ASSILEA
Associazione Italiana Leasing

IASB/FASB EXPOSURE DRAFT-LEASES

17th august 2010

ASSILEA RESPONSE TO EFRAG'S DRAFT COMMENT LETTER

26th November 2010

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Assilea, the trade association representing leasing in Italy, very much welcomes the "Exposure Draft Leases – EFRAG's draft comment letter" as it represents an opportunity to provide comments for the purpose of improving future lease accounting standards.

Please find summarized below the view on the ED Leases' main topics that we have expressed in a more detailed way by providing our responses to the EFRAG in the attached comment letter.

- We share EFRAG's view that the ED Leases proposes criteria for distinguishing leases and sales/purchases which are inconsistent with those set in the ED Revenue from Contracts with Customers. However we do not support the choice to qualify as a sale a lease agreement containing a "bargain" purchase option.

- We support the derecognition approach for all leases even if we acknowledge that there are practical issues of applying this approach for the leases where only a portion of the asset is leased or where the lease term is for a period substantially less than the life of the asset. However, based on our business model, as the residual value of the underlying asset at the commencement of the lease is equal to the present value of the residual asset fair value at the end of the lease, we believe that the unwinding of the discount on such residual value should be recognised during the contract life.

- We share EFRAG's concern about possible distorting effects which may arise in practice if similar contracts, including both renewal or purchase options as alternative solutions, are managed with a different accounting treatment. We believe that both renewal and purchase options do not differ greatly from one another and thus they not require a different accounting treatment. Therefore, we believe that a different accounting treatment for them would be inconsistent.

- We agree with EFRAG's arguments supporting the need to distinguish between contingent rentals deriving from factors under the lessee control and contingent rentals based on factors outside the parties' control. Consequently we express our concerns about the complexity resulting from the proposal contained in ED Leases.

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- We express our concern about economic effects that might occur in lessees' financial statements as a consequence of adopting the proposed accounting model, should the right-of-use be accounted in accordance with the amortized cost method. We think that the economic substance of a lease cannot be reflected by considering the right-of-use and the linked liability as separate items. We think that the economic characteristics and risks of the lease are closely related and it would therefore be conceptually inappropriate to prescribe accounting treatments that do not reflect this intrinsic characteristic of the transaction. More specifically, we think that the inconsistency in accounting treatment that would derive in the lessee's financial statements where it does not adequately present the link between the right-of-use and the lease payment liability, would not be substantially different from the accounting mismatch identified in IAS 39 and also referred to in IFRS 9. In our opinion, by solving the accounting mismatch, the IASB has clearly expressed its intention to remedy the situations where the application of a different accounting treatment to assets and liabilities which are closely related does not allow presenting a transaction in accordance with its substance.

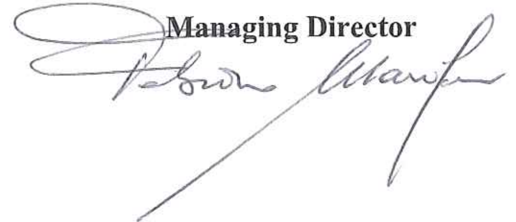
If you wish to discuss our comments further, please do not hesitate to contact us.

Your sincerely.

ing. Fabrizio Marafini

Italian Leasing Association

Managing Director



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IASB/FASB EXPOSURE DRAFT LEASES 17th AUGUST 2010
ASSILEA RESPONSE TO EFRAG'S DRAFT COMMENT LETTER

Question 1: Lessees

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

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

EFRAG's response to question 1

EFRAG acknowledges that the model has conceptual merits and can be supported, subject to the development of robust criteria for distinguishing between leases and service contracts.

4[1] EFRAG agrees that the existing model in IAS 17 has limits and application issues. Therefore, we appreciate the IASB' s efforts to develop a new approach to address these issues.

5 As explained in Appendix 1, EFRAG believes that the IASB has not provided a robust rationale to support the right-of-use model. We also have a number of concerns about some specific aspects of the model that are addressed in our responses to Questions 6 to 10 below. However, on balance we believe that a right-of-use model provides useful information and satisfies users' needs about recognition of assets and liabilities arising from leases. Therefore, EFRAG has concluded that it can support the right-of-use model.

6 As further explored in our response to Question 4 below, under the proposals the accounting treatment of lease transactions and service arrangements is significantly different. Therefore, it is crucial that the definition of a lease be further improved to distinguish clearly leases from services.

7 We agree that if the right-of-use model is applied, a lessee should recognise amortisation of the right-of-use and interest on the lease liability. We agree that neither the right-of-use nor the lease liabilities are required to be measured at fair value.

Assilea Response to Question 1

Even though we consider inconsistent the fact that - in determining the present value of lease payments payable - a lesse shall include optional periods, an estimate of contingent rentals payable, an estimate of amounts payable to the lessor under residual value guarantees and an estimate of expected payments to the lessor under term option penalties because all these are uncertain elements distinct from the contractually unavoidable rental payments and moreover of no use for users of financial statements (see responses 7 to 10), however we fully support the "right of use" as the only approach that clearly explains the real specific lessee's legal-economic position compared with lessor's; we also agree with EFRAG about recognition of the "right to use" asset in the statement of financial position and a liability to make lease payments.

The accounting novelty - despite IAS 17 - should lead to a complete and understandable picture of an entity's leasing activities telling freehold from leasehold properties and giving evidence of the actual debt in accordance with the "*faithful representation*" declared by Framework paragraphs 33-34 (pargraphs QC12-QC16 of the new Framework version) and embedded also in the Italian civil law (see article 2423 Italian civil law).

[1] Efrag's answers numbering is the same as in the "draft comment letter".

We agree that a lessee should recognise interest on its liability to make lease payments and amortisation of the right of use asset (even though not on a systematic basis but in accordance with a *linked approach* (see response to question 10) in Profit &Loss.

With regard to arrangements containing both lease and service components, we think that it's not always an easy task to distinguish the 'right of use' from the service component because of the lease definition as at IASB/FASB exposure draft.

This kind of uncertainty is extremely warned in those contracts that the IAS 17 in force today describes as operating leases despite of finance leases (in these latters contracts, indeed, the two arrangements are often separated).

Question 2: Lessors

Do you agree that a lessor should apply the performance obligation approach when the lease exposes the lessor to significant risks and benefits associated with the underlying asset, and a derecognition approach otherwise? Why or why not? If not, what alternative model would you propose and why?

Do you agree with the boards' proposals for recognition of assets and 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?

EFRAG's response to question 2

EFRAG supports a single partial derecognition model for lessors.

11 The current proposals require lessors to use a hybrid model based on exposure to the risks associated with the underlying asset. If the IASB is persuaded that there are valid arguments to support a hybrid model for lessors (which EFRAG does not believe) but not for lessees it should provide a clear rationale for why it is the case.

12 Paragraph BC25 of the ED states that one approach to lessor accounting would not be appropriate for all leases due to the differences in the economics of the transactions (or business models for different transactions). We are not convinced by this argument as the same can be said about lessees. Some lease arrangements are entered into by lessees as an alternative way to finance the acquisition of the underlying asset while in other cases they merely intend to obtain the use of an asset for a limited time.

13 As mentioned in Appendix 1 to this letter, the IASB seems to have adopted a conceptual premise based on the view that an asset is a bundle of rights. The performance obligation model does not appear to be consistent with this premise. The requirement to recognise a right-of-use asset and a liability by the lessee implies that a transfer has been executed by the lessor – and therefore the lessor should be able to derecognise an asset or part of it.

