Dear Sir/Madam,

Exposure Draft: *Leases*
Proposed Accounting Standards Update (Revised): *Leases*

Mazars and its independent US member firm WeiserMazars LLP welcome the opportunity to comment on the IASB 2nd Exposure Draft *Leases* and the FASB Proposed Accounting Standard Update (Revised) *Leases* (together referred to as the ED). Our general comments are included herein. Our responses to the specific questions included in the ED are given in the Appendix.

We note the Boards’ significant efforts to provide responses to the criticisms expressed by stakeholders on the first Exposure Draft.

We acknowledge that room for improvement exists in lease accounting, both within IFRS and US GAAP. In particular, both standards offer structuring opportunities that allow entities that are actually financing their assets not to recognize any liability for that financing. We welcome the efforts made by the Boards to propose a converged solution to reduce structuring opportunities, and we encourage the Boards to continue to work together to improve the accounting and reporting of leases.
Having said that we also note that the current standards have not failed in providing comparability. No significant divergences of practices have been identified and, the standards in the past decade have not resulted in numerous requests for interpretations. They seem to be well understood by both preparers and users of financial statements, and sufficiently applied.

We understand from discussions with users that they are more interested in getting improved disclosures on leases than in changing their accounting because they feel the current proposal does not reach its stated objective of giving the users pertinent and reliable information on leases. Thus, we urge the Boards to re-consider all relevant feedback that was received during the 2010 ED, and carefully consider the results of the due process activities related to the current ED, in order to elaborate new proposals that will truly provide guidance that is useful, comparable, without unnecessary complexities, and has a sufficient amount of examples that will facilitate ease of application and a clear understanding of the principles by all stakeholders.

In our opinion, the current outcome of the Boards’ Lease project does not provide an improvement in financial reporting for leases, while increasing costs for preparers –for initial application and on an on-going basis– at a level that does not outweigh the expected benefits of the reform.

We believe that the proposed amendments do not provide an improvement in the usefulness of the information, or in the relevance of such information. We believe, that in some respects, the proposed guidance lacks a sound conceptual basis and introduces inconsistencies within the draft standard itself and with other standards, in particular relating to assets and revenue recognition. We question whether the starting point of the project, i.e. accounting for a Right of Use asset and the corresponding liability for all leases, may have been the original sin of the successive EDs.

Furthermore, we believe the proposed guidance does not achieve its initial goal to reduce structuring opportunities: the area for structuring will no longer be driven by the distinction between finance and

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1 According to the Audit Analytics 2012 Financial Restatements: A Twelve Year Comparison, in the U.S. environment. Leases have not appeared in the top reasons for companies to restate their financial statements with the Securities Exchange Commission over the past 12 years.
operating leases. Instead, entities will strategize with the distinction between service and lease contracts or between fixed and variable lease payments, and they will grapple with the definition of property, as defined in the ED, etc.; this is only the beginning.

Since US GAAP and IFRS standards on leases both rely on the distinction between finance and operating leases, with consistent definitions but implementation differences, we kindly request the Boards to reconsider the current core principles of the standards as well as other studies, such as the G4+1 study done in 2001, as a means to redirect the project to arrive at a converged standard. Based on our experience and frequent feedback from our clients, we believe that many of the structuring opportunities inherent in the current standards could be addressed without changing either their basic principles or their accounting models and by requiring robust disclosures that are more transparent and will not create undue hardship in providing such information, with respect to the costs involved.

We therefore urge the Boards to consider all comments received from stakeholders as a result of this comment letter process, and redeliberate the issues to arrive at a standard for accounting for leases that addresses the concerns in the preparers’, users’, and auditors’ community, which were initially identified at the launch of this project several years ago.

We would be pleased to discuss our comments with you and are at your disposal should you require further clarification or additional information.

Yours faithfully,

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Appendix: Answers to the specific questions raised in the questions for respondents

Question 1: identifying a lease

The revised Exposure Draft defines a lease as “a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration”. An entity would determine whether a contract contains a lease by assessing whether:

(a) fulfilment of the contract depends on the use of an identified asset; and
(b) the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.

Do you agree with the definition of a lease and the proposed requirements in paragraphs 6-19 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

Response

We agree with the basic definition of a lease that it is “a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration”. We consider the proposed guidance for assessing whether an arrangement contains a lease to be an improvement to the existing criteria under IFRIC 4, and ASC 840, formerly, EITF 01-08 Determining Whether an Arrangement Contains a Lease, which were difficult to apply in practice.

Nevertheless, we believe that the criteria used to identify a lease, which is based on both: 1. the use of an identified asset and 2. the right to control the use of the identified asset, is subjective, complex, will require significant judgement and as a result could be difficult to apply in practice.
Indeed, assessing the right to control the use of the identified asset is a difficult and complex determination due to the many different levels of control each party could have over the identified asset, the fact that the identified asset may not be directly managed by the lessee, and the impact of legalities with respect to the actual contracts. As a result of these factors and because of the amount of judgment that could be involved, we anticipate there will be inconsistencies in practice when applying this guidance and less comparable information.

