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## THE CHAIRPERSON

Hans Hoogervorst  
Chairman  
International Accounting Standard Board  
30 Cannon Street  
London  
EC4M 6XH

13 September 2013

### Exposure Draft ED/2013/6: Leases

Dear Mr Hoogervorst

The European Banking Authority (EBA) welcomes the opportunity to comment on the IASB's Exposure Draft ED/2013/6 Leases (ED). The EBA has 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.

The EBA welcomes the efforts of the IASB to improve financial reporting in the area of leasing and in particular the aim to reflect the substance and the economics of the lease transactions in the financial statements of both lessees and lessors. The current accounting treatment of leases allows some assets and liabilities relating to leases to remain off-balance sheet, there is inadequate disclosure of operating leases and the leverage position of lessees may not be accurately reflected. The EBA believes that the core principle of the proposed model in which a lessee is required to recognise assets and liabilities arising from a lease will improve the transparency of information about lease rights and obligations.

The EBA acknowledges the efforts of the IASB to maintain an appropriate balance between faithful representation of the various types of lease transactions and simplicity in application. The new proposal to determine the lease term and the conditions under which contingent clauses need to be factored in the lease payments address some of the concerns raised in relation to the cost and complexity of the previous proposals. Additionally, the EBA welcomes the efforts of the IASB in analysing the effects of the proposed requirements as explained in the Basis for Conclusions (BC329-465), which highlight the benefits of the proposed model compared against the costs of implementation and the impact of the changes in the existing arrangements. We support that the IASB continues to work on this analysis through further outreach activities.

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We also welcome the IASB's efforts to distinguish between a lease contract and a service contract. We understand that these changes are introduced to better portray the different types of contracts that exist today and we support a model that achieves faithful and transparent accounting of the various types of arrangements.

The EBA appreciates the challenges to develop a single approach that could be appropriately applied to all the various types of lease arrangements. The proposed dual approach that requires a lessee to recognise a lease liability and a corresponding right-of-use asset (RoU) for all leases of more than 12 months (whether they are classified as Type A or Type B leases) should limit the opportunities for structuring arrangements to achieve a beneficial accounting treatment and increase the transparency of financial statements, through the wider recognition of financial liabilities and the right-of-use assets on the balance sheet. However, we would welcome further developments of the conceptual basis of the "right-of-use" asset in the proposed model.

In addition, we have concerns about the clarity and soundness of some of the terms and requirements of the ED for the accounting treatment of leases. These could result in significant scope for judgment and inconsistency in the application, which will undermine the comparability of the financial information. The EBA believes that in order for the proposed accounting model for leases to achieve its objectives, these requirements need to be adequately articulated and robustly set. Also, we would support requirements for more regular and robust reassessment of lease classification and lease payments to be included in the Standard.

The EBA welcomes the commitment of the IASB and FASB in reaching a converged high quality solution. We encourage both Boards to continue their efforts in developing a single set of accounting requirements, which will be of benefit for the preparers and users of financial statements.

In the Appendix, we discuss certain aspects of the ED that could be further improved together with more general considerations that the IASB should consider. We have not explicitly addressed the specific questions raised in the ED.

If you have any questions regarding our comments, please feel free to contact Mr. Colinet (+32.2.220.5247) in his capacity as Chairman of the technical group that coordinated this comment letter.

Yours sincerely

*(Signed)*

Andrea Enria

CC: Mr Michel Colinet, Chairman of the Technical Group

Appendix: detailed comments on the Exposure Draft

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## Appendix

### Accounting model

The EBA supports the core principle of the proposed model which generally requires lessees to recognise assets and liabilities arising from lease transactions on the balance sheet. Overall, compared to the current requirements, the proposals of the ED should improve the transparency of information, result in a wider recognition of financial liabilities for all types of leases for lessees and should reduce the room for structuring leases in order to achieve beneficial accounting treatment. However, we believe that some of the elements introduced in the proposed dual approach seem to lack conceptual consistency.

More specifically, under the proposed model for type B leases, a lessee will recognise a right-of-use asset when it is not expected to consume more than an insignificant portion of the economic benefits in the underlying asset (and the payments will provide the lessor with a return on its investment in the underlying asset). The recognition of a right-of-use asset is not considered as equivalent to a sale of a portion of the asset and will be subsequently measured as the balancing figure, calculated by the single lease expense minus the unwinding of discount of the lease liability. In our view, the subsequent measurement proposed in the ED of the right-of-use asset may not reflect the pattern of consumption of the economic benefits of the asset. Also, it is not clear how information about these types of assets could be useful to the users. Thus, the IASB should clarify further the conceptual basis of recognition and measurement of the right-of-use asset in order to achieve faithful representation of lease transactions.