14 Paragraph BC7 of the ED states that in the IASB' s view a lease ceases to be an executory contract after the date of commencement of the lease. When the lessor provides access to the underlying asset, the lessee has an unconditional right to use it and the lessor cannot prevent the lessee from using the asset. If the lessee has an obligation for the full term when it obtains initial access to the asset then it follows that from that moment the lessor has completed the execution of its part of the transaction.

15 Paragraph BC18 of the ED explains the rationale for the performance obligation approach and states that lessors should recognise revenue when their performance obligation is performed, as required in the proposals of the Revenue Recognition ED. The IASB' s view is that the

performance obligation of the lessor is to permit the lessee to use the underlying asset over the lease term, and that this obligation is satisfied continuously during the lease term.

16 EFRAG believes that there is a contradiction between the view in paragraph BC18 and that in paragraph BC7, under which the lessee has an unconditional obligation to pay for the right-of-use over the full lease term as soon as the lessor has provided access.

17 Another weakness of the performance obligation approach is that the lessor continues recognising the whole asset but also recognises a lease receivable. The lease receivable embodies part of the future cashflows that the underlying asset will generate for the lessor, therefore recognising it without derecognising part of the underlying in our view results in a double counting of the same asset.

18 For the reasons above, EFRAG supports a single derecognition model for all leases. We also believe that the IASB should try to avoid a hybrid model that would closely duplicate the distinction in the existing IAS 17 between finance and operating leases. As indicated in Chapter 1 of the Discussion Paper, many criticise the current model because distinction is difficult to operate and leads to accounting arbitrage.

19 Some argue that it is more appropriate to differentiate between lease transactions based on the nature of the risk the lessor is exposed to: when a lease is in substance a secured sale, the lessor is only exposed to credit risk, while in other cases the lessor maintains a degree of exposure to the asset risk.

20 However, EFRAG notes that the proposed approach is a partial derecognition approach under which the lessor is required to maintain the residual asset in its books. Therefore, the derecognition approach does not fail to represent that the lessor may still be exposed to some asset risk.

21 Those who oppose the derecognition model seem mainly concerned that the lessor could recognise revenue for services that have not yet been delivered to the lessee; and the lessor would recognise a Day-1 gain for all lease transactions.

22 EFRAG notes that the first concern is addressed by the requirement that a lessor applying a derecognition model shall separate service components even when they are non-distinct.

23 EFRAG believes that the recognition of a gain is conceptually consistent with a derecognition model. We also note that such a Day-1 gain would only arise if the lessor is in an economic position similar to a that of a manufacturer/dealer. Both under the current proposals and under the existing IAS 17, Day-1 manufacturer/dealer gains would be recognised immediately.

Assilea Response to Question 2

We agree with EFRAG's response but we suggest improving the partial derecognition model because we believe the "*frozen*" subsequent measurement of the 'residual asset' is faulty. The residual – indeed – should be accreted at the rate in the lease as this reflects the way the lessor's right become progressively less encumbered by the lease as the contract term progresses. However, based on our business model, as the residual value of the underlying asset at the commencement of the lease is equal to the present value of the residual asset fair value at the end of the lease, we believe that the unwinding of the discount on such residual value should be recognised during the contract life.

Question 3: Short-term leases

The exposure draft proposes that a lessee or a lessor should apply simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term 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 and 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 short-term leases in the statement of financial position, nor derecognise any portion of the right to use the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit and 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?

EFRAG's response to question 3

EFRAG believes that the IASB should propose a more meaningful relief for lessees.

26 EFRAG believes that the main burden for lessees of applying the proposed model to short-term leases is the cost of identifying and tracking a large number of expected lease payments, rather than the cost of discounting those lease payments. Also, the application of the accounting model for lessees may prove complex, especially when the contract includes contingent rentals. Therefore, we are not persuaded that the simplification proposed for lessees offers much relief in practice.

27 Paragraph BC43 of the ED states that a scope exemption for short-term leases would introduce an artificial distinction between leases that are recognised and leases that are not.

28 EFRAG agrees that short-term leases are not inherently different from other leases. However, EFRAG notes that users mainly criticise the existing model in relation to long-term arrangements that involve core operating assets. In other words, users do not seem to be concerned about short-term leases of non-core assets such as cars or hotels room not being recognised in the statement of financial position.

29 For this reason, EFRAG supports an exception to the general model on practical grounds and proposes that lessees apply to short-term leases the treatment of operating leases in the existing IAS 17.

30 EFRAG does not believe it is appropriate to extend a similar exception to other leases. Therefore, a robust definition of short-term leases is needed to prevent extending this exception. We suggest specifying that entities should consider the economic substance of clauses to determine if contracts include any options to extend the term beyond 12 months.

31 Paragraphs 64 and 65 of the ED allow lessors and lessees to choose on a lease-by-lease basis whether to use the simplified requirements or not. EFRAG is concerned that this option affects comparability and believes that lessors and lessees that decide to use the simplified requirements (or the exemption proposed by EFRAG) should apply them to all short-term leases.

Assilea Response to Question 3

We fully agree with EFRAG's response.

Question 4: Definition of a lease

(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 for distinguishing a lease from a purchase or sale in paragraphs B9 and B10? Why or why not? If not, what alternative criteria would you propose and why?
(c) Do you think that the guidance provided for distinguishing leases from service contracts in paragraphs B1-B4 is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

EFRAG's response to question 4

EFRAG believes that the criteria to identify a lease put excessive weight on the physical delivery or access to the underlying physical asset rather than the benefit or the right-of-use that is actually transferred with the lease itself.

EFRAG believes that the criteria for distinguishing leases and sales/purchases are inconsistent with those set in the Revenue Recognition ED.

Is the lease defined appropriately?

34 EFRAG notes that the boundary between leases and service contracts will be difficult to determine. We are not convinced that the criteria indicated in IFRIC 4 Determining whether an Arrangement contains a Lease (that have been in substance carried forward to the Exposure Draft) will provide the necessary robust and operational distinction required to determine which (very different) accounting treatment is appropriate and most meaningful for each specific transaction. We believe that the criteria 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.

35 EFRAG thinks that the IASB should further clarify and improve the criteria in paragraphs B2 to B4. We disagree with the way the proposals define the notion of specific. We think that a key feature is whether the asset used is easily exchangeable or replaceable by another that can provide substantially the same goods or services. When transactions involve non-specialised assets or assets that are not strictly related to the activity of the entity, those transactions are more likely to be entered into to obtain a service rather than the right to use the underlying asset. For example, a broadband customer will usually receive a modem or router that meets specifications set by its internet provider, such an asset is an unavoidable necessity rather than something the customer set out to acquire.

36 We also believe that the ability of the supplier to replace the assets and continue providing the required goods or services is a key indicator of whether the customer is interested in the asset as such or whether the asset is merely a 'vehicle' for receiving a service. In this context it is irrelevant that the supplier does not have a practice to replace the assets.

Do you agree with the criteria for distinguishing leases and sales/purchases?

37 We note that the IASB identifies purchases/sales in those arrangements that transfer the control of the underlying asset and all but a trivial amount of the risks and benefits associated with the

underlying assets. The wording indicates that both conditions have to be satisfied. However, we note that the two criteria indicated in paragraph B10 (automatic transfer of title and existence of a bargain purchase option) only deal with the transfer of control and not the exposure to risks and benefits.

