.g., lessee's off-balance sheet financing), we have concerns that the burden for financial statement preparers to implement and maintain all aspects of the model will be very significant. For example, we anticipate practical difficulties in the measurement of lease payments, determination of lease term, reassessment of lease term and lease payment, and the volume and complexity of disclosure. The proposed model entails the use of significant estimates and judgements such that the burden to audit the accounting treatment will also be high.

Also, we do not believe the Boards members have captured all of the costs associated with the proposal, such as human capital, accounting systems, tax impacts, internal controls and processes, capital requirements for regulated financial institutions, and among others contracts with business partners.

We believe that with the alternatives we have described in our responses to the previous questions, the cost of compliance will significantly decrease while still achieving the Boards' objectives.