In addition, the Basis for Conclusion (BC55) refers to the consumption principle and explains how it is linked to the classification criteria for property assets as described in paragraph 30. More specifically, it explains that in Type B leases, the lessee is not expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset, and the proposed accounting treatment is consistent with the consumption principle. However, the requirements in paragraph 30 seem to establish different criteria ('major part of the remaining economic life' or 'substantially all of the fair value') compared to the consumption principle ('insignificant portion of the economic benefits'). Therefore, we suggest that the IASB further clarifies the requirements for the classification of leases and their relationship with the consumption principle in the classification assessment, within the Standard.

### Right-of-use asset

In the proposed ED, the nature of the "right-of-use" asset (i.e. whether it is tangible or intangible) is not clarified in the Standard. Paragraph 44 of the Basis for Conclusions refers to the 'loaned' assets as tangible assets rather than financial assets, but does not describe the nature of the right-of-use asset itself. A lack of clarification of the nature of these assets might encourage inconsistent practices in the interpretation and use of the same financial information by the users of financial statements (for example in the analysis of financial statements' and/ or ratios' calculation) and could also attract

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different treatment under prudential rules. Thus, we would suggest that the nature of these types of assets is described appropriately in the main part of the Standard.

#### Lease classification criteria

Under the proposed model, the classification of a lease as Type A or Type B depends on the nature of the underlying asset (whether it is property or not) unless specific classification criteria are met (paragraphs 29-31). As explained in paragraphs BC50-52 of the Basis for Conclusions, the classification will result in most leases being classified according to the consumption principle used in the model with reference to the different economic life of the underlying assets. We appreciate that such simplified requirement is to enable ease and consistent application of the classification principle by entities.

The EBA has continuously supported accounting standards based on principles supplemented by appropriate guidance. In the specific context of the lease contracts classification, the EBA would suggest to base the classification on the principles set out in paragraphs 29-31, which depend on the length of lease and the present value of the lease payments, while the nature of the underlying assets to be used as a guidance for classification.

Under the proposed model entities do not reassess the lease classification after the commencement date (paragraph 28), unless there is a substantive change in the existing lease arising from the modification of the contractual terms and conditions of the lease, in which cases the modified contract shall be accounted as a new contract (paragraph 36).

In our view, in the absence of a requirement for regular review of the lease classification, especially from Type B leases to Type A leases, there is a risk that the accounting treatment for leases will not reflect the changes in the substance and economics of the leases, or may lead to structuring of certain lease transactions, towards achieving more beneficial accounting treatment. For example, a property lease could be initially agreed for a short maximum possible term compared to the remaining economic life of the underlying property, and the lease may be renewed several times subsequently. Under the proposed model, this arrangement would be accounted for as a Type B lease, despite the several renewals of the arrangement which may result in the consumption of more than an insignificant portion of the economic benefits embedded in the property, thus indicating that a classification as Type A would have been more appropriate. Other examples include exercise of an existing option for extension of lease term (which at lease commencement the lessee did not have a significant incentive to exercise) or a change in the likelihood of an existing contingent feature.

Thus, the EBA would support further improvements of the proposed model by requiring a robust and regular reassessment of lease classification in order to improve transparency and comparability when reflecting the various types of lease arrangements and their economic substance.

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### Clarification of terms and requirements

We are also concerned about the interpretation and the application of some of the requirements of this ED. The terms “substantive” right to substitute the asset, “significant economic incentive” to exercise an option, “significant/ insignificant” part of the economic life, “major part of the remaining economic life”, “substantially all”, “in-substance fixed” payments, “significant/ insignificant” economic incentive to exercise an option, “substantive” change to the existing lease etc may result in significant scope for judgement and inconsistent application which will undermine the comparability of the financial information. In particular, it is not clear how these individual requirements should be weighted when being assessed and if both qualitative and quantitative measurements would be necessary.

The EBA understands that the assessments of these criteria are important for accurate and consistent identification, classification and measurement of leases. Unless the above mentioned criteria are adequately articulated and robustly set, the objective of the ED may not be met and the quality of financial information will be impaired. Further clarification, guidance and examples on these requirements would ensure that there is a clear understanding and consistent application of the model. The IASB could also assess whether there is a need to use all these terms or if the Standard could be simplified in this regard. Also, supplementing these qualitative requirements with quantitative thresholds could improve the consistency of assessment of leases. However, quantitative metrics should not replace the qualitative assessment requirements or lead to undue reliance on the use of prescriptive criteria.

### Reassessment of lease payments

In the proposed model (paragraphs 44, 45 for lessee and 79, 80 for lessor), a reassessment of lease payments is required only under certain circumstances. The EBA is concerned that in the absence of a requirement for regular reassessment of the measurement of lease payments (hence the lease liabilities/ receivables) there is a risk that changes in the economics of lease transactions will not be reflected timely in the financial statements. Thus, there will be a delay in the recognition in the financial statements of the changes in the substance and the economics of leases. In view of the above, the EBA would support further improvements of the model, by requiring regular reassessments of the measurement of lease payments to be performed, e.g. at each external reporting date or when the specific conditions occur.