38 A lessor may retain an exposure to the risks and benefits of an asset when the lease payments are adjusted to reflect the fair value at the end of lease term. We agree that an entity should consider all relevant facts and circumstances, but it may be useful to include additional indicators in paragraph B10.

39 We are concerned that the proposal is not fully consistent with the Revenue Recognition ED which only requires the transfer of control as a condition to recognise a sale. We believe that in some circumstances (for instance, when contingent payments exist) a transaction would not qualify for as a sale under the Leases proposals but may qualify as such in the Revenue Recognition ED.

40 To avoid any inconsistency we would recommend that the scope exemption for sale/purchases in the Leases proposals would be defined by reference to the scope criteria in paragraphs 25 and applicable guidance in the Revenue Recognition ED.

Assilea Response to Question 4

We don't fully agree with the EFRAG's response because closely duplicates the distinction in the existing IAS 17 between finance and operating leases by criticizing the lease definition as from the ED. We support the "specific asset" principle in order to distinguish a lease arrangement from a service one. Any criteria based on lessee's services interest would be – indeed - doubtful.

We agree with EFRAG about the fact that there is no conceptual basis for excluding from the scope of the draft IFRS, all leases including a 'bargain purchase option' so that most of the "Italian" finance leases would be treated as 'instalment sale' with heavy bankruptcy, regulatory, tax and legal, consequences.

We also believe that the 'Leases ED' proposal is not fully consistent with the Revenue Recognition ED which only requires the transfer of control as a condition to recognise a sale (see par. 39-40 in the draft comment letter).

Moreover this 'scoping out' of leases (including bargain purchase options) from the new IFRS - on a hand - shall be inconsistent with EFRAG's will to get a separated evaluation of the options when the only valuable options would be the bargain purchase options.

On the other hand there is no reason why the "*scoping out*" doesn't affect the arrangements with residual value guarantees to the lessor by the lessee or the arrangements with net present value of the lease payments equal or higher than the asset original fair value, that both actually lead to the same outcome of a bargain purchase option.

In the end, the proposal to distinguish a lease from an instalment sale based on a discretionary power generated by the scope out above, clashes with IASB purpose to eliminate the distinction in the existing IAS 17 between finance and operating leases.

Question 5: Scope and 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, 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?

EFRAG's response to question 5

EFRAG believes that there is no conceptual basis for excluding intangible assets from the scope of the proposals.

46 EFRAG notes the following implications of the decision to exclude intangible assets from the scope of the Lease proposals:
(a) Lessors of intangible assets shall use the guidance in the Revenue Recognition ED that provides criteria to decide if a contract should be treated as a sale or a license of an intangible asset, and how to account for these transactions.
However, there will be no accounting guidance for lessees of intangible assets;
(b) In some circumstances, the recognition of revenue on license of exclusive rights to intangible assets may be different in the Revenue Recognition ED from what it would be under the Leases proposals; and
(c) Options to purchase or extend the term of the license are treated differently in the Revenue Recognition ED and in the Leases proposals therefore the measurement of the revenue and receivable will differ.

47 Also, EFRAG notes that contracts may include both tangible and intangible assets, as is the case in the IT industry where many lease solutions include both equipment and software. Entities will have to segment those contracts and apply different requirements to each component. We believe that this creates additional complexity that does not benefit user.

48 The exclusion of all intangible assets from the Leases proposals represents a backward step from IAS 17, which excludes only some intangible assets from its scope. EFRAG agrees with the IASB's statement in paragraph BC36 of the ED that there is no conceptual reason to exclude lease of intangible assets and we think that this exclusion may lead to a different accounting treatment of transactions that have similar economic substance.

49 While recognising the complexities involved in applying the notion of date of commencement to intangible assets, EFRAG encourages the IASB to do further work on the issue and explore the possibility to include intangible assets in the proposals.

50 EFRAG supports the proposed specific requirements for investment property valued at fair value in accordance with IAS 40 Investment Property. We agree that measuring these assets at fair value provides relevant information to users so it is appropriate to maintain this option.

51 We note that both the definition of investment property in IAS 40 and some of the examples in paragraphs 8 and 9 in that Standard are based on the distinction between finance and operating leases. Since the proposals remove this distinction, consequential amendments to IAS 40 should be made to clarify when a property held under a lease is considered an investment property.

Assilea Response to Question 5

We fully agree with EFRAG's response.

Question 6: Contracts that contain both service 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, B6-B8 and BC47-BC54). If the service component in a contract that contains service components and lease components is not distinct. The FASB proposes that the lessee and lessor should apply the lease accounting requirements to the combined contract.
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 appropriate? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

EFRAG's response to question 6

EFRAG believes that when a contract includes both lease and non-distinct services, a lessee should identify the predominant component and treat the whole contract accordingly.

EFRAG believes that the lessor should always be required to account for the services and lease components of a contract separately.

53 EFRAG has concerns about the proposals for the treatment of arrangements that have both service and lease components.

54 We agree that entities should assess if services are distinct using the criteria in the Revenue Recognition ED. However, we have a concern about these criteria that we expressed in our comment letter on the Revenue Recognition ED.

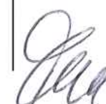
55 EFRAG believes that an entity should consider its own business practices in determining how to unbundle performance obligations. The wording of paragraph 23
(a) of the Revenue Recognition ED suggests that an entity should also consider what other entities do. We disagree with this and believe that unbundling should be based solely on an entity"s own business practices.

56 EFRAG in general supports symmetry of treatment between lessors and lessees; this is especially useful when the same entity is a lessee in a head lease and a lessor in a sub-lease of the same asset (or portion of the same asset). However, when an arrangement includes a lease and non-distinct services, EFRAG accepts that there may be different requirements for lessors and lessees because the two parties are unlikely to have access to the same information when non-distinct services are included. When services cannot be purchased separately, lessees are unlikely to have information to allocate payments reliably. Therefore, we agree that it would not be appropriate to force a lessee always to separate the contract into the different components.

57 EFRAG disagrees with the rule to apply lease accounting to the whole contract if it includes both service and non-distinct service components. We believe that entities should rather picture the economic substance of the transaction. To do so the lessee should assess what the predominant component is, then treat the whole contract accordingly. Identifying the predominant company requires a lesser degree of precision than identifying the relative fair values of each component, and lessees should be able to achieve it in most cases.

58 On the other hand, EFRAG believes that lessors are generally able to determine this information even when there is no market for these services because they need the information on the cost of all service components to price their contracts and handle a much larger volume of transactions than lessees. We think that this holds true regardless of the accounting model that the lessor applies.

59 Having a different requirement based on the accounting model creates an inconsistency in the presentation of the financial position: when lessors apply the derecognition approach, the receivable will not include the amounts for undelivered non-distinct services, while when they apply the



performance obligation approach it will. EFRAG believes that the lessor should always be required to separate lease and service components, whether they are distinct or not.

60 EFRAG notes however that an entity that acts simultaneously as lessee and lessor of the same asset (or portion of it) has the information to separate the contract also in its capacity as a lessee.

Assilea Response to Question 6

We do not agree about the proposal to separately account in any case the two components in the lessor's financial statement (service and lease components are distinct or indistinct) because this kind of approach is inconsistent with the "right of use" principle. We agree with EFRAG about the proposal to account for alternatively a lease or service arrangement in the lessee's financial statement based on the "preponderance" criterion.