In particular, confusion may exist between “the right to control the use of the identified asset” and “the right to control the benefit of the use of the identified asset”. The latter may better reflect the abilities a customer may have in using the identified asset.

Therefore, we kindly request that the Boards provide additional guidance on how control should be interpreted and applied in practice, across many different industries and scenarios. We believe in certain industries this could be a simple assessment but in others perhaps not.

Due to the complexity of the models, we anticipate that the Boards will need to furnish a significant amount of clarification and interpretative material to assist all affected by its initial and on-going application. Hence, if such a need will exist upon issuance of a new standard, we truly question the operationally of the proposed model.

**Supplier’s right to substitute**

The ED states that a contract is not a lease if the supplier has a substantive right to substitute the underlying asset without requiring the consent of the customer during the contract. We are concerned by:

- the meaning of “without requiring the consent of the customer”. We recommend that the Boards clarify this principle and include additional guidance on the assessment of the substitutability of an asset. We are unclear with respect to whether this criterion is meant to have a restrictive interpretation or more extensive interpretation. For example, we expect that at a minimum a supplier would need to have the customer’s consent to have access to its premises. Could there be any implicit interpretations that the consent to access their premises also includes other unstated obligations that may not provide specific consent from the customer?

- the subjectivity of the criterion of economic barriers that could prevent the supplier from substituting alternative assets;
• the subjectivity of the existence of a substantive right to substitute where the supplier does not hold other assets than those used to fulfil the contract (as explained by Example 1 (842-10-55-7) - Contract for Rail Cars).

We are also questioning the Boards’ explanation on paragraph BC 105(b):

“The boards have included additional language to help determine when substitution rights are substantive. Their intention in doing so is to discourage the insertion of a substitution clause in a contract which does not change the substance or character of the contract, solely to achieve a particular accounting outcome. If a substitution clause is not substantive because it does not, for all intents and purposes, change the substance of the contract, that substitution clause should not affect an entity’s assessment of whether a contract contains a lease.” [Emphasis added]

We believe it would be very helpful for the Boards to provide additional information regarding the need for the additional criteria included in the Identifying a Lease section, Fulfillment of the Contract Depends on the Use of an Identified Asset (842-10-15-6 / IFRS 8-11). In addition, we believe additional examples regarding the application of the criteria should be provided. The scenarios in Example 1 conclude that the contract does not contain a lease. It would be helpful to have additional examples that conclude that the contract is a lease. We feel this is necessary as it is unclear how the substitution of an asset by another one with the same characteristics would change the substance of an equipment contract for the lessee.

Ability to Derive the Benefits from Use

 Existence of a market for the consumables

The identification of a lease contract depends on whether the customer can obtain the benefits from the use of an asset. Part of the assessment is evaluating when the benefits from the use are dependent on receiving additional goods or services that are provided ONLY by the supplier and not sold separately by the supplier or other suppliers.

We have questions on whether a contract, that did not meet the criteria for a lease because the supplier was the sole provider of goods or services that enabled the customer to obtain benefit from the identified asset, should be reassessed once such goods or services are sold separately from the identified asset and are available by other suppliers. If reassessment of this contract is triggered, what would the accounting be?
As an illustration: in Example 2 (842-10-55-20), *Contract for Coffee Services*, if the consumable (i.e., the coffee) becomes available during the lease term, because the specific patent for the coffee used in the machines is now in the public domain, the customer would no longer need to depend on the supplier to obtain benefit from the identified asset (the coffee machine).

- **Ability to derive the benefits from the use**

We support the principle exposed in paragraph 19/IFRS, or paragraph ASC 842-10-15-16, stating that a customer does not have the ability to derive the benefits from use of an asset if:

(a) it can obtain the benefits from use of the asset only in conjunction with additional goods or services that are provided by the supplier and not sold separately by the supplier or other suppliers; and [Emphasis added]

(b) the asset is incidental to the delivery of services because the asset has been designed to function only with the additional goods or services provided by the supplier.

However, we are concerned with the conclusions reached by the Boards on the ability to derive the benefits from the use of the asset demonstrated in Example 2, *Contract for Coffee Services* and Example 3, *Contract for Medical Equipment*. These examples provide two situations that seem to be very similar from the lessee’s point of view. In both cases, there is a restriction to purchase the consumables only from the supplier of the equipment. In Example 2 there is no other option, and in Example 3, there is a possibility to purchase the consumables from other suppliers, but the contract binds the lessee to purchase the consumables from the supplier of the equipment only.

We are not clear on the distinction being made as it leads to very different conclusions. For Example 3, is it implying that just the mere fact that it is theoretically possible to use the identified asset without the supplier’s goods, makes it a lease? Alternatively, are the differences based on the ability or not to separate different components of the contract, rather than a difference in the customers’ obligations created by the contract? Example 2 concludes that the contract did not contain a lease, and Example 3 that it does contain a lease. We believe that the guidance in the two examples noted above will ultimately result in very similar transactions being accounted for differently. It is unclear how the differences in the conclusions reached in these examples will help users understand and apply the principles to these transactions.
Other concerns

- **Separating Components of a Contract/ Allocation of the consideration**

We agree with the requirement to allocate the consideration between lease components and non-lease components, but have significant concerns regarding:

  - **Stand-alone price**

  We are concerned by the lack of clarity of the notion “stand alone price”, and consider that it will be difficult to apply without more guidance, especially when there is a range of observable stand-alone prices for one or more components. We request that the Boards provide interpretative guidance and additional examples surrounding the allocation of consideration to different components of a contract. We are concerned that the reference to “similar leases” in BC 116 (e) has the potential to be misconstrued. What constitutes a “similar lease”?

