CNC **Commission des Normes Comptables**

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Correspondant	Your references	Our references	Date
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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 (the "Boards") on 16 May 2013 (hereinafter the "ED").

Question 1: identifying a lease
This 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.

The BASB agrees with the direction of the ED regarding scope and definition of a lease, but it needs more clarity to make it operational. We believe the principle of identifying a lease is an improvement compared to IFRIC 4 *Determining whether an Arrangement contains a Lease* in that it is intended to narrow the population of contracts that qualify as a lease. Even though the Boards decided to retain the definition of a lease in IFRIC 4, they changed the application guidance supporting the definition to align the concept of control more closely with the control principle in the revenue recognition project and in IFRS 10 Consolidated Financial Statements. Most importantly, the Boards decided not to retain the provisions in IFRIC 4.9(c).

However, for more complex contracts that contain significant service elements (e.g. power purchase, IT outsourcing, time charters, drilling contracts), the identification of a lease based on the control concept still leaves room for interpretation and, if not further improved, would likely result in diversity in practice.

We agree with the concept that a lease should contain the two elements: (a) fulfilment of a 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. However, we do not believe the principle is clearly expressed in the ED. Additional application guidance and illustrative examples may be required, especially because we believe the focus in the ED is on identifying a lease, compared to current lease accounting where the focus is on differentiating between operating and finance leases.
More clarity is needed around the 'ability to direct the use' of the asset to make this concept operational:

- The proposal is not clear on how to address arrangements for which significant decisions regarding the use of the asset are prescribed in the contract agreed to by both parties. That is, it is unclear whether the decisions agreed upon by both parties in negotiating the contract are to be considered and if so, how entities are to assess which party made the decision.
- The factors that need to be assessed when determining the ability to direct the use of the asset and how to identify the decisions that 'most significantly affect' the use of the asset need to be clarified and the Boards should explain how those factors do or do not align with the similar concepts in IFRS 10 and the proposed revenue recognition standard.

The concept of 'ability to derive the benefits from use' is not clearly articulated:

- We believe paragraph 19 is unclear, especially the phrase 'the asset is incidental to the delivery of services', which leads to confusion. Determining whether the customer is seeking the asset versus the output from the asset is judgemental and without more clarity, opportunities for diversity and structuring are likely to arise.

- Illustrative examples 2 (contract for coffee services) and 3 (contract for medical equipment) are particularly confusing. These examples illustrate that the determination of whether a contract contains a lease may depend on a party outside the arrangement supplying goods or services. Although most of our concerns regarding the scope of the ED involve application vs. conceptual issues, we do not see the conceptual basis for the requirements in paragraph 19 and believe this might lead to similar contracts being treated differently over time.

We believe that identifying a lease is one of the most critical issues in the current proposal. During redeliberations and the Boards' outreach, a number of arrangements were identified for which determining whether the arrangement is or contains a lease was not clear. We note that examples of these types of arrangements (e.g., power purchase agreements, telecommunication towers, time charters, drilling contracts) are not included in the ED. It would help practice if such examples would be included. However, the need for additional examples indicates the principles are difficult to interpret on their own.

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?

Under the right-of-use model, we do not see a conceptual basis for the distinction between the proposed two types of leases. Having two approaches (if the exception for short-term leases is also included there are really three types of leases) is inconsistent with one of the objectives of the Leases project, which was to eliminate the arbitrary distinction that exists under current accounting between operating and finance leases.

We understand the Type A lessee approach is based on the premise that such leases effectively include a financing component.
Conceptually, we do not understand the Type B lessee approach. We believe that the Type B approach is proposed in response to feedback from financial statement users; however, the conceptual basis for the approach is not clear:

- If the Boards believe Type B leases should have different expense and cash flow presentation, it is unclear why the presentation in the statement of financial position would be the same as Type A leases (i.e., a lessee would be allowed to present right-of-use assets within the same line items as the corresponding underlying assets, irrespective of whether they are Type A or Type B leases).
- Also, we question the usefulness of the right-of-use asset measured under the Type B approach to financial statement users. The periodic change in the right-of-use asset is a balancing figure (i.e., a plug), which causes the subsequent measurement of the asset to lose its usefulness.

