DUTCH ACCOUNTING STANDARDS BOARD (DASB)

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EFRAG
Attn. EFRAG Technical Expert Group
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Our ref : AdK
Date : Amsterdam, 26 November 2010
Re : Comment on your letter regarding the IASB ED Leases

Dear members of the EFRAG Technical Expert Group,

The Dutch Accounting Standards Board (DASB) appreciates the opportunity to respond on your draft comment letter regarding your opinion on ED Leases.

Your draft comment letter is an excellent summary of the main changes proposed and includes many comments with which we concur. We have however different views or some additional comments on certain questions, which we included in appendix B, of this letter. Our reply to the question to constituent is included in appendix A.

Our main comments on the ED are:

- We believe that the concept of the right-of-use model is not well founded. We see a conflict between the recognition criteria of the right-of-use asset and the related lease liability and the definition of an asset, respectively a liability in the current and new Framework.
- Furthermore, we question whether the measurement of a liability that will not necessarily result in an outflow of resources meets the definition of a liability as included in the current and new Framework. We believe that the liability should be measured on minimum lease payments including bargain options. All other contractual options will have to be disclosed.
- The new model does not necessarily improve comparability and reliability at all, as contracts with economical substantial equal terms may be accounted for as either a lease contract or a service contract. The definition of a lease contract and a service contract will have to be improved. The difference between them will become more important, as lease contracts will always result in on balance accounting of the asset and the relating liability. The existing difficulties with the application of IFRIC 4 (such as with providing capacity for storage or transport) will have to be solved in the new standard.

- As well, we do not agree with the performance obligation model for lessors. The distinction between the performance obligation model and the derecognition model appears to be similar to the current distinction in IAS 17 between operating leases and finance leases, which distinction the ED wants to eliminate. We believe that the (partial) derecognition model will have to be applied by lessors for all leases. The partial derecognition model is consistent with the principle that an asset consists of multiple “right-of-use” units. For this reason, we have not further commented on the performance obligation model for lessors in the answers to the questions in the appendix.
- Finally, we do not believe that the simplified requirements for short term leases are an important relief for lessees. We recommend to exclude short term leases (with a maximum contractual period of less than 12 months) from the scope. This will give lessees a significant simplification for the accounting of lease agreements that usually are not material for the financial statements.

Four of our main comments are also described in your draft comment letter to the IASB. We have a different view regarding the short term lease. We recommend to exclude short term leases from the scope.

Yours sincerely,

Hans de Munnik
Chairman Dutch Accounting Standards Board

- **Specific questions EFRAG**

Questions to constituents

41. Do constituents believe that a distinction between leases and sales/purchases is required? If so, do they believe that the criteria are appropriate?

Answer DASB

Yes, DASB believes that distinction is required.

We do not believe the criteria are appropriate. We agree with the comment of EFRAG that the criteria in ED revenue recognition should be similar but we believe that the criteria should be included in the leasing standard.

Questions to constituents

61. Do constituents agree with EFRAG"s suggestion on the lessee"s treatment of a contract that includes non-distinct services? If not, what other approach do you support?

Answer DASB

Yes we agree with EFRAG's suggestion.

Questions to constituents

97. Do constituents believe that separating different categories of contingent rentals might be too complex?

Answer DASB

Yes, we believe that separating different categories of contingent rentals will be too complex. We therefore are in favor of measurement at best estimate if the liability is measured including contingent rentals.

However, we question whether the measurement of a liability that will not necessarily result in an outflow of resources meets the definition of a liability as included in the current and new Framework. We believe that the liability should be measured on minimum lease payments including bargain options and contingent rentals that are virtually certain to occur.

Questions to constituents

123. Do constituents agree with the analysis and EFRAG's proposals for the treatment of sale and leaseback transactions?

Answer DASB

We agree with the analysis and EFRAG's proposal.

Questions to constituents regarding cash flow presentation

135. Paragraph 44 of IAS 7 Statement of Cash Flows requires treating the acquisition of an asset by means of a finance lease as a non-cash transaction. The proposals do not change the requirement. Do constituents agree with the treatment? Or do constituents believe that a lease is essentially a financing transaction and therefore should be presented in the statement of cash flows in the same way an entity presents the purchase of an asset financed by way of a bank loan?

Answer DASB

We believe that non-cash items should be disclosed and not be included in the statement of cash flows, which is in line with the requirements of IAS 7 today.

Appendix B to Comment on EFRAGs letter regarding the IASB ED Leases

Question 1: Lessees
(a) Do you agree that a lessee should recognise a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?
(b) Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

Answer DASB

We agree that the proposed model can have conceptual merits in specified circumstances. However, it must fit into the Framework and be supported by robust criteria for distinguishing between leases and service contracts.

However, we see a conflict in the proposed model between the recognition criteria of the right-of-use asset and the related lease liability and the definition of an asset, respectively a liability in the current and new Framework.

The new model does not necessarily improve comparability and reliability at all, as contracts with economical substantial equal terms may be accounted for as either a lease contract or a service contract. The definitions of a lease contract and a service contract will have to be improved. The difference between these contracts will become more important, as lease contracts will result in on balance accounting of the assets and relating liabilities. The existing difficulties with the application of IFRIC 4 (such as with providing capacity for storage or transport) will have to be solved in the new standard.

Reference is made to our response to question 9, regarding the valuation of the asset and liability.