  BC116 (e) states:

  “...The Boards are proposing a hierarchy of requirements that a lessee would follow when allocating consideration to different components of a contract. According to these requirements, a lessee would be required to obtain observable standalone prices for each component, if possible, and allocate any remaining consideration to components without observable prices. In setting a threshold that must be met to separate lease components and nonlease components, the Boards did not wish the threshold to be so high that a lessee would find it too difficult, or could choose whether, to separate lease components and nonlease components. Accordingly, observable is not limited to being lessor-specific, and obtaining the price of **similar leases**, goods, or services is sufficient (i.e. observable does not mean that a lessee is required to obtain the stand-alone price of an identical lease, good, or service component)”. [Emphasis added]

  - **Lessees’ ability to have access to information**

The project gives more emphasis to the distinction between lease and non-lease components, even though this distinction may introduce practical difficulties, especially for the valuation of the service components of a contract containing a lease.

We note that the IASB seems to be aware of these difficulties, and expects that practice will evolve whereby lessors would provide the information required by the lessees (BC 409 IFRS only).
Besides the fact that we are unable to predict how practice will evolve, we believe that the current practice which consists of one unique price for a bundle arrangement that includes both lease and non-lease components may indicate that for the lessee, some of those contracts are in-substance service arrangements. We believe this would be the case where the supplier does not sell the right of use of the asset and the related goods or services separately (Example 2).

- **Allocating the consideration to the lease component where there are no observable stand-alone prices.**

IASB § 23 – FASB § 842-10-15-20 of the ED states that a lessee shall allocate the consideration (or all the remaining consideration) to a single lease component if there is no observable stand-alone prices.

We disagree with this proposal, which is not conceptually robust and seems to be mostly driven by anti-abuses purposes.

In our view, the absence of an observable stand-alone price indicates that the asset is of no use to the client without additional goods or services provided by the supplier, and therefore that the “lease component” is not a lease.

Rather than allocating all consideration to a lease component by default, we suggest that the Boards:

- Clearly state that situations where there are no stand-alone prices should be rare in practice, and

- Consider that where the absence of stand-alone prices is confirmed it is an indicator that the contract is an all-in-one service arrangement rather than a lease contract with embedded non-lease components.

Overall, we believe that implementing the Boards’ proposals regarding the allocation of the consideration will imply initial and on-going costs that will far outweigh any benefits derived from the proposed changes.
Identifying lease contracts and allocating consideration: a decision tree would be helpful

Assuming that the IASB and the FASB finalized their proposals, we believe that a decision tree (presented as implementation guidance) would be helpful in the determination of whether a contract is a lease contract, whether a contract contains one or more lease components, how to qualify each of these components (Type A vs. Type B), and how to allocate the consideration. In other words, we consider that a decision tree would be helpful in order to clarify the articulation between the different concepts used to identify a lease contract, and its components.

Structuring opportunities still exist

We acknowledge that the current accounting model for leases has been criticised, in part, because of the bright-line distinction between finance leases and operating leases. However, we believe that if the Boards implement the guidance in the proposed ED, the Boards most likely will continue to be criticised, because of the new, complex and unfamiliar bright-line distinctions between leases and non-leases components, as well as the new not so bright line distinctions affecting many industries when determining the type of lease. The existence of two very different accounting models for leases components and for non-leases components means that transactions that are economically similar can be accounted for very differently, and therefore provides opportunities to structure transactions to achieve a particular accounting outcome, especially on the following issues:

- capacity portion of an asset versus physically distinct portion of an asset;
- supplier’s right to substitute;
- identified asset versus non-identified asset.

We expect as time goes on this list will become very long.
Question 2: lessee accounting

Do you agree that the recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Response

Overall analysis

No, we disagree.

Some of what follows is mentioned in our cover letter, but we believe it is necessary to stress certain points, and we do appreciate this opportunity. We acknowledge that the objective of both the FASB and the IASB is to serve the public interest by developing high quality standards that will provide decision-useful information to stakeholders by improving the relevance, representational faithfulness and comparability of the information included in the financial statements. That being said, we do not believe that the proposed approach to account for leasing transactions particularly for lessees, but also for lessors (see response in Q3), will achieve these objectives.

We acknowledge that the project was put on the Boards’ agenda for a variety of reasons, one being to respond to investor concerns that the existing guidance did not clearly portray the resources and obligations from leases in a complete and transparent manner; primarily because operating leases were recorded off-balance sheet.

The 2010 ED noted that users of financial statements made adjustments to the statement of financial position to reflect the assets and liabilities arising from operating leases. The 2010 ED also noted that the current models were not meeting the needs of users of financial statements because they did not provide a faithful representation of leasing transactions.