Question 7: Purchase options

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

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

EFRAG's response to question 7

EFRAG does not see a conceptual reason to treat options to purchase and options to extend a lease differently.

EFRAG believes that options should be recognised and measured separately.

64 As explained below in the response to Question 8, EFRAG believes that options should be recognised separately and measured based on their value.

65 EFRAG does not see a conceptual reason to treat options to purchase and options to extend a lease differently. We do not agree with the argument presented in paragraph BC64 of the Exposure Draft that the exercise price of an option is not a lease payment. We think that if the IASB adopts a "single asset and single liability" approach as opposed to a component approach, a purchase option is as integral to the agreement as an option to renew.

66 EFRAG is concerned that the proposals regarding purchase options result in very different accounting for scenarios that are similar. Under the proposals, the presence of a bargain purchase option results in treating the arrangement as a purchase; but when the option is not considered a bargain purchase option, then it is to be ignored until it is exercised. This difference in treatment is likely to give rise to application issues. Also, if the purpose is to assist users in predicting future cashflows, exclusion of options that are likely to be exercised decreases the relevance of the information.

67 We also note that if a lease arrangement includes both options to extend and options to purchase, a difference in accounting treatment has confusing consequences. For example, assume a lease arrangement that at the end of its contractual duration of 5 years has either an option to extend for another 5 years or an option to purchase:

(a) If the lease is expected to be extended, the lessee recognises a right-of-use asset and a liability amounting to the rentals due over the 10 years;

(b) If the lessee is expected to exercise the purchase option, the lessee will only recognise a right-of-use asset and a liability amounting to the rentals due over the 5 years contractual term without considering the purchase price. A lessee that is expected to use the purchase option ends up with a lower liability, although the payment under the purchase option may be higher than the rentals for a 5-year extension.

68 Also, it is possible to change the initial assessment of the likelihood of the two scenarios and this reassessment would result in a significant change of accounting for the transaction.

69 Based on the above, we disagree with the proposal that options to purchase should be ignored until they are exercised. We believe that they should be separately recognised and measured and we suggest doing the same with options to extend as explained in our answer to Question 8.

Assilea Response to Question 7

We support EFRAG's comments. We believe that the renewal and purchase options, which may be contained within the lease arrangements, do not differ to such an extent to justify a different accounting treatment.

The lessee, by entering into a lease agreement with a possibility to execute an option, to renew or to purchase, acquires a right that he would not otherwise have had. Therefore, we think that it is not consistent to treat these aforementioned two types of options differently. We believe that the purchase options should be accounted for at the date of commencement of the lease as provided for renewal options by the ED Leases. For further comments on the accounting treatment of the purchase or the renewal options, please refer to the response provided to question No. 8.

We share EFRAG's concern about possible distorting effects, which may arise in practice where contracts with similar characteristics, providing alternative options to renew or to purchase, may be accounted for in different manners because of the different intentions of lessees about whether to exercise either of the options.

The presence of alternative options could facilitate earnings management decisions. As a matter of fact, as subsequent to the initial estimate, the preparer may alter at its discretion, even in a significant way, the measure of the right-of-use and the amount of the lease liabilities.

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?

EFRAG's response to question 8

EFRAG does not support the proposal that amounts due under renewal options should be included in the lease receivable or lease payable.

EFRAG believes that options should be accounted for, but their measurement should reflect their values rather than the gross cash flows resulting from the exercise.

73 EFRAG believes that the proposal to include amounts due under renewal options in the measurement of lease payable and receivable is inconsistent with the Conceptual Framework and does not provide relevant information to users of the financial statements.

74 EFRAG shares the concern expressed by Stephen Cooper in paragraph AV2 and following of the ED. We agree that options to extend or cancel a lease provide the lessee with the flexibility to react to changing business circumstances and consequently these features reduce risks. If these amounts are included in the measurement of the lease liability, a 10-year lease would be accounted for in the

same way as a 5-year lease with a 5-year extension period (assuming the lessee is likely to extend the lease). In our view, this fails to provide useful information about the different economic position of the lessee in each of these transactions. Furthermore, we consider that:
(a) rentals payable in an extension period do not meet the definition of a liability based on the Conceptual Framework. The lessee does not have an unconditional obligation to pay as long as it does not exercise the option;
(b) rentals receivable in an extension period do not meet the definition of an asset based on the Conceptual Framework. The lessor has neither an unconditional right to receive nor control over these amounts as long as the lessee does not exercise the option;
(c) including amounts payable and receivable in extension periods requires the lessee and the lessor to assess the likelihood of the exercise of the option. This is complex and judgemental for both parties because:
(i) The lessee may not have reliable information at every reporting date about future market rentals for the asset and therefore be unable to assess if the option is favourable or not;
(ii) The lessor may not be aware of lessee's decisions that may impact the likelihood of the renewals (e.g., a decision to relocate); and
(d) Including these amounts increases volatility because they are likely to be reassessed; and may reduce comparability because entities in similar situations with similar leases may end up accounting for them quite differently.

75 On the other side, we do not propose that the parties should ignore the existence of the options because of the following reasons:
(a) The accounting treatment of a 5-year lease with a 5-year extension period should be different from the treatment of a 5-year lease. A lessee that has a favourable extension option has a more valuable asset than a lessee that does not have an extension option or one that is unfavourable ; and
(b) If the measurement excludes amounts payable in extension periods, this may create structuring opportunities. Entities may structure agreements with a short initial period and multiple short with renewal options only to achieve a certain accounting treatment. Therefore, EFRAG believes that options should be accounted for, but their measurement should reflect their values and not the gross cashflows resulting from the exercise.

76 EFRAG notes that in the Revenue Recognition ED an entity that grants an option to a customer recognises a separate performance obligation only if the option provides a material right to the customers that they would not receive without entering into that contract. The portion of the consideration that the entity allocates to the option reflects its intrinsic value.

77 EFRAG acknowledges that the IASB rejected treating options as derivatives because it believed that it might prove too complex to determine the fair value of this type of option. However, we encourage the IASB to develop an approach similar to that in the Revenue Recognition ED.

78 As mentioned in Appendix 1 of the present letter the IASB acknowledges that many users of the financial statements of lessees adjust the amounts presented in the statement of financial position to reflect the assets and liabilities arising from operating leases. A common way of doing this in practice has been to recognise an assets and a corresponding liability based on a multiple of the minimum lease payments as defined under IAS 17. This may suggest that users are interested in the expected cash outflows arising from the lease contract.

79 Although users may be interested in this information, it does not provide a solid basis for concluding that recognition in the statement of financial position of highly likely lease payments is to be preferred in all cases over a more disclosure-focused approach.

80 Moreover EFRAG believes that the appropriate measurement is the one that helps users to predict future cashflows. If the IASB were to proceed with its proposal to include these amounts in the lease assets and the liability, which we disagree with, EFRAG"s view is that the measurement should be based on the term that has the highest probability to occur. This term is not more difficult to determine than the longest term that is more likely than not to occur.

Assilea Response to Question 8

We share EFRAG's view on this topic. Consistently with the view expressed in response provided to the question No. 7, we think that in the absence of conceptual elements that would support a distinction between renewal and purchase options, these aforementioned options should be accounted for in the same manner, but separately from the lease payment.

