Committee of European Banking Supervisors

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International Accounting Standards Board
30 Cannon Street,
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Dear Madam, dear Sir,

Exposure Draft ED/2010/9 Leases

The Committee of European Banking Supervisors (CEBS), comprised of high level representatives from banking supervisory authorities and central banks of the European Union, welcomes the opportunity to comment on the IASB's Exposure Draft on Leases (ED/2010/9).

Banking supervisory authorities and central banks have a strong interest in promoting sound and high quality accounting and disclosure standards for the banking and financial industry, as well as transparent and comparable financial statements that would strengthen market discipline.

CEBS welcomes the efforts of the IASB to improve financial reporting in the area of leasing and in particular the intent to remove the distinction between operating and finance leases.

CEBS notes that the Exposure Draft (ED) encourages transparency and would reflect an improvement to current lessee accounting for operating leases.

CEBS also welcomes the Board's proposal to link the derecognition approach to the concept of transfer of 'significant risks and benefits' instead of the concept of control. This is a point that we already raised when we commented on the ED2009/3 on derecognition of financial assets.

However, the objective of a single accounting treatment for all lease transactions (with regard to the lessor) has not been really achieved, and that the proposed two approaches (performance obligation vs. derecognition) - depending on whether or not there is a transfer of significant risk and benefits – reintroduce another form of complexity and contain significant scope for judgment while potentially reducing comparability.

While CEBS notes the IASB's attempt to align the accounting for leases to the economic reality of the transaction, we are concerned that the ED might be complex to apply in practice. We invite the IASB to explore ways to simplify the standard.

In addition, the Exposure Draft (ED) contains too much scope for judgment, due to the necessity for both lessor and lessee to model behavioral clauses (e.g. renewal options, prepayment options) and to estimate variables (e.g. lease terms, contingent rentals). While potentially adding to the complexity of financial statements, this may also reduce the level of comparability.

We would also encourage the IASB to investigate further how to distinguish a lease contract from a service contract.

CEBS also encourages both the IASB and FASB to continue developing a single set of high quality converged lease accounting requirements as this would be beneficial to investors and users across the globe.

In the appendix, we discuss certain aspects of the Exposure Draft (ED) that could be further improved together with more general amendments that the IASB should consider. We have not explicitly addressed the questions raised in the ED.

The comments put forward in this letter and in the related appendix have been coordinated by the CEBS's Expert Group on Financial Information (EGFI) chaired by Mr. Didier Elbaum (Deputy Secretary General, Autorité de Contrôle Prudentiel) - in charge of monitoring any developments in the accounting area and of preparing related CEBS positions - and in particular by its Subgroup on Accounting under the direction of Mr. Michel Colinet of the Belgian CBFA. If you have any questions regarding our comments, please feel free to contact Mr. Elbaum (+33.1.4292.5801) or Mr. Colinet (+ 32.2.220.5247).

Yours sincerely,

Giovanni Carosio

Chair, Committee of European Banking Supervisors

Appendix

Detailed comments

Scope of Standard

The ED proposes to eliminate the distinction between finance and operating leases. While we support this approach, it is not clear whether all finance leases under the existing IAS17 will come under the new standard when applying the ED's guidance on distinguishing a lease from a sale/purchase contract. The guidance in B9 and B10 focuses only on the 'control' aspect, and ignores the 'risks and benefits' aspect which is part of the criteria in paragraph 8 ('…all but trivial risks and benefits'). The potential scoping-out of those transactions could also lead to some reduction in terms of disclosure about financial transactions, compared to what is required under IAS 17.

This could also raise significant legal or tax issues in some jurisdictions.

Lessor Accounting

CEBS supports the IASB's proposals that lessor accounting should reflect whether the lessor retains exposure to significant risks or benefits. In line with our earlier comments on the ED 2009/3 related to the derecognition of financial assets, CEBS has a preference for the concept of 'risks and benefits' rather than the concept of (legal) "control" as proposed in ED 2009/3.