Therefore, we support the core principles of the proposed model for an entity to recognize assets and liabilities arising from a lease if it results in providing financial information that is more meaningful to users and represents the economics of leasing transactions in a complete and more transparent manner without causing undue cost to reap the benefits.
However, because of our deep concerns about the future of financial reporting, and the diversity of existing types of leasing arrangements, we have great concern that the end result of applying the principles in this proposed ED across a broad spectrum of industries will not result in decision-useful information. We feel strongly that this is not a one-size fits all model and we question the broadness of the outreach performed, as leasing truly is a business that impacts every company in one way or another. That being said, we recommend that the Boards, continue their outreach, and carefully consider the feedback received and leverage off previous studies done, as well as a reconsideration of the current principles.

We urge the Boards to focus on developing a standard that reflects feedback from lessees, users of lessees’ financial statements in many different industries, and any other market participants.

In general terms, it is difficult to argue that a lease is not providing a right to use an asset; but does that necessarily mean it is the best model to account for a lease? We also believe that it is difficult to argue that a lessee does not have a liability based on the lease contract for the right of use of the asset; but would anything differ if the legally enforceable document did not exist?

We also believe it is difficult to argue that financing is not an element that is significant in many leases. The following questions should apply to determine the financing dimension of each lease:

- What does the payment represent?
- Is it considered to be linked to the ultimate purchase of the identified asset, or is the payment for the current use of the identified asset?
- Is the payment for a short period of time, or the majority of the economic life of the asset?

Considering this, the distinction in the accounting and presentation between different types of leases should not be based on whether the lessee is expected to consume more or less than an insignificant portion of the economic benefits embedded in the underlying asset. Furthermore, it is unclear how “more than insignificant” would even be interpreted in practice.

We also fully support eliminating criteria that allow transactions to be structured in a fashion to achieve a desired accounting outcome. However, we do not believe the proposed model is conceptually or operationally sound. Consistent with our response to Questions 3 and 4, we have significant concerns about the boundaries in accounting for different types of leases proposed in this model. The model is not a one-size fits all model. Every company has a business model that it follows regarding its use of assets, its cash flow management techniques, incurring liabilities and expenses, and its sources of revenue.
That being said, we do not believe the model in the proposed ED has the appropriate dividing line to account for the different types of leases across a multitude of industries so it could be applied in a manner that improves consistency, comparability and most importantly provides transparent decision useful financial reporting.

We question why nature and level of consumption of the asset determine how it is accounted for. Will it be obvious why one lease is classified as a Type A and another Type B?

We also question why the Boards believe that the accounting and presentation of a Type A lease should be different than a Type B lease. Do the Boards feel the users require this different accounting recognition and presentation under the proposed model? If so, please provide support from users, specifying what industries and the reasons why this is so critical.

During the upcoming months, as you perform your additional outreach to users of lease information and during the redeliberations of the proposed guidance, we request you consider the following approaches/ideas:

**Option 1**

**Modified IAS 17 / ASC 840 approach**

Under the approach followed by the current standards, When a lessee enters into a lease contract it fulfils one of the two following needs of the lessee:

1. Financing an investment in a non-current asset to provide the right to use the asset over a large part of its economic life, and assuming a significant part of the risk and rewards embedded in the asset, or

2. Obtaining access to the use of an asset for a limited period of time, without assuming a significant part of the risks and rewards embedded in the asset.

In our view, a modified IAS 17 / ASC 840 approach could be based on defining differently the boundary between both types of leases. Such an approach would recognise more leases as finance leases as the differentiating criterion would be the transfer of a significant part (rather than substantially all) of the risks and rewards of the underlying asset. This approach should be completed by specific disclosures regarding those operating leases.
Option 2

Use of an asset approach

This approach is based on the idea that when a lessee enters into a lease contract it wishes to obtain access to the use of an asset for a period of time in exchange for consideration.

The recommendation below is a high-level recommendation, based on where we see the need for immediate changes to the model being proposed. However, as already indicated above we urge the Boards to seek input from users of the financial information to determine whether the information that is being presented can be applied as a general principle for accounting for leases or whether additional modifications are necessary.

To start with, we believe the following changes would help yield decision-useful information:

  - The boundary would not be based on a consumption model or a nature of an asset model, because we believe the model is very complex, very subjective, and will require a significant amount of judgement to be exercised, thus making it very difficult to apply in practice and as a result causing the information presented in the financial statements to be non-comparable and difficult to understand.
  - Accounting for all leases consistently is based on the premise that a lessee is obligated to pay for the use of an asset. We believe it is difficult to support (or conceptualize) how two leases with the same terms and cash flows would be accounted and reported differently.

- Lessees would initially record an asset and a liability at the present value of the future payments required pursuant to the lease.

- Lessees would record an expense and reduce their asset over time in the same manner for all leases.

This method would be consistent with the one proposed for Type A leases, for both the amount and presentation of the expense and the reduction of the asset.
Note - Since the liability is recorded at the present value of the future payments required pursuant to the lease it indicates that there will be interest expense (basic time value of money principles).

