



11 January 2011

Barbara Davidson  
International Accounting Standards Board  
30 Cannon Street  
London  
EC4M 6XH

Dear Barbara

**Exposure Draft: Leases**

IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of £3.4 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, the Annual IMA Asset Management Survey shows that in 2009 IMA members managed holdings amounting to 40% of the domestic equity market.

In managing assets for both retail and institutional investors, IMA members are major investors in companies whose securities are traded on regulated markets and have an interest in the standards governing how such companies prepare their accounts and the information disclosed to them as users. In this context, we welcome the IASB undertaking this project with the FASB and developing a new approach to lease accounting and giving us the opportunity to comment. We support proposals to remove the arbitrary distinction between operating and finance leases, recognise the appropriate assets and liabilities on the balance sheet, and apply the right-of-use model for both lessees and lessors. These changes will help address users' concerns with a number of the requirements in IAS 17 which impaired transparency and comparability in accounts and resulted in many users making their own adjustments to the reported amounts. However, we have concerns with certain of the proposals which we set out below and our answers to the specific questions in the attached annex.

- We support lessees recognising assets under the right of use approach and lessors, having transferred those rights, accounting for the transfer in accordance with the derecognition model. However, we do not support a hybrid approach for lessors in that if there is an acceptable single model for lessee accounting, there should also be a single approach for lessors who should record a lease receivable symmetrical to the lessee's liability and include the residual value of the asset at the end of the lease term. We do not support the adoption of performance obligation accounting for lessors.

- We support some form of exemption for short-term leases. However, we do not support both lessees and lessors being able to opt for the accounting treatment on a lease-by-lease basis in that this will impair comparability. If the reporting entity opts for a particular treatment then the same treatment should be applied to all short-term leases and the policy should be clearly disclosed.
- The criteria in B9 and B10 for distinguishing a lease from a purchase and sale contract are helpful. However, the criteria in B9 that a contract represents a purchase and sale if, at the end of the contract, an entity transfers control and all but a trivial amount of the risks and benefits associated with the entire underlying asset are inconsistent with the ED 'Revenue from Contracts with Customers' which only require the transfer of control. This inconsistency should be addressed.
- We agree that an asset is owned rather than leased when a purchase option has been exercised and the lease contract should be considered terminated at this juncture. However, there is a recognition issue to be addressed as to whether the option has a value that needs to be separately recognised as an asset in the statement of financial position of the lessee - the amount payable under the option is not a lease payment as there is no obligation under the lease contract to pay the exercise price.
- We do not agree with the lease term being the longest possible taking into account any options to extend or terminate the lease. This could result in the same liability being recognised for a straight 10 year lease and a 5 year lease which has an option to renew for another 5 years when there is no obligation to pay for the latter 5 years until the option is exercised. The lease term should be limited to the minimum contractual lease term, with the option to extend only recognised when it is virtually certain. However, an option to extend should not be ignored but would be better addressed through disclosure.
- We share the concerns in AV5 to AV8 over contingent rentals. We support them being taken into account where they are contingent on an index or rate. In such instances the rentals are an unconditional obligation in that the uncertainty only relates to the amount payable. However, where they vary according to usage or performance, the lessee is afforded flexibility and control and the lessor has an increased exposure to asset risk. We do not consider reflecting these in the lessee's liability and the lessor's asset reflects the true economics of the transaction and as such, they should not be included.
- We understand that preparers in particular are concerned about the costs of the proposals and their impact. Given our concerns about a number of the proposals as set out above, we would encourage the IASB to undertake further outreach on the costs and benefits before finalising the IFRS.

Please contact me if you would like clarification on any of the points in this letter or the attached, or if you would like to discuss any issues further.

Yours sincerely



LIZ Murrall  
Director, Corporate Governance and Reporting

## **IMA's ANSWERS TO THE DETAILED QUESTIONS RAISED**

IMA's answers to the detailed questions raised are set out below.

***1 (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?***

IMA agrees with the proposal that a lessee should recognise an asset under the right of use approach and a liability to make lease payments. A right of use model goes some way towards addressing the concerns of users in that many made their own adjustments to the amounts recognised to reflect the entity's leasing activity. In addition, IAS 17 afforded the opportunity for leasing transactions to be structured which does not assist transparency and comparability in accounts.

***1 (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?***

IMA agrees that, if the right of use model is applied, it is appropriate to amortise the asset and recognise interest on the liability.

***2 (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?***

***2(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?***

IMA does not support a hybrid approach for lessors in that if there is an acceptable single model for lessee accounting, there should also be a single approach for lessors who should record a lease receivable symmetrical to the lessee's liability and include the residual value of the asset at the end of the lease term. We do not support the adoption of performance obligation accounting for lessors.

***3: 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?***

We support some form of exemption for short-term leases. However, we do not support both lessees and lessors being able to opt for the accounting treatment on a lease-by-lease basis in that this will impair comparability. If the reporting entity opts for a particular treatment then the same treatment should be applied to all short-term leases and the policy should be clearly disclosed.

***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?***

IMA agrees with the proposed definition of a lease.

## **IMA's ANSWERS TO THE DETAILED QUESTIONS RAISED**

### ***4 (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?***

The criteria in B9 and B10 for distinguishing a lease from a purchase and sale contract are helpful. However, the criteria in B9 that a contract represents a purchase and sale if, at the end of the contract, an entity transfers control and all but a trivial amount of the risks and benefits associated with the entire underlying asset are inconsistent with the ED 'Revenue from Contracts with Customers' which only require the transfer of control. This inconsistency should be addressed.

