

BELGIAN ACCOUNTING STANDARDS BOARD



International Accounting Standards Board
30 Cannon Street – first floor
London EC4M 6XH
United Kingdom

correspondent
Ignace Bogaert
Tel: +32(2)277 61 74
ignace.bogaert@cnc-cbn.be

Our reference
C-106

Your reference

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Dear Sir, Madam,

Invitation to comment – IASB ED *Leases*

The Belgian Accounting Standards Board (BASB) is pleased to respond to the Exposure Draft on Leases issued by the IASB and the FASB (the “Boards”) in August 2010 (hereinafter the “ED”).

Overall, we generally support the Boards efforts to improve lease accounting. The proposals in the ED address the criticism of ‘off-balance sheet financing’ by requiring that assets and liabilities arising from leasing arrangements are brought onto the balance sheet. However, there are key conceptual and application issues related to the proposals in the ED that must be addressed in order for these proposals to be operational.

Our answers to the specific questions raised in the ED are included in the attached appendix to this letter. Should you wish to discuss the content of this letter with us, please contact Jan Verhoeve at jan.verhoeve@cnc-cbn.be.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Jan Verhoeve', written over a horizontal line.

Jan Verhoeve
Chairman BASB

Appendix 1

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?

- Conceptually, we agree that the right to use a leased item is an asset and that the obligation to make lease payments that are required to obtain that right is a liability.

Question 2: Lessors

- (a) Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term, and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?
- (b) Do you agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

- We believe having two separate approaches for lessor accounting is contrary to the Boards' objective to establish a single right-of-use model for lease accounting, therefore we only support the derecognition model.

Question 3: Short-term leases

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

- We do not support the proposed accounting treatment for short-term leases as we are of the opinion that this will inevitably result in long-term leases being transformed into short-term leases.
- In order to define a short-term lease, we believe that an overall materiality test on a contract per contract basis would be required. This assessment should also be disclosed in the notes to the financial statements.

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 in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?

(c) Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

- We are of the opinion that the definition of a lease did not change significantly compared to the current IAS 17. However, taking into account the current exposure draft on Revenue from Contracts with Customers and the scope exclusions within the Leases exposure draft, we believe that the difference between a lease contract and a service contract will not be clear.
- We do not support a distinction for in-substance purchases versus leases. Any attempt to distinguish them simply creates another arbitrary bright-line in lease accounting.
- In-substance purchase/sale leases are economically different from outright asset purchases/sales. For example, in the event of bankruptcy, the risks to the lessor are different. We believe that such leases should be included within the proposed lease model.

Question 5: Scope exclusions

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?

- Leases of intangible assets are scoped out of the ED. However, certain leases of intangibles appear to be economically similar to leases of tangible assets. Therefore, we would suggest to include guidance on accounting for leases of intangible assets.

Question 6: Contracts that contain service components and lease components

The ED proposes that lessees and lessors should apply the proposals in *Revenue from Contracts with Customers* to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B5–B8 and BC47–BC54). If the service component in a contract that contains service components and lease components is not distinct:

(a) the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.

(b) the IASB proposes that: (i) a lessee should apply the lease accounting requirements to the combined contract. (ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract. (iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements, and the service component in accordance with the proposals in *Revenue from Contracts with Customers*.

Do you agree with either the IASB or FASB approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

- Including amounts for material non-distinct services to be provided in the measurement of a lessee's right-of-use asset is inconsistent with the accounting for other service contracts.
- We also believe that the definition of a (non) distinct service will be difficult to apply in practice.
- For lessors, the gross revenue related to the lease will be split into two components, i.e. the lease revenue and service revenue. This artificial split will lead to an excessive administrative burden for long-term car leases with an embedded service contract (e.g. maintenance services etc).

Question 7: Purchase options

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

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

- We believe that purchase options should be accounted for in the same way as options to extend or terminate the lease. Similar to renewal options, purchase options provide the lessee with the contractual ability to acquire additional rights associated with the leased asset. As such, we believe that purchase options that are reasonably certain of exercise should be included in the lease term and lease payments. See our response to question 8 related to renewal options.
- We also believe the proposed exclusion of purchase options complicates the definition of lease term and lease payments and clarification is required.

Question 8: Lease term

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

- We agree that 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.

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?

- If the contingent rents and residual value guarantees can be estimated reliably, we believe that they should be included in the lease payments.

Question 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

- We agree that a periodic reassessment is necessary given the significant use of estimates and judgement, however we would propose to include guidance on the determination of a significant change.