Additional commentary

If the Boards were to continue with the models in the ED, we have concerns regarding the accounting models proposed for Type A and Type B leases. Those concerns are set out below:

- **Type B: amortisation of right of use**

  We have concerns about the lack of a conceptual basis on the amortisation of the right of use asset.

  Under the proposed approach the carrying amount of the right-of-use asset depends on the interest charge calculated on the lease liability, and amortisation shall therefore be determined as the difference between the periodic lease expense and the periodic unwinding of discount on the lease liability.

  In our opinion, the amortisation charge may not reflect the pattern in which the right of use asset is expected to be consumed by the lessee.

  We also have concerns about the consequence of this amortisation method, especially in terms of adaptability of systems and eventual costs incurred to adapt them.

- **Firm commitment to replace some of the lease components of a contract**

  We are also concerned with the functionality of the lessee accounting model when the lessor is engaged contractually to replace one of the lease components during the lease term.

  For example, if we consider a ten years lease contract on a hotel, without any option for renewal, with an annual lease payment of 100, covering building and equipment assets (beds, furniture, refrigerators, etc.) and assume that the equipment assets are replaced by the lessor once during the lease term, the lessee accounting model requires:

  - identifying the different components of the contract: a component for the equipment assets, which would be qualified as Type A lease, and a component for the building, which would be qualified as Type B lease;
allocating the consideration in the contract to each component, using observable stand-alone prices: for example 90 for the building and 10 for the equipment assets; and

- a lease liability and a right of use asset for each component identified to be recorded, at an amount corresponding to the present value of the lease payments discounted using the rate the lessor charges the lessee.

Under this model, the right-of-use asset recognised for the equipment assets are of an amount corresponding to the present value of two sets of equipment assets, whereas only one set of equipment asset is at the lessee’s disposal at the commencement date of the contract. In others terms the lessee accounting model requires a liability to be recognized for the lessee’s firm commitment to purchase a second set of equipment assets during the lease term.

In our opinion, this is not compliant with the general requirement about recognition of firm’s commitment to purchase or sell goods or service, which are not recognised until at least one of the parties has performed under the agreement.

We believe that the Board’s need to consider that some lease contracts should be analysed as executory contracts, as such lease contracts demonstrate that the lessor has not fulfilled its entire obligation when it makes available the underlying asset for use by the lessee. We request clear guidance be provided on the accounting as an executory contract. We also request that the Boards come up with an adequate definition of an executory contract. The current accounting literature lacks such definition and it would be helpful to include.

**Use of estimates and judgement**

We believe the proposed accounting model requires a significant amount of judgment to be exercised and therefore creates uncertainty in the estimates derived at. For example, when estimating the lease term (the lessee assesses whether it has a significant economic incentive to exercise that option to extend or terminate a lease) or the rate to discount the lease payments is not always evident, (i.e. in many cases, it would be the lessee’s incremental borrowing rate).

Thus, we have concerns whether the models proposed in the ED will provide more relevant information than providing additional disclosures in the current models, or will increase the comparability of leased and owned assets and, thus result in improving the information provided to users of financial statements.

In our view, users will have an incomplete representation of contract assets and liabilities and will be forced to seek additional information to adjust the
statement of financial position to understand and faithfully represent the present value of cash flows committed to be paid under lease contracts.

In this area we note that the IASB seems to have some reservations about the relevancy of information provided in the financial statement, and considers that the cost of analysis for users of lessee’s financial statements would remain the same, as stated in BC413 (IASB only).

**BC 413 “The IASB expects the cost of analysis for users of a lessee’s financial statements to remain the same. Some users of financial statements may rely solely on the improved information provided in the financial statements. However, other users would be expected to continue to make adjustments to suit their needs, but those adjustments would be made on the basis of better quality information available in a lessee’s financial statements.” [Emphasis Added]**
**Question 3: lessor accounting**

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

**Response**

No, we disagree. As in our response to Question 2, we urge the Boards to focus on developing a standard that reflects feedback from lessors’, users of lessors’ financial statements in many different industries, and any other market participants.

**Different types of leases**

We favour the proposal that a lessor should apply a different accounting approach to different leases, but we disagree with a classification based on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset. As explained in our response to Question 2 and inferred in Question 4, we have significant concerns about the boundaries in accounting for different types of leases proposed in the ED. We believe that the consumption-based principle is an ambiguous benchmark, even more that the ED proposes very different guidance in applying this principle according to whether the leased asset is equipment or property.

Every company has a business model that it follows regarding its use of assets and its sources of revenue. Any lessor structures its lease contracts according to its own business model, consistently with the nature of the risks it assumes.

For instance, some lessors’ business model are based on credit risk (finance leases according to the current standards, car leasing) while others are based on demand risk (short-term leases, property leases other than finance leases, some equipment leases).

We do not believe the proposed model in the ED has the appropriate dividing line to account for the different types of leases across a multitude of industries. We believe it should be based on the business model of the lessor, rather than consumption-based, so it could be applied in a manner that improves consistency, comparability and most importantly decision-usefulness of financial reporting.
Accounting models for the different types of leases

For Type B leases, we agree with the model proposed, although, as indicated above, we do not agree with the classification criteria for Type B. We are convinced that this accounting model is relevant for property leases other than finance leases, but it could be applied to other lessor industries.