We agree with EFRAG's view to include in the right-of-use and in the linked financial liability the outflows resulting from the exercise of renewal or purchase options is not consistent with the definition of asset and liability contained in the Conceptual Framework, since the assets and liabilities arising from the exercise of such options can only occur with their exercise.

The rights and obligations arising upon the parties who enter into lease agreements differ according to whether such contracts provide for different durations and contain renewal and/or purchase options. We therefore agree with the EFRAG's view which indicates that the nature of the options in the leases is relevant to the analysis of the economic substance of such contracts. In particular, we share the concerns expressed by Stephen Cooper and also mentioned by EFRAG in its comment letter. In our opinion a lease contract with a term of 10 years is not comparable to a 5-year contract that includes a renewal option for a further 5-year period. The uncertainty in estimates of the future benefits that the lessor may obtain from the leased asset, linked to the flexibility granted to the lessee by a contract providing the option to renew, is usually valued by higher rentals. We believe that the different rights acquired by the lessee under the two scenarios, as well as the different lease rentals depending on it, would not be adequately reflected by the accounting treatment proposed in the ED Leases. Consequently, we support EFRAG's proposal to measure the options separately from the right-of-use and the lease liability.

We suggest that in its final version the standard contains clear guidelines for the options measurement (with particular focus on the purchase options). Since the option cannot be transferred separately from the host contract, there cannot be an active market for those options, therefore it must be clearly defined which evaluation approach should be taken.

In our opinion the options measurement should take into account that the difference between the expected fair value of the underlying asset at the exercise date and the purchase price is included in the rental payments. We therefore believe that the date of commencement of the lease the option has a value near to zero (except when at the date of commencement of the lease the lessee repays a significant amount) and that this value increases during the life of the lease contract.

We urge the Board to provide for the involvement of independent experts in the option measurement process. This will avoid the risk that the process is based only on the management own assumptions.

We are aware that this approach is difficult to implement and may result in excessive costs compared to the relevance of the option's value to be represented in the financial statements. We propose that, where the accounting for options is too complicated and costly, it is acceptable to describe the options in the notes without any further calculation.

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 contract should be included in the measurement of lease assets and lease liabilities 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 can only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the lease receivable if they can be measured reliably? Why or why not?

<u>EFRAG's response to question 9</u>

EFRAG believes that rentals that are under the control of the lessee, such as rentals contingent on usage or performance of the asset, should not be included in the measurement of lease assets and liabilities.

EFRAG supports a measurement based on a most likely outcome approach for components included in the measurement of lease assets and liabilities.

86 EFRAG believes that there are two different issues to address regarding contingent rentals and residual value guarantees:
(a) Should all contingent rentals receive the same accounting treatment?
(b) If some of these components are included, how should they be measured?

87 EFRAG notes that there are different categories of contingent rentals. Contingent rentals that are linked to the use of an asset (such as mileage) are under the control of the lessee and similar to an extension option – the lessee has the right to acquire more of the right-of-use of the asset.

88 Lease payments that are contingent on the performance of the asset are less under the control of the lessee. It may be argued that the lessee could reduce or avoid the liability (because it has the ability to affect the performance) but at the same time the lessee is interested in obtaining benefits from the asset. This type of rental is similar to a profit-sharing agreement.

89 Finally, lease payments that are contingent on a price index are totally outside the control of the parties and unrelated to the proportion of the right-of-use that is controlled by the lessor or the lessee.
90 Therefore, the arguments presented above in the reply to Question 8 apply differently to the different categories of contingent rentals. It may be argued that contingent rentals linked to use of an asset do not meet the definition of current obligation because the obligation results from a future decision of the lessee. Rentals that are contingent on a future price index meet the definition of an unconditional obligation where the uncertainty only relates to the measurement of the amount to be paid (see also paragraph 25 of IAS 32).

91 EFRAG supports the alternative view expressed by Stephen Cooper, that contingent rental agreements that vary upon usage or performance 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 agreement.

92 However, EFRAG acknowledges that when an agreement includes different types of contingent rentals applying a different treatment to each component may increase complexity.

93 Residual value guarantees can be viewed as unconditional rights and obligations – only their amounts is contingent on future events, but not their existence. To treat residual value guarantees as assets and liabilities is consistent with the treatment of obligations to stand ready to perform in the ED Liabilities.

94 With reference to the measurement basis, EFRAG favours a consistent approach for all variable lease payments. As explained above, we believe that a measurement based on a most likely outcome is more relevant for users as it is more helpful to predict future cashflows. EFRAG also notes that the argument in Paragraph BC120 of the ED – that a weighted average approach to assess the lease term might be difficult to be measured reliably and may result in a lease term that do not reflect a possible outcome – can be offered for contingent rentals and residual value guarantees.

95 Paragraphs 35(b) and 52(b) of the ED require lessors to include in the measurement of the lease payments an estimate of the amounts receivable by the lessee under residual value guarantees that the lessor can measure reliably. Residual value guarantees that are provided by an unrelated third party are not lease payments.

96 Based on the above, it is seems that residual value guarantees are included when they are provided by a lessor"s related party are lease payments. The current definition in Appendix A of the ED however includes guarantees extended by the lessor only. To avoid misunderstanding, we suggest that the definition in Appendix A is amended to explicitly include guarantees extended by a lessor"s related party.

Assilea Response to Question 9

We agree with EFRAG's proposal to distinguish the accounting treatment applied to contingent rentals on the basis of the nature of the factors affecting variability.

We agree with EFRAG's arguments supporting the need to distinguish between contingent rentals deriving from factors under the control of the lessee and those based on factors outside the parties' control (e.g. fees varying based on the change in a reference rate or the inflation rate). The first should not be included in the right-of-use and linked liability measurement, while the latter should be treated consistently with the accounting treatment of an indexed floating rate financial instrument.

With reference to the accounting treatment proposed by ED Leases for the measurement of changes in the financial components of contingent rentals, we would like to point out that paragraph 19 is not crystal clear. This paragraph provides that the internal rate of return, by which the lease liability is accounted for under the amortised cost method, should be modified only as a consequence of "the changes in reference to the interest rates when contingent rentals are based on those reference interest rates", and concludes by prescribing the recognition the effects of this change in profit or loss. We think that this paragraph, as a consequence of the requirement to change the liability's internal rate of return, if read consistently with the wording of paragraph AG7 of IAS 39 and paragraph B29 ED/2009/7 Financial Instruments: Measurement and Classification, should not result in any changes to the carrying amount of the liability. However, this seems to be contradicted by the last sentence of the paragraph 19 of the ED Leases, which instead requires the recognition of changes in profit or loss. In order to avoid difficulties in interpretation, we suggest that in its final version the standard should use a different wording to make it clear that the accounting treatment applicable to the lease liability in the presence of contingent rentals based on reference interest rates should be consistent with the treatment of an indexed floating rate loan. In case IASB confirms that the liability should be modified, then we urge to the Board to adequately support its decision regarding the possibility to not adjust the right-of-use. The latter aspect does not appear to be in line with the requirements contained in paragraph 18 of ED Leases in relation to the effects of changes in non-financial parameters when contingent rentals are based on those non-financial parameters.