Question 2: Lessors
Agree with EFRAG.

Question 3: Short-term leases
The exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is twelve months or less:
(a) At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial
measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of

lease payments plus initial direct costs. Such lessees would recognise lease payments in profit or loss over the lease term (paragraph 64).
(b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognise assets and liabilities arising from a short-term lease in profit or loss, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit or loss over the lease term (paragraph 65). (See also paragraphs BC41–BC46.)
Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

Answer DASB

No. we do not believe that the proposal for short term leases is a simplification. Companies would have to keep track of all short term leases during the year. We recommend to scope out all short term leases, since these leases are not material for the financial statements. Furthermore the benefits for accounting of short term leases on-balance are not expected to exceed the costs.

Question 4
Agree with EFRAG

Question 5: Scope exclusions
The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33–BC46).
Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and

Answer DASB
No, there is no conceptual basis for excluding intangible assets from the scope.

Question 6: Contracts that contain service components and lease components
Agree with EFRAG.

Question 7: Purchase options
The exposure draft proposes that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraphs 8, BC63 and BC64).

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

Answer DASB

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

We believe that bargain purchase options, should be included in the measurement of the asset and relating liability.

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?

Answer DASB

We question whether the measurement of a liability that will not necessarily result in an outflow of resources meets the definition of a liability as included in the current and new Framework. We believe that the liability should be measured on minimum lease payments including bargain options. All other contractual options will have to be disclosed.

Question 9: Lease payments

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

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

Answer DASB

Reference is made to the answer to question 8.

We disagree with the probability weighted average method, as earlier described in our comment letters on non-financial liabilities and taxes. We are not at all convinced that the measurement based on probability-weighted average lease period, options and contingencies will result in decision-useful information. The probability-weighted

average of the lease period, options and contingencies will result in the reporting of amounts that by definition will not be the amounts that will be paid. .

For example, a retailer that has a rental contract for real estate which is a one year roll over contract of which the amount payable is based on the realized revenues, will have to estimate the number of years it expects to rent. Because of the location this could be rather long. Based on the proposal this will result in a significant asset and relating liability, although the retailer could discontinue the contract every year. We do not believe that the recognition of this liability appropriately reflects the financial position of the retailer as well as the risk of the retailer in this situation.

Question 10: Reassessment
Agree with EFRAG.

Question 11
Agree with EFRAG.

Question 12: Statement of financial position
(a) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment or investment property as appropriate, but separately from assets that the lessee does not lease (paragraphs 25 and BC143–BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?
(b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totaling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?
(c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?
(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

Answer DASB
We agree that liabilities and assets, if significant, should be presented separately on the face of the statement of financial position. If not significant these disclosure are to be made in the notes.

Question 13: Statement of comprehensive income
Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

Answer DASB
We agree that lease income and expense, if significant, should be presented separately on the face of total comprehensive income. If not significant these disclosure are to be made in the notes.

Question 14: Statement of cash flows
Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

Answer DASB
We agree that cash flows arising from leases, if significant, should be presented separately on the face of the statement of cash flow. If not significant these disclosure are to be made in the notes.

Question 15
Agree with EFRAG

Question 16
(a) The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186–BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?
(b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?
(c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

Answer DASB
We agree with the simplified retrospective approach as transition. We are in favor of allowing full retrospective application of lease accounting for conceptual reasons., should companies wish to do so.

We believe that the transition rules should also describe how companies should account for any deferred income due to past sale and lease back transactions.

Question 17
Agree with EFRAG.

Question 18
Do you have any other comments on the proposals?

Answer DASB

Yes, we have 3 other comments on the proposal:

1) SIC 27 "Evaluating the Substance of Transactions Involving the Legal Form of a Lease" ("SIC 27")
2) Impact of other standards under revision that are subject to comments and revisions
3) Lessor accounting of residual value financed by lessee.

Sub 1) SIC 27:
The ED eliminates SIC 27, without explaining whether the interpretation of the existing standards is incorporated in the ED, while the issue of SIC 27 is not gone. We recommend including the consensus of SIC 27 in the revised standard.

Sub 2) Impact of other standards under revision that are subject to comments and revisions
The ED refers to other projects of the IASB, such as the revenue recognition project, as if the projects are already finalized and will not be revised anymore until the final standards will be issued. However, we would expect that all comments will be considered by the Boards and, as a consequence, e.g. the revenue exposure draft could be revised due to comments received.

Sub 3) Lessor accounting of residual value (RV) financed by the lessee
The current proposal for subsequent measurement of the leased asset under the de-recognition approach does not reflect the economic characteristics of a lease from the point of view of the lessor. In the current exposure draft, no accretion of the residual asset is allowed, which contradicts the economic reality of a lease contract.
The following elements are in a standard lease contract:

1) A lessor invests in an asset to be leased to a lessee and the full asset (including RV) has to be financed and therefore will result in interest expenses.
2) The lease rentals payable by a lessee include an interest compensation for the residual asset. The lessee therefore pays a compensation for the redemption/depreciation of the leased part of the asset and an interest compensation for the full investment of the asset.

The incoming interest compensation for the full investment should be reflected in the lessor's accounting for these contracts. This should be done by accretion of the residual value from the discounted value of the residual value to the expected residual value at the end of the agreed lease term. This will result in a constant return over the life of the leased asset for the lessor, which is in accordance with the economic reality of the lease contracts.