We have more concerns regarding the proposed accounting model for Type A leases. Those concerns are set out below:

➢ Over-complexity of the Type A model for lessors

We believe that the accounting model proposed for Type A leases is overly complex and will necessitate considerable investment in robust accounting systems and reporting processes developments.

In particular, we are worried by the complexity of:

- the measurement of the gross and net residual asset, and of the rental income recognized at inception,
- the calculation of the accretion of the residual asset,
- the remeasurements of the residual asset in case of reassessment of the lease term and their accounting consequences.

➢ Absence of a conceptual basis for Type A model

We agree with the Boards’ view (BC229) that for a lessor, entering in a lease is not equivalent to the sale of the underlying asset, unless the lease contract is for the entire economic life of the underlying asset or where it is almost certain that ownership will pass to the lessee at the end of the lease term. Therefore, as indicated in BC229, we agree that the lessor should measure the residual asset on a cost basis.

Thereby we disagree with the full derecognition of the underlying asset of Type A leases and recognition of a lease asset (i.e. the sum of the carrying amounts of the lease receivables and residual asset), treated as a whole as a kind of financial asset.
In particular, we consider that:

- the accretion of the residual asset (increasing its carrying amount for the effect of the unwinding of the discount on the gross residual asset, using the rate that lessor charges the lessee) is inconsistent with a cost basis approach;

- the lessor does not perform any revenue-generating activity in relation to the residual asset during the lease term. Therefore, we do not see any rationale for recognising the unwinding of the discount on the gross residual asset as interest income.

We recommend to the Boards to reconsider a partial derecognition approach for Type A leases, should they continue with this model for accounting for leases.

➢ Type A: Measurement of the residual asset

We are concerned by the meaning of “the amount the lessor expects to derive from the underlying asset following the end of the lease term”, in particular if the lessor intends to lease the underlying asset several times, as is the case with long life equipment, such as rail cars or ships.

Is this meant to be interpreted by the lessor to estimate the cash flows to be derived from the leases it intends to contract during the total economic life of the underlying asset?

If this is the case, it would result in obtaining projections that extend beyond the normal projections used in the impairment test under IAS 36 (IAS 36 states that projections based on budgets shall cover a maximum period of five years), and introducing a large amount of estimation uncertainty.

Therefore, we do not believe that the Boards intended this, and perhaps did not contemplate the assets that are leased out several times. We recommend to the Boards to clarify the meaning of “the amount the lessor expects to derive from the underlying asset following the lease term”.

➢ Type A: Relevance of the accounting model for some business models

The Type A model for lessors is a financial one. We believe that this model may be appropriate / relevant in certain situations, but we do not believe it is appropriate in all situations.

We acknowledge that this model, with the accretion of a residual asset over the lease term, may be relevant to portray a specific business model where the
leased asset is new at the inception of the lease and is to be sold at the end of the lease term, such as many car leases.

As explained above, we believe that accounting models for lessor accounting should portray the specific business model of each lessor. As indicated in the previous paragraphs related to Type A: Measurement of the Residual Asset, we find the model inappropriate for the business model where the asset is to be leased under several successive contracts with several clients. Under that model the lessor bears a significant risk for demand of the underlying asset that is not reflected in the Type A model.
**Question 4: classification of leases**

Do you agree that the principle on the lessee’s expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 28-34, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

**Response**

No, we disagree.

As already explained in our answer to Question 2, we do not agree with the definition of the boundary between Type A and Type B leases.

We do not understand why the requirements for classifying lease contracts should differ depending on whether the underlying asset is a property or equipment.

According to the Board’s proposal, a contract where the lessee is expected to consume half of the economic benefits embedded in the underlying asset would be considered as Type A if the underlying asset is equipment, and as Type B if the underlying asset is property. We do not see any rationale for such a difference between two situations that appear to be very similar.

Assuming that the Boards confirm the proposed classification of leases, we have the following concerns:

**Total economic life vs. remaining economic life**

We are concerned by the fact that classification criterion for leases of equipment refers to the relative length of the lease term compared to the total economic life of the underlying asset, whereas property lease classification criterion refers to the remaining economic life of the asset.

We do not see any rationale for such a difference, and we believe that lease classification assessment should rely on the situation of the asset at inception of the contract, i.e. taking into account its remaining economic life whatever the nature of the underlying asset.
Lack of explanation and guidance on the meaning of the different thresholds

We are concerned by the meaning of the different thresholds used in the Exposure Draft to assess the classification of a leases contract either in Type A or in Type B.

Furthermore, it is unclear how “more than insignificant” would be interpreted in practice. It is a very subjective and complex model, and would likely lead to inconsistency in practice and ultimately less transparent financial reporting.

We therefore recommend to the Boards to explain add guidance on the terms “Insignificant”, “Major part”, and “Substantially all”.