We would also like to point out the opportunity that the final standard clarifies the accounting treatment that the lessee should apply to recognise the estimated amount that he expects to recover under a residual value guarantee issued by third parties. We understand that the guarantee, where provided by a third party, should be treated as an insurance, as a consequence it gives rise to the

recognition of a receivable (and a corresponding revenue) only when repayment is virtually certain (see IAS 37, paragraph 33). However, we do not understand the reasons for which the accounting treatment should be different based on the grantor, and we suggest that the final standard should overcome this apparent inconsistency.

Finally, we would like to express our concerns about the complexity resulting from the proposal contained in ED Leases.

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 obligation or receivable arising from changes in the lease term or contingent payments since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

EFRAG's response to question 10

EFRAG agrees that it would be onerous to require a periodic reassessment of changes in the obligation or receivable arising from changes in the lease term or contingent payments.

101 As mentioned in the replies to Question 8 and 9 above, EFRAG does not support the proposal that options to extend the lease term and contingent rentals based on performance or usage are included in the measurement of lease receivables and payables as proposed by the IASB.

102 However, if the IASB were to proceed with their proposal then EFRAG would agree that requiring a periodic reassessment could be very onerous. We also believe that this requirement is more compatible with a most likely outcome approach and less compatible with a weighted-average approach.

103 Under a weighted-average approach, a probability is allocated to each possible outcome. Any change in the likelihood of possible outcomes changes the weighted-average result. Therefore, if an entity does not adjust the measurement for each and every change, it actually moves away from a weighted-average approach. On the other side, an immaterial change is unlikely to affect a measurement based on the most likely outcome.

104 EFRAG does not agree with the proposal that when the lessor is in a derecognition model, any subsequent remeasurement of contingent rentals should be recognised as part of the result of the period. We believe that a reassessment of certain contingent rentals requires a remeasurement of the residual asset.

105 When contingent rentals are based on usage, a remeasurement arises when it is expected that the lessee will acquire more or less of the right-of-use. This is not different from a reassessment of the lease term that is treated as a new recognition (derecognition) event.

106 It may be argued that when the lessor expects a future increase in the use of the asset, this may lead to the need to recognise an impairment charge on the residual asset. Therefore, the lessor may need to recognise an impairment charge that offsets the additional revenue recognised. However, as the recoverable amount of the residual is affected by other factors, the lessor could recognise no impairment at all, or an impairment different from the adjustment of the contingent rentals.

Assilea Response to Question 10

We agree with EFRAG's view. Should the IASB decide to retain the right-of-use and lease payments measurement criteria contained in ED Leases, the burden of a periodic review of values, in the absence of facts or circumstances indicating the occurrence of significant changes compared

to earlier estimates, would be too onerous. In this regard, therefore, we fully support the position taken by EFRAG. We express our concern about the economic effects that might occur in the lessees' financial statements as a consequence of adopting the proposed accounting model, should the right-of-use be accounted for under the amortized cost method (see ED Leases, paragraph 20). As a matter of fact we think that the proposed model does not properly reflect the economic substance of the leases.

The accounting model proposed by ED Leases requires that the right-of-use is amortised in accordance with IAS 38 while the linked liability is accounted for under the amortised cost method. In the absence of an explanation on the amortisation method applicable to right-of-use, the prevailing attitude should be to post straight-line depreciation. We expect a negative impact on the lessee's profit or loss in the first years of the lease. This negative impact, determined as the sum of the right-of-use amortisation and the interest expense on the linked liability, would diminish as a consequence of the gradual repayment of the liability. We think that this scenario, substantially different from the accounting model for operating leases designed by IAS 17, does not properly reflect the economic substance of the lease.

We think that the economic substance of a lease cannot be reflected by considering the right-of-use (an intangible) and the linked liability (a financial liability) as separate items. In our view the lease agreement is a single transaction by which the lessee obtains, at the same time, the right-to-use an asset and commits to repay a loan allowing him/her to access the right. We think that the economic characteristics and risks of the lease are closely related and it would therefore be conceptually inappropriate to prescribe accounting treatments that do not reflect this intrinsic characteristic of the transaction. Moreover, we would like to point out that the Board, in paragraph BC145 of the ED Leases, stating that "a liability to make lease payments is a unique class of liability that is linked to a corresponding asset" has acknowledged the existence of a link between assets and liabilities arising from the lease agreement. We think that this assumption could be supported by the operational implications of reference to IAS 36 in paragraph 24 of the ED Leases.

Paragraph 24 of the ED Leases requires that at each reporting date the lessee applies IAS 36 to determine whether there are any impairment indicators requiring to submit the right-of-use to an impairment test. As well known, IAS 36 requires that the estimation of inflows arising from the use or sale of the asset (or group of assets) subject to impairment test should not take into account the impact of potential outflows deriving from the related financial liabilities. However, paragraph 76, letter b), of IAS 36, requires that, where the recoverable amount of an asset (or group of assets) cannot be estimated without taking into account the linked liabilities, it should include the future cash outflows arising from these liabilities. In our opinion, as the lessee obtains access to the economic benefits generated by the right-of-use only by assuming the corresponding liability, the recoverable amount should be estimated by applying the requirements contained in the above-mentioned paragraph 76, letter b), of IAS 36.

We believe that the consequence of this evaluation approach is to recognise the unbreakable link between the economic benefits produced by the right-of-use and the cash outflows incurred by the entity to repay the liability assumed to access these benefits. This link does not occur only at the commencement of the lease, but continues along its entire life, since the lessee, as a rule, is not in a position to dispose of the right-of-use without transferring or settling the linked liability.

We believe that the link between the right-of-use and the linked liability should not be taken into account only at the date of commencement of a lease, or for the purpose of executing an impairment test, instead it should always find an adequate presentation. Moreover, we think that the inconsistency in accounting treatment that would derive in the lessee's financial statements where it does not adequately present the link between the right-of-use and the lease payment liability, would not be substantially different from the one identified in IAS 39, paragraph AG4D (also referred to in IFRS 9, paragraph 4.5). The said paragraph in IAS 39 provides that an entity should measure at fair value through profit or loss the financial assets and the financial liabilities that are linked. In our

opinion, this way the IASB has clearly expressed its intention to remedy the situations where, by applying a different accounting treatment to assets and liabilities which are closely related, a transaction is not presented in the financial statements in accordance with its substance. Based on these assumptions, we suggest that the right-of-use should be amortised in accordance with the economic benefits that the lessee may obtain from the lease contract as a whole. More specifically, we believe that the systematic amortisation of the right-of-use, as defined in paragraph 98 of IAS 38, to reflect "the pattern in which the asset's future economic benefits are expected to be consumed by the entity", should take into account that these "economic benefits" are partly absorbed by the remuneration and repayment of the financial liability, as a consequence they flow to the lessor and not to the lessee. The economic benefits obtained from the right-of-use by the lessee will be increasing along the life of the lease and it is therefore in this way that we believe the right-of-use amortisation should be recognised in profit or loss. In short, in our opinion, to obtain an accounting treatment consistent with the economic substance of the lease, it is necessary to recognize the related costs (the sum of the right-of-use amortisation and the interest expenses) on a straight-line basis along the life of the lease.

Question 11: Sale & Leaseback

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

EFRAG's response to question 11

EFRAG supports an alternative accounting model for sale and leaseback transaction based on a "partial asset" approach.

EFRAG disagrees with the requirement that a lessor in a sale and leaseback transaction shall use a performance obligation approach because EFRAG supports a partial derecognition approach for lessors.