The approach to Type B leases would not be easy to apply. It would increase the record-keeping burden for lessees since it introduces a new amortisation method; many IT systems today are not designed to perform the proposed amortisation method. To the extent the Boards determine that the needs of financial statement users would be best met through a straight-line approach to certain types of leases, a less complex approach that would have equal conceptual merit could be used.

We regard the amortisation for Type B leases as similar to annuity amortisation, which is not generally permitted under IFRS. From an economic point of view, we fail to understand how an increase in the depreciation of the right of use asset is justifiable – it appears that the concept of the depreciation, generally understood under IAS 16, is not withheld within the ED.

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?

We believe lessor accounting should be conceptually consistent with lessee accounting. We do not see a conceptual basis for the lessee in a Type B lease recording a right-of-use asset because the lessor has made that asset available to the lessee, and the lessor in a Type B lease not reflecting on its books that it has made that asset available.

We believe the proposed lessor approach for Type A leases is overly complex. For example, the accounting for a lease with initial direct costs, expected variable lease payments based on usage, lease payments depending on an index and a residual value guarantee would be very complex. The primary cause of the complexity results from the requirement to reassess the lease receivable, which requires periodic recalculations. In addition, the complexities of multiple discount rates and calculations would be very difficult to apply and we believe the costs would not out-weigh the benefits.

We believe that the proposed changes to lessor accounting may lead to difficulties in interpreting the financial results of lessors:

- For lessors that lease an asset multiple times over the life of the asset, the proposed model may lead to income recognition patterns that may differ substantially over time depending on the fair value of the asset (and - in the case of property - the remaining economic life of the asset).
- For equipment lessors that today have primarily operating leases that would be Type A leases under the ED, the recognition of profit at the commencement of the lease and interest income from the receivable and accretion of the residual asset would result in fluctuations in revenue patterns compared to what preparers and users are accustomed.

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?

We believe the classification based on the nature of the underlying asset is arbitrary. It does not appropriately reflect the principle of consumption of the underlying asset.

We do not see the conceptual difference between leasing 50% of the life or fair value of equipment compared to a building, although they lead to different accounting under the ED.

We question whether the proposed classification represents an improvement over the classification of leases under IAS 17. As the proposed classification does not appear to be grounded in conceptual principles, we question whether an alternative approach using the well understood current IAS 17 classification concepts might be more pragmatic.

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?

We are concerned that the reassessment requirements (i.e., requirement to reassess the lease term upon a change in relevant factors) may be burdensome. We believe the Boards should explore whether practical expedients (e.g., allowing lessees to apply an annual reassessment similar to requirements under IAS 16 and IAS 38 and requiring additional periodic reassessment only when renewals are exercised or contractual terms change) could be included to simplify the process and reduce the costs of compliance.

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?

We generally agree with the proposals on determining variable lease payments and support the changes made from the 2010 ED.

We believe more guidance and additional illustrative examples are necessary. It is not clear, for example, what circumstances the Boards consider to be variable lease payments that are in-substance fixed payments.

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?

We generally agree with the transition proposals. We believe entities should have an option to apply the ED's requirements using either the full retrospective or modified retrospective approach.

Question 8: disclosure
Paragraphs 58–67 and 98–109 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments; reconciliations of amounts recognised 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?

We would not expect that a proposal that attempts to provide greater transparency related to leases by recognising the assets and liabilities that arise in leases should require significantly more disclosure than under current standards, whereby most leases are not recognised on the statement of financial position. In fact, we would have expected less disclosure.

We agree that lessees and lessors should disclose quantitative and qualitative information that identifies and explains the amounts recognised in the financial statements arising from leases and describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows.

However, the ED requires a significantly increased volume of disclosures and we do not believe all of the required disclosures are necessary or useful. Certain new disclosure requirements for leases, including disclosing significant judgements and estimates and balance sheet reconciliations, will necessitate such information to be tracked and compiled. Compilation of this information will be costly for many entities.

Should you wish to discuss the content of this letter with us, please contact Jan Verhoeye at jan.verhoeye@cnc-cbn.be.

Yours faithfully,

Jan Verhoeye
Chairman BASB,
Belgian Accounting Standards Board