IASB § 32 and 33 – FASB 842-10-25-9 and 10

We are concerned that the notion of “primary asset” used in IASB § 32 – FASB 842-10-25-9 is not defined in the draft standard itself:

“If a lease component contains the right to use more than one asset, an entity shall determine the nature of the underlying asset on the basis of the nature of the primary asset within the lease component. An entity shall regard the economic life of the primary asset to be the economic life of the underlying asset when applying the classification criteria in paragraphs 29–30 (IASB) – paragraphs 842-10-25-6 through 25-7.”

We consider that the Boards should define the term “primary asset” in the standard rather than in the Basis for Conclusions, as it is the case. BC 122 defines a primary asset as follow:

“The primary asset within a lease component is the predominant asset for which the lessee has contracted for the right to use. The main purpose of any other assets that form part of the lease component is often to facilitate the lessee obtaining benefits from the use of the primary asset.”

We are also concerned by IASB § 33 – FASB 842-10-25-10, which states that:

“Notwithstanding the requirements in paragraph 32 (IASB) – the preceding paragraph (FASB), if a lease component contains both land and a building, an entity shall regard the economic life of the building to be the economic life of the underlying asset when applying the classification criteria in paragraph 30 (IASB) – paragraph 842-10-25-7 (FASB).”
In our opinion, situations may exist where the primary asset should be the land even if the lease component contains both land and building. This could be the case when the lessee makes more use of the land than of the building and would have entered into the lease contract even if there were no building.

Therefore, we recommend to the Board to introduce a rebuttable presumption that the building is the primary asset.
Question 5: lease term

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

Response

We welcome that the Boards have abandoned their initial proposal to determine the lease term based on “most likely” measurement approach, i.e. the lease term would be the longest possible term that is more likely than not to occur.

We agree with the new Boards’ proposal that the lease term is linked to a lessee having a significant economic incentive to exercise an option.

We believe however that clarifications are required in the standard as regards the threshold of “significant economic incentive” since this is a new concept under IFRSs.

We suggest to the Boards to keep the existing notion of “reasonably assured” or “reasonably certain”, well known by constituents, since the Board considers (BC 140) that the concept of “significant economic incentive” provides a threshold that is similar to the concept of “reasonably assured” or “reasonably certain” in existing US GAAP or IFRS.

The ED states that when assessing whether a lessee has a significant economic incentive to exercise an option an entity shall consider at the commencement date all the relevant factors– contract based, asset based, market-based and entity based factors. Concerning the “entity-based factors”, the Boards (BC 140) consider that the expectation of exercise alone does not constitute a significant economic incentive. We believe that this meaningful precision should be included in the standard rather than in the Basis for Conclusions.

Reassessment of lease term

We globally agree with the proposals regarding reassessment of the lease term. Nevertheless, when an important change in market conditions makes a renewal option becoming a significant economic incentive, we do not understand why this event should not trigger reassessment. We do not agree with the Boards’ rationale (BC 171) that including market changes in the reassessment triggers would increase the frequency of lease term reassessment.
We believe that market changes of such importance that they create a *significant* economic incentive should be rare in practice, and we agree with the Boards’ view that reassessment of lease term will be infrequent (BC 171).

**Other concerns: short-term lease**

We agree with the practical option to account for short-term leases payments in profit or loss on a straight-line basis over the lease term, because applying the full proposals to short-term lease do not justify the cost.

However, we regret that the simplified accounting model proposed in the ED does not provide real relief for lessees and lessors.

Indeed, the simplified accounting model will apply to very few contracts in practice, due to an overly restrictive definition (“A lease that, at the commencement date, has a maximum term under the contract including any options to extend, of 12 month or less. Any lease that contains a purchase option is not a short term lease”), that seems to be mostly driven by anti-abuse considerations, as explained in the Basis of Conclusions (BC298).

To avoid complexity and undue costs for preparers we suggest a lease be considered as a short-term lease if the lease term (according to the definition, i.e. including any renewal period if the lessee has a significant economic incentive to exercise the renewal option). We also believe that this criterion of significant economic incentive should apply to purchase options at the end of the lease term. Therefore we propose to define a short-term lease as follow:

“A lease that, at the commencement date has a maximum term under the contract of 12 month or less, including any options to extend the lease **which the lessee has a significant economic incentive to exercise**. Any lease with the above characteristics that contains a purchase option is not a short term lease unless the lessee has no significant economic incentive to exercise that purchase option.”
**Question 6: variable lease payments**

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

**Response**

We welcome the Boards’ proposals to exclude variable lease payments (that are not based on an index or a rate) from the measurement of the lease liability and lease receivable, irrespective of whether the variable lease payments are highly probable or not.

We generally agree with the approach of including variable lease payments based on an index or a rate in the measurement of the lease liability (lessee) and lease receivable (lessor). However, we believe that the proposed reassessment provisions relating to the lease liability and the Right Of Use asset will be complex to apply and we wonder whether the benefits of reassessing lease assets and liabilities according to changes in an index or a rate outweigh the cost of implementing.

We are concerned by the lack of clarity of the notion of “in-substance fixed payments”. Therefore we recommend to the Boards to provide a clear definition of what they are, and provide more guidance to identify them. Examples are useful, but they cannot replace principles-based requirements and may be interpreted in different ways.