### ***4 (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?***

The guidance in paragraphs B1–B4 sets out why some transactions fall to be classified as leases without addressing specific examples of transactions that are service contracts. Practical examples of both types of transaction would be helpful as otherwise this implies if a contract is not a lease then it is a service contract rather along the lines in IAS 17 which defines an operating lease as a lease other than a finance lease.

### ***5. 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?***

IMA agrees with the proposed scope of the IFRS and generally with BC 36 in that, whilst there is no conceptual basis for excluding intangible assets from the proposed IFRS, it is pragmatic to do so. In this context, IMA noted in its response to the ED 'Revenue from Contracts with Customers' that it believed with regard to licences, it should be clear from the underlying commercial substance as to whether these fall within the definition of leasing contracts in which case they should be covered by a future leasing standard.

### ***6. 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?***

IMA supports the IASB's proposal that a lessee should apply the lease accounting requirements to the combined contract as subjective judgement could lead to different accounting across entities which would impair comparability in accounts.

With regard to the lessor, since IMA favours a single accounting model, the component that represents the undelivered service should be excluded from the lease receivable. It should not be difficult to identify this amount as it will have been taken into account when pricing the contract.

### ***7. 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 agree that an asset is owned rather than leased when a purchase option has been exercised and the lease contract should be considered terminated at this juncture. However, there is a recognition issue to be addressed as to whether the option has a value that needs to be separately recognised as an asset in the statement of financial position of the lessee -

## **IMA's ANSWERS TO THE DETAILED QUESTIONS RAISED**

we agree that the amount payable under the option is not a lease payment as there is no obligation under the lease contract to pay the exercise price.

***8. 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?***

IMA does not agree with the lease term being the longest possible taking into account any options to extend or terminate the lease. This could result in the same liability being recognised for a straight 10 year lease and a 5 year lease with an option to renew for another 5 years when there is no obligation to pay for the latter 5 years until the option is exercised. The lease term should be limited to the minimum contractual lease term, with the option to extend only recognised when it is virtually certain. However, we acknowledge that an option to extend should not be ignored but would be better addressed through disclosure.

***9. 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?***

IMA shares the concerns in AV5 to AV8 over contingent rentals. We support them being taken into account where they are contingent on an index or rate as they are an unconditional obligation in that the uncertainty only relates to the amount payable. However, where they vary according to usage or performance, the lessee is afforded flexibility and control and the lessor has an increased exposure to asset risk. We do not consider that reflecting these in the lessee's liability and the lessor's asset reflects the true economics of the transaction and they should not be included.

***10. 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?***

IMA agrees that lessees and lessors should remeasure assets and liabilities arising under a lease when 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. The remeasurement of contingent payments should only apply in relation to those that are taken into account (see 9 above).

## **IMA's ANSWERS TO THE DETAILED QUESTIONS RAISED**

***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?***

IMA agrees 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 the same criteria should be used for a sale as those used to distinguish between purchases or sales and leases. However, we note our concerns about the criteria in B 9 in 4 (b) above. B 31 contains additional examples that do not result in a purchase or sale. This seems to indicate that the sale in a sale and leaseback situation is different from a straight sale. All the purchase/sale information should be in one place and should be consistent. Nor do we agree that the transferee/lessor should account for the purchase in accordance with the performance obligation approach as is required by paragraph 68 (a) in that we favour a single approach for lessors (see 2 (a) above).

***12 (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?***

IMA agrees with the proposals for separate presentation of right-of-use assets and the liabilities to make lease payments by lessees. Users will find this helpful to determine how core assets are funded.

***12 (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?***

IMA supports a single approach for lessors based on the derecognition model. However, if the hybrid model is adopted, when applying the performance obligation approach disclosing this information on the face of the balance sheet adds clutter that would be better placed in the notes.

***12 (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?***

IMA agrees that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets but residual assets should not always have to be classified as property, plant and equipment. Such classification could be misleading if the lessor uses leases as an alternative means of realising value from the goods it would otherwise sell such that the residual assets would be more appropriately

## **IMA's ANSWERS TO THE DETAILED QUESTIONS RAISED**

classified as inventory. (Paragraph 61 of the ED acknowledges the different business models of lessors by requiring separate line items in the statement of comprehensive income for lease income and expense when this particular business model is used.)

***12 (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?***

IMA agrees with the proposal for separate presentation of the amounts that relate to the sublease.

***13. 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?***

IMA agrees with the separate presentation of lease income and lease expense.

***14. 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?***

IMA agrees with the separate presentation. It will assist in providing a clearer picture of the reporting entity's leasing activity.

***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?***

IMA agrees with the disclosure proposals particularly paragraph 71 which requires entities to consider the level of detail necessary to satisfy the disclosure requirements. Users prefer quality information rather than quantity.

***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?***

IMA acknowledges that mandatory full retrospective application would be too onerous for some reporting entities and that it is, therefore, necessary to allow a simplified retrospective approach.

## **IMA's ANSWERS TO THE DETAILED QUESTIONS RAISED**

### ***16(b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?***

IMA would welcome full retrospective application being permitted. Users want to be able to compare previous and current year information based on the same accounting treatment. If this were to be an option, on first time application it would be necessary for the reporting entity to disclose its approach on transition.

### ***16 (c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?***

IMA has no further points to make on transitional issues.

### ***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?***

IMA welcomes the boards' consideration of the needs of users in drafting the ED. However, we understand that preparers in particular are concerned about the costs of the proposals and their impact. Given our concerns about a number of the proposals, we would encourage the IASB to undertake further outreach in this area before finalising the IFRS.

### ***18. Do you have any other comments on the proposals?***

IMA has no further comment on the proposals.