

*Sir David Tweedie, Chairman  
International Accounting Standards Board*

*Ms Leslie F. Seidman, Acting Chairman  
Financial Accounting Standards Board*

21 December 2010

**Global Leasing Industry Views on the IASB/FASB Exposure Draft Leases**

Dear Sir David,  
Dear Ms Seidman,

This paper identifies the *six key concerns of the global leasing industry*, represented by the US Equipment Leasing and Finance Association (ELFA), Leaseurope (the European leasing and automotive rental federation)<sup>1</sup>, the Japanese Leasing Association (JLA), the China Leasing Business Association (CLBA), the Canadian Finance and Leasing Association (CFLA), the Australian Equipment Lessors Association (AELA), the Australian Fleet Lessors Association (AFLA) and the Truck Renting and Leasing Association (TRALA) with respect to the proposed lease accounting model described in the IASB/FASB Leases Exposure Draft.

The global leasing industry considers it is essential these fundamental issues be resolved before the Leases standard is finalized. We have therefore provided suggestions and alternatives in our letter and we encourage the Boards to explore these in the context of their forthcoming re-deliberations.

While this paper sets out the common, high-level views shared by the global leasing industry, we invite the Boards to refer to the individual submissions of each signatory association for further details on these issues as well as on the specific questions raised in the Exposure Draft.

Yours sincerely,

*The global leasing industry associations*



<sup>1</sup> Leaseurope represents 45 leasing and automotive rental associations in 32 European countries

## **1. The scope of the proposed standard needs work at its boundaries**

### **Issue**

The term “leasing” covers a very wide spectrum of different types of contracts. In order for a future lease accounting standard to be practicable, the capitalization of all leases under a right of use model requires a robust definition of a lease contract. We are not convinced the Exposure Draft has achieved this for the following reasons:

- At one end of the leases spectrum (leases vs services), the proposals do not provide a clear rationale for why leases should be accounted for differently from non-lease executory contracts.
- At the other end of the spectrum (leases vs sales/purchases), the proposal to scope-out such contracts leads to multiple definitions of a sale in the accounting literature.

### **Suggestion**

The Boards must address the issue of whether it is indeed appropriate to capitalize all leases as currently defined. We suggest that it is not and that this can be dealt with in one of two ways: either by maintaining a difference in accounting treatment between types of leases or by clarifying and narrowing the scope of what constitutes a lease contract compared to a service contract. It is essential that the Boards make this determination on the basis of a thorough cost/benefit assessment.

There is no need to maintain an artificial and unnecessary scope-out for leases that are in-substance sales/purchases. Instead, the accounting under a right of use model should provide similar results to the accounting for sales and purchases from the perspective of lessors and lessees respectively.

## **2. The proposals for lessor accounting require considerable improvement**

### **Issue**

The leasing industry considers that if accounting for lessees is changed, it is also necessary to change accounting from the perspective of lessors. However, the proposed hybrid approach to lessor accounting does not represent an improvement compared to the current lessor accounting model and is inconsistent with the right of use approach for lessees. Additionally, we do not think that the performance obligation model reflects the economics of lease transactions nor the conceptual premise underlying right of use that an asset is a bundle of rights.

### **Suggestion**

The de-recognition model, where the discount on the lessor’s residual asset is unwound over the lease term, should apply as the general model to those contracts defined as leases rather than service contracts. Investment property lessors should continue to apply IAS40 and other property lessors can be catered for under the existing operating lease model.

### **3. Further simplifications are required for lessees of short term contracts**

#### **Issue**

The proposal that lessees of leases with a maximum possible lease term of 12 months omit a present value calculation does not provide sufficient relief for preparers. These firms will still have to deal with the burden of indentifying large numbers of low-value, short term contracts and applying all of the other requirements of the proposals such as determining the lease term and lease payments.

#### **Suggestion**

Lessees of short term leases should be allowed to continue to apply existing operating lease accounting on the grounds of simplicity. This is in line with the proposals for lessors of short term leases, which we support.

### **4. The subsequent measurement proposals will produce P&L impacts for lessees that do not match the pattern of benefits consumed over the lease**

#### **Issue**

The proposals for subsequent measurement of a lessee's right of use asset and obligation to make lease payments lead to front-loaded lease costs for all current operating leases. Lessees will experience losses on transition but also, in many cases, on an ongoing basis. It is questionable whether this approach will provide the most useful information for users of accounts.

#### **Suggestion**

The Boards recognize that a lessee's asset and liability are linked upon initial measurement. Lessees should be allowed to amortize their right of use assets on an annuity basis so that in the case of leases with even rental payments their assets and liabilities remain equal throughout the lease term, continuing to reflect their linked nature. Assets and liabilities may in some cases no longer be equal (e.g. revaluation or impairment of the right of use asset or prepaid rentals) but this does not detract from the usefulness of annuity amortization of right of use assets.

**5. The single asset and liability approach is inconsistent with the Conceptual Framework and a significant source of complexity for preparers**

**Issue**

The inclusion of optional periods and contingent rentals in the lessee's liability (lessor's receivable) on the basis of probability assessments will lead to an overstatement of the lessee's liability (lessor's receivable). We consider that the complexity of this approach risks jeopardizing the flexibility and simplicity that leasing provides to businesses. Not only will it be extremely difficult for preparers to apply in practice, it is not clear that it will provide useful information for the users of accounts.

**Suggestion**

We recommend that the Boards simplify their proposals by either maintaining current definitions of lease terms and lease payments or by adopting the approaches below:

- Lease term: raise the probability threshold from "longest possible lease term that is more likely than not to occur" to a higher threshold where the lease term includes periods covered by payments that are legal obligations of the lessee or where the lessee is economically compelled to make payments.
- Lease payments: contingent rentals should only be included in the lessee's liability (lessor's receivable) when they meet the definition of a liability (asset); in other words, when they are being used as a means to "disguise" minimum rental payments. A principle for recognising such cases could be "situations where contingent rentals are included in lease contracts to compensate for below market committed rentals".

**6. The principle that an asset is a bundle of rights should be reflected consistently throughout the standard**

**Issue**

The proposed treatment of sale and leasebacks does not reflect the conceptual premise that an asset is a bundle of rights that can be separated and transferred. This is also true of the performance obligation model (see above).

**Suggestion**

A right of use concept should be applied to sale and leaseback transactions. In such transactions, the seller/lessee is transferring only the residual rights to use the asset after the lease term has expired to the purchaser/lessor, retaining a right to use the asset during the lease term. These rights can be determined using the de-recognition methodology.