Regarding this issue, we believe that Examples 17A-C portray “minimum lease payments” rather than “in-substance fixed payments”. Therefore we encourage the Boards to re-name this concept, and make it clear that the lease liability should be measured at the present value of the minimum lease payments including variable lease payments that depend on an index or a rate, payments structured as residual value guarantees, and exercise price of a purchase option or payment for penalties for terminating the lease, if the lessee has a significant economic incentive to exercise the purchase or termination option.

Furthermore, we believe that Example 17C should make it clear that the lessee should measure its lease liability at the lower of the two amounts, instead of “at the present value of either of the following…”
**Question 7: transition**

Paragraphs C2-C22 state that a lessee and a lessor would recognise and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach? Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?

Are there any additional transition issues the boards should consider? If yes, what are they and why?

**Response**

We support the Boards’ decision to introduce practical reliefs that lead to the reduction of implementation cost, and agree with the proposal to carry forward the amounts recognised before the transition date for leases previously classified as finance leases.

However, we are concerned by the complexity of the modified retrospective approach for leases previously classified as operating leases and qualified as Type A.

**Lessee accounting:**

We suggest for the leases previously classified as operating leases and qualified as Type A to require the same modified retrospective approach as those for leases previously classified as operating leases and qualified as Type B, so that the right-of-use asset should be measured at an amount that equal to the lease liability.

**Lessor accounting:**

When drafting their transitional provisions for lessors, the Boards assumed that there always exists an interest rate the lessor charges the lessee, and that this information is available. We believe it is true for lessors within the finance industry, but rarely true for other lessors whose business model relies on a succession of different lessees for one underlying asset. It is notably the case in the construction industry where some lessors are specialized in heavy construction equipment provided to lessees for the duration of their construction project.

**Contracts whose term has ended before the end of the reporting period**

In order to facilitate the implementation, we believe that an entity should not be required to apply the requirements if the lease term has ended before the end of the period in which the new Standard is applied for the first-time.
Question 8: Disclosure

Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1 through 50-13 (IFRS § 58-67 and 98-109) set out the disclosure requirements for a lessee and lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

Response

We support the Boards efforts to improve the accounting standards to make them more useful, meaningful and enable transparent financial reporting. However, the disclosures being proposed do not seem that they provide the most decision-useful information. For companies to gather this data will be a huge undertaking and costs appear to outweigh the benefits.
Question 9: Nonpublic Entities (FASB Only)

To strive for a reasonable balance between the costs and benefits of information, the FASB decided to provide the following specified reliefs for nonpublic entities:

(a) To permit a nonpublic entity to make an accounting policy election to use a risk-free discount rate to measure the lease liability. If an entity elects to use a risk-free discount rate, that fact should be disclosed.

(b) To exempt a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability.

Will these specified reliefs for nonpublic entities help reduce the cost of implementing the new lease accounting requirements without unduly sacrificing information necessary for users of their financial statements? If not, what changes do you propose and why?

Response

We support the Board’s efforts to consider the needs of private companies. We also think the Private Company Council should review the Exposure Draft and provide their thoughts on it early in the process. This is especially important if the direction is moving towards possible relief or accommodations from any of the requirements for nonpublic entities.

The purpose of the Private Company Council is to work with the FASB to identify parts of GAAP when exceptions or modifications are warranted for private companies. The entire process would be more effective if the Private Company Council evaluated proposed changes to GAAP during the Exposure Draft stage and throughout redeliberations, so that any actual changes to GAAP would incorporate a relief for nonpublic entities simultaneously upon the issuance of the new standard, rather than at a later date when it is an urgent matter for the private sector.

It would be helpful for preparers, auditors and users if this was done early in the process since preparers and others would need to start to gather data needed to comply with the new guidance and this would help minimize what would need to be done if certain exceptions were granted.

We acknowledge the comment letter submitted by the Private Company Council and look forward to future insights throughout the redeliberations.
Question 12: Consequential amendments to IAS 40 (IASB only)

The IASB is proposing amendments to other IFRSs as a result of the proposals in this revised Exposure Draft, including amendments to IAS 40 Investment Property. The amendments to IAS 40 propose that a right-of-use asset arising from a lease of property would be within the scope of IAS 40 if the leased property meets the definition of investment property. This would represent a change from the current scope of IAS 40, which permits, but does not require, property held under an operating lease to be accounted for as investment property using the fair value model in IAS 40 if it meets the definition of investment property.

Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

Response

We agree that a right-of-use asset arising from the lease of a property should be within the scope of IAS 40 if this right of use is held by the lessee to earn rentals or for capital appreciation or both. We believe that the Board’s proposal, as drafted, is not precise enough (“if the property would otherwise meet the definition of investment property”) to make it clear that in order to be in the scope of IAS 40, a right of use of a property must be used by the lessee as an investment property. Therefore we suggest that the Board uses the wording of the definition of investment property in IAS 40 (as we did in the sentence above) instead.

We have also concerns regarding the interaction with the pending discussions around the definition of property at the IFRS Interpretations Committee.