This ED proposes two approaches for lessor accounting: derecognition or performance obligation. The standard could be simplified if it clarified that the accounting treatment for lessor accounting is dependant on one criterion - the lessor's exposure to significant risks or benefits. The standard could then go on to require that the accounting treatment reflects the level of exposure of the lessor by including assets and liabilities accordingly, as currently proposed. This would not change the substance of the eventual accounting outcomes, but it would appear as a more consistent and principle-based approach.

It would also help to clarify in the standard and in the guidance that the accounting treatment (derecognition or performance obligation) is not optional but compulsory depending on whether the lessor retains or not exposure to significant risks or benefits.

Another issue is to ensure that the approach applied by the lessor and the treatment applied by the lessee in relation to the same underlying asset do not result in double counting of this asset. Further specifications to this end would be most welcome.

In addition we have the following more specific comments on the proposal for lessor accounting:

a) The ED could usefully provide more guidance on how to determine whether the lessor retains exposure to significant risks or benefits, notably where the ED introduces the notion of the transfer of 'all but a trivial amount' of risks and benefits.

b) According to the ED on Revenue Recognition, a transaction is a 'true sale' when it transfers the control of the underlying asset; vice versa, according to the ED on Leases a transaction is a 'true sale' when it transfers both 'all but a trivial amount' of risk and benefits and the control. We believe that a unique definition of a "true sale" should be adopted across different standards.

c) We suggest clarifying BC 27 which indicates that the business model of the reporting entity is an indicator for determining when the derecognition or the performance obligation approach would be appropriate. This paragraph can be read as leaving an option which - we understand - is not the case (see our comment above). Moreover, this paragraph could be misunderstood as giving to the 'business model' more prominence than the criteria set in the standard (i.e. the exposure to risk and benefits).

Lease Term and Other Optionalities

While CEBS welcomes the IASB's attempt to align the accounting for leases to the economic reality of the transaction, we have concerns that the ED might be complex to apply in practice and might limit comparability of the financial statements across entities.

This is particularly the case for the determination of the present value of lease payments on the basis of expected outcome, taking into account the "likely" lease term, contingent rentals, residual value guarantees or term option penalties. The magnitude of required management judgment may reduce the reliability and comparability of financial statements. CEBS believes that more reference to the contractual elements of the lease transaction (for example, "minimum lease payments") could be appropriate together with clear disclosure in the notes of the expected effects of the contract's provisions.

Another aspect is that the ED gives the lessee the option to revalue the right-of-use asset for each class of property, plant and equipment. While we recognise that this is consistent with the revaluation that may be employed in IAS 16 – Property, Plant and Equipment, this option could impair comparability, introduce complexity and cause volatility in the lessee's equity. We understand that this re-measurement option would not be allowed under US GAAP, and would thereby create an unnecessary source of divergence between the two frameworks. Thus, we suggest that the IASB reconsider this aspect of the proposal.

Short term leases

CEBS welcomes a less onerous accounting requirements for short term leases but considers that the proposed approach would in practice not provide sufficient relief as lessees would still be required to recognise an asset and a liability for their short-term leases.

CEBS therefore encourages the Board to investigate further how to distinguish lease contracts from service contracts, with an objective to provide a simplification similar to that proposed for lessors which are permitted to maintain operating lease accounting requirements.

CEBS would also welcome reference being made in the standard, for entities to consider the economic substance of clauses in the contract which would extend the term beyond the 12 month period, so that short term leases whose economic substance extends beyond 12 months cannot avail of the short term leasing option. Furthermore, to avoid the potential for structuring leases to benefit from the short-term treatment, further simplifications could be introduced based on materiality considerations as explained in the paragraph below.

Further simplifications could achieved by applying the treatment for service contracts to non-core asset leases (contracts with individually minimal costs and which are currently treated as operational leases), such as cars, photocopiers, telephone and information technology related equipment (e.g. personal computers). CEBS is not convinced that the IASB has appropriately considered the cost / benefits ratio for the preparers of the information provided to users for these contracts.