Link between the sale and the leaseback

112 If the IASB were to continue with its approach to sale and leaseback transactions, EFRAG would suggest including a general statement that the parties should look at the commercial substance of the arrangements to determine if it is a linked transaction or not. This would be similar to the approach taken in IAS 16, IAS 38 and IAS 40 regarding asset exchanges.

Identification of a sale

113 Paragraph BC162 of the ED states that the IASB proposes to use the same criteria for a sale as those used to distinguish between sales/purchases and leases. However, IASB has added in paragraph B31 examples of conditions that the parties must assess to reach a conclusion on whether the transfer is a sale.

114 EFRAG notes that the additional conditions in paragraph B31 of the ED imply that sale and leaseback transactions have to satisfy a higher threshold to qualify as sales than separate lease transaction that are subject to paragraphs B9 and B10 of the ED. If this is not the IASB"s intention, EFRAG suggests moving all examples of conditions to paragraph B9. This would clarify that there are no additional criteria to be met for sale and leaseback transactions to qualify as sales.

Accounting treatment of sale and leaseback transactions

115 EFRAG believes that the treatment of sales and leaseback that are linked should reflect the conceptual premise that an asset is a bundle of rights, which can be separately negotiated or exchanged.

116 In this view, in a linked sale and leaseback transaction the seller/lessee has actually:
(a) Transferred the residual asset; and
(b) Financed the portion of the asset that the seller/lessee is still entitled to use[2]
EFRAG believes that this view is consistent with the partial derecognition approach that we support for all lease transactions.

117 In this alternative model the accounting treatment of a linked sale and leaseback transaction (when the first transfer meets the definition of a sale) is as follows:
(a) the seller/lessee should derecognise the portion of asset transferred and recognise a financial liability for the obligation to pay rentals over the lease term; and
(b) the buyer/lessor should recognise the asset purchased, and a financial receivable.

118 EFRAG notes that the IASB had considered this "partial asset" approach (see paragraph BC161 of the ED) and rejected it because it believed that it was too complex. EFRAG notes that this approach relies on an allocation of the consideration paid between the purchase/sale of the residual asset and the financing of the right-of-use; a similar allocation process is required in paragraph 50 of the ED when a lessor applies the derecognition approach. We do not see why applying a "partial asset" approach in a linked sale and leaseback transaction should prove to be more complex.

Additional comments on the proposals

119 Paragraph B31 of the Application Guidance in the Exposure Draft includes examples of conditions that normally preclude the recognition of a sale/purchase and require treating the whole transaction as a financing transaction. We agree with most of them, but we are concerned about the criterion listed in B31 j)

Any other provision of circumstance exist that allow the seller/lessee to
participate in any future profits of the buyer/lessor or the appreciation of the
transferred asset, eg a situation in which the seller/lessee owns or has an
option to acquire a significant interest in the buyer/lessor

120 Based on the above, any sale and leaseback transaction where the seller/lessee is a parent company or an investor, and the buyer/lessor is a subsidiary or an associate would always be treated as a financing transaction in the separate accounts of the seller/lessee.

121 We agree that when the seller/lessee has the right to a significant portion of the appreciation of the transferred asset the transaction normally would not qualify as a real sale. However, we are not persuaded that it is appropriate to conclude that any transaction between a parent and a subsidiary is a financing transaction. This will be the case when the subsidiary is a vehicle and its only activity is to manage the transferred asset, but it is not necessarily true when the subsidiary is an operating entity.

[2] "Portion of the asset" does not refer to a physical portion but to the right of use for the period of the leaseback term.

122 EFRAG believes that this requirement may have an anti-abuse purpose and be meant to prevent structuring. We do not support including anti-abuse rules in principles-based Standards. Also, we think that this is part of a more general issue of how to treat intra-group transactions in separate accounts of participating entities and this should be addressed in a separate project and not on a case-by-case basis.

Assilea Response to Question 11

We do not agree to assess whether the transferred asset has been purchased or sold in accordance with paragraphs B9-B10 of the IASB/FASB ED, because we support criteria in IAS 18-*Revenue* (the same criteria included in the exposure draft that modifies IAS 18) in order to avoid useless duplications.

We instead agree to support a partial DR approach as the only lessor's accounting model that fit well into his economic *status*.

Question 12: Statement of financial position

(a) Do you agree that a lessee should present its liability to make lease payments separately from other financial liabilities and present right-of-use assets as if they were tangible assets within property, plant and equipment, or investment property as appropriate, but separately from other assets that the lessee does not lease (paragraphs 25-27, 42-45, 60-63 and BC142-159)? Why or why not? What alternative presentation do you propose and why?

(b) Do you agree that a lessor applying the performance obligation approach should present its 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? 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 residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? What alternative presentation do you propose and why?

(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease separately (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?

EFRAG's response to question 12

EFRAG agrees with the proposals for lessees.

EFRAG agrees with the proposal that a lessor using leases as an alternative way to realise an asset should disclose separately the lease income and expenses.

EFRAG is not persuaded by the presentation requirements for lessors applying a performance obligation approach.

Lessees

124 EFRAG agrees with the proposals for lessees and with the arguments in paragraph BC143 of the ED. We believe that there are differences between owned assets and assets held under a lease and between lease liabilities and other borrowings that justify a separate presentation.

Lessors

125 With reference to the presentation requirements for lessors applying derecognition approach, we note that paragraph 6 of IAS 16 Property, plant and equipment defines property, plant and equipment as tangible items that:

(a) Are held for use in the production or supply of goods or services, for rental top others or for administrative purposes; and
(b) Are expected to be used during more than one period.
Paragraph 6 of IAS 2 Inventories defines inventories as assets:
(a) Held for sale in the ordinary course for business;
(b) In the process of production for such sale.

126 The proposals for lessors applying the derecognition approach require a different presentation in the statement of comprehensive income based on the business model.
EFRAG agrees with this proposal but believes that a similar distinction should be also made in the statement of financial position. If the lessor has to separately the lease income and expenses, in our view this implies the underlying assets are more akin to inventories than to items of property, plant and equipment and should be classified as such.

127 EFRAG is not persuaded by the presentation requirements for lessors applying a performance obligation approach. We think that the proposals reflect the ambiguity of the approach. Paragraph BC148 of the ED explains that the linked presentation is required because of the interdependency of the assets and liabilities originated by the lease transaction and because it alleviates the concern that under the approach both assets and liabilities are overstated in the statement of financial position.

128 We agree with these points, but we think that they are a consequence of the approach.As mentioned in our response to Question 2 we do not support the performance obligation approach and we do not think that adding a subtotal addresses the underlying issues.

129 If the IASB retains the performance obligation approach and believes that some form of aggregation is advisable, EFRAG would suggest requiring a net presentation of the underlying asset and performance obligation. The lease receivable should not be included in the net total, because it is subject to a different type of risk (e.g., the lessor could transfer the receivable without terminating the lease arrangement). On the other hand, the underlying asset is strictly linked to the obligation to provide access.
130 EFRAG believes that presenting a net balance on the face of the statement of financial position (and providing a breakdown in the notes) would be a more effective way to mitigate the concerns about the "grossing up" effect of the performance approach rather than inserting an additional sub total line.

131 However, entities should always consider the general requirements in paragraph 57 of IAS 1 Presentation of Financial Statements to include line items in the statement of financial position when separate presentation is relevant to an understanding of an
entity"s financial position.

Assilea Response to Question 12

We fully agree with EFRAG's response.

Question 13: Statement of comprehensive income

Do you think that lessees and lessors should present lease income and expense separately from other income and expenses in the statement of comprehensive income (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? 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?

EFRAG's response to question 13

133 EFRAG supports the presentation requirements in the Exposure Draft and believes that it provides useful information.

Assilea Response to Question 13

We fully agree with EFRAG's response.

Question 14: Statement of cash flows

Do you think that cash flows arising from lease contracts should be presented on 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?

EFRAG's response to question 14

134 EFRAG agrees with the proposals and believes that it provides useful information.

Assilea Response to Question 14

We fully agree with EFRAG's response.

Question 15: Disclosures

Do you agree that lessee and lessors should disclose quantitative and qualitative information that: (a) identifies and explains the amounts recognised in the financial statements arising from lease contracts; and (b) describes how lease contracts 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?

EFRAG's response to question 15

137 EFRAG welcomes the requirement in paragraph 71 of the Exposure Draft that an entity should consider the level of disclosures appropriate to satisfy the objectives in paragraph 70. The list of disclosure requirements is extensive and we believe that the IASB should state even more clearly that they should not be regarded as mandatory in all situations.

138 Some of the disclosure requirements are reflect the existence of a hybrid model for lessors or diverging recognition requirements for different options. As mentioned above, EFRAG does not support a hybrid model or a different treatment of options.

Assilea Response to Question 15

We agree with EFRAG's response.

Question 16: Transition

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?

Do you think that full retrospective application of lease accounting should be permitted? Why or why not?

Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

EFRAG's response to question 16

140 We agree that mandatory full retrospective application would be onerous for long-term leases, and welcome the relief given to preparers.

141 Paragraph 91 of the Exposure Draft requires that when lease payments are uneven over the lease term, a lessee shall adjust the right-of-use asset recognised at the date of initial application by the amount of any recognised prepaid or accrued lease payments. Paragraph BC190 of the ED explains that this occurs when lease payments include relatively large amounts at the beginning or the end of the lease term. We understand that the requirement in paragraph 91 should apply only to unavoidable lease payments; however "lease payments that are uneven over the lease terms" may be read to also include contingent rentals. We suggest amending the definition in order to clarify that this is not the case.

142 In general terms, EFRAG is in favour of full retrospective application. We appreciate the reasons why the IASB is not mandating it, but we do not think that there are conceptual reasons to prohibit it when entities have the relevant information.

143 However, if the IASB decided to allow an option for transition rules, we recommend that entities should treat it as an accounting policy option in accordance with paragraph 13 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Therefore, an entity that decides to adopt full retrospective application should do that for all arrangements for which the entity has the relevant information.

144 Paragraph 29 of the Exposure Draft requires a lessor to assess its exposure to significant risks and benefits associated with the underlying asset at inception of the lease. This assessment shall not be reassessed subsequently.

145 We note that the transition requirements in paragraphs 94 and following do not specify at what date lessors should assess their exposure to risks and benefits when first applying the new rules. EFRAG recommends that it is specified that this assessment should be made at the transition date based on the information available at that time.

Assilea Response to Question 16

We agree with EFRAG's point of view and we acknowledge that even the transitional issues indirectly support the financial amortisation of the "right of use" as procedure in a linked approach (see response to question 10)

Question 17: Benefits and Costs

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 outweigh the cost? Why or why not?

EFRAG's response to question 17

We encourage the IASB to expand its outreach activities to collect additional information on the costs associated with the implementation of the proposals and their potential effects.

146 In paragraph BC203 of the ED, the IASB states that the following costs will be incurred by preparers to implement the new proposals:

(a) The cost to determine an appropriate discount rate on a contract-by-contract basis;

(b) The cost to reassess contingent rentals and options on a contract-by-contract basis;

(c) The cost of gathering and compiling lease information that might be distributed all over the world and associated with leases that have different contract terms.
The IASB is confident that they have adequately addressed these concerns by allowing simplified requirements for short-term leases and requiring remeasurements of contingent rentals and options only when there is an indication of material changes.

147 EFRAG has not conducted a cost-benefit analysis. However, we are aware that material from other sources supports the view that other costs are likely to be incurred.
These additional costs include for instance education (for preparers and analysts), robust upgrades of accounting systems and implementation of new processes and controls.

148 The proposals are also likely to impact financial ratios and debt covenants of entities.
This may affect capital requirements based on local regulation and possibly increase the cost of capital for some entities.

149 Based on the above, we are uncertain that the analysis presented in the Basis for Conclusions is conclusive. We believe that the IASB should expand its outreach activities and do further work to ensure that the benefits of the proposals do not outweigh costs. For this reason, EFRAG welcomes the publication of a questionnaire for users by the IASB.

Assilea Response to Question 17

We support EFRAG's suggestion responding to question 17 and repeating what it's been already clarified before, we believe that the ED has conceptual merits, but it needs a deep simplification process in order to not take into account contingent rentals, optional periods, term option penalties, residual value guarantees in the measurement of lease payments foe the reasons explained above (see responses 7-10).

Question 18: Other comments

Do you have any other comments on the proposals?

EFRAG's response to question 18

Initial direct costs

150 Paragraph 12 of the Exposure Draft requires a lessee to measure the right-of-use asset initially at the amount of the liability to make lease payments plus any initial direct costs incurred by the lessee. Initial direct costs are defined as recoverable costs that are directly attributable to negotiating and arranging a lease that would not have been incurred had the lease transaction not been made.

151 The accounting treatment for costs incurred in the context of a transaction is not unique to leases. The recently issued Exposure Draft Insurance Contracts requires including incremental acquisition costs in the present value of the fulfilment cash flows; and exclude all other acquisition costs. The Revenue Recognition Exposure Draft allows capitalising contract costs only if certain conditions are met, and require expensing the cost of obtaining a contract (for example, the cost of selling, marketing, advertising, bid and proposals, and negotiations).

152 It is unclear if the capitalisation requirements under the different proposals are meant to be equivalent or not. We believe that equivalent requirements should apply and advise to use consistent concepts and wording across the different proposals.

Impairment of the underlying asset in the performance obligation approach

153 Paragraph 41 of the Exposure Draft requires lessor to apply IAS 39 to assess whether the right to receive lease payment is impaired. There is no indication about how to assess impairment of the underlying asset but IAS 36 Impairment of Assets should apply.

154 IAS 36 requires the entity to assess the recoverable amount of the asset being the higher of fair value less cost to sell and its value in use. However, the lessor cannot include the cashflows arising from the lease payments in the value in use if the asset, because they already support the recoverable amount of the lease receivable. It is therefore likely that the value in use will result lower than the carrying amount of the asset.

155 One possible solution is to aggregate the underlying asset and the lease liability arising from the performance obligation for the purpose of impairment testing. Paragraph 67 of IAS 36 states that the recoverable amount of an individual asset cannot be determined only if the asset does not generate cash inflows that are largely independent of those from other assets; paragraph 78 of IAS 36 states that it may be necessary to include liabilities in a cash-generating unit when disposal of a cash-generating unit would require the buyer to assume the liability.

156 EFRAG is unsure that under the existing requirements in IAS 36 a performance obligation qualifies for the inclusion in a cash-generating unit for impairment testing purposes. Therefore, we would recommend the IASB to specify in the proposals that a performance obligation meets the conditions in paragraph 78 of IAS 36.

Assilea Response to Question 18

We agree with EFRAG's response.