

January 8, 2014

(By e-mail to [ifric@ifrs.org](mailto:ifric@ifrs.org))

IFRS Interpretations Committee  
30 Cannon Street,  
London EC4M 6XH  
United Kingdom

Dear Sirs,

**Re: Tentative agenda decision on IAS 17 Leases—Meaning of ‘incremental costs’**

This letter is the response of the staff of the Canadian Accounting Standards Board (AcSB) to the IFRS Interpretations Committee’s tentative agenda decision on the meaning of ‘incremental costs’ in the context of IAS 17. This tentative agenda decision was published in the November 2013 IFRIC Update.

The views expressed in this letter take into account comments from individual members of the AcSB staff but do not necessarily represent a common view of the AcSB or its staff. Views of the AcSB are developed only through due process.

We agree with the Committee’s decision not to add this item to its agenda. We note that describing incremental costs as “costs that would not have been incurred if the entity had not negotiated and arranged a lease” is consistent with paragraph B10 of ED/2013/6 on Leases and we agree with that description. The tentative agenda decision states that “there does not appear to be diversity in practice on this issue”. We have found some limited diversity and note that the fact that the issue was raised also suggests some diversity. Therefore we suggest the agenda decision read “there does not appear to be significant diversity in practice on this issue”.

We would be pleased to provide more detail if you require. If so, please contact me at +1 416 204-3276 (e-mail [pmartin@cpacanada.ca](mailto:pmartin@cpacanada.ca)), or Mark Walsh, Principal, Accounting Standards at +1 416 204-3453 (e-mail [mwalsh@cpacanada.ca](mailto:mwalsh@cpacanada.ca)).

Yours truly,



Peter Martin, CPA, CA  
Director, Accounting Standards

Wayne Upton  
Chairman  
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EC4M 6XH

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21 January 2014

Dear Mr Upton

## **Tentative agenda decision – IAS 17 Leases: Meaning of ‘incremental costs’**

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee’s publication in the November IFRIC Update of the tentative decision not to take onto the Committee’s agenda a request for clarification on whether the salary costs of permanent staff involved in negotiating and arranging new leases (and loans) qualify as ‘incremental costs’ within the context of IAS 17 for inclusion as initial direct costs in the initial measurement of a finance lease receivable.

We agree with the IFRS Interpretations Committee’s decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision, but note that the statement that “only costs that would not have been incurred if the entity had not negotiated and arranged a lease” is drawn from the definition of transaction costs included in IAS 39 *Financial Instruments: Recognition and Measurement* (and, by cross-reference, in IFRS 9 *Financial Instruments*). We believe the tentative agenda decision could be made clearer by referring to this definition and stating that the term ‘incremental costs’ is expected to be applied consistently in the context of finance lease receivables and other financial assets.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0)20 7007 0884.

Yours sincerely



Veronica Poole  
Global IFRS Leader

International Financial Reporting Standards  
Interpretations Committee  
30 Cannon Street  
London  
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20 January 2014

Dear IFRS Interpretations Committee members,

**Tentative agenda decision - IAS 17 Leases - Meaning of incremental costs**

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on the above tentative agenda decision, as published in the November 2013 *IFRIC Update*.

The Interpretations Committee received a request for clarification of the meaning of 'incremental costs' within the context of IAS 17 *Leases*.

"The submitter asks whether the salary costs of permanent staff involved in negotiating and arranging new leases (and loans) qualify as 'incremental costs' within the context of IAS 17 and should therefore be included as initial direct costs in the initial measurement of a finance lease receivable."

We do not support the Interpretations Committee's tentative decision not to add this issue to its agenda, as we believe preparers would benefit from additional guidance related to capitalising certain internal costs as incremental costs. IAS 17.38 clearly indicates that some internal costs are incremental and directly attributable to negotiating and arranging a lease. Without additional clarification, preparers of financial statements may find it difficult to distinguish between certain internal costs that are incremental and internal costs that are not incremental.

The IASB and FASB staffs issued agenda paper 11A for the 21-23 March 2011 joint meeting addressing the definition of initial direct costs for the joint project on leasing. On page 4, paragraph 14 of this agenda paper, the staffs note that the definition proposed for the joint exposure draft *Leases* is not intended to change current practice for how initial direct costs are defined. ASC 840-20-25-18 permits "that portion of employees' total compensation and payroll-related fringe benefits directly related to time spent performing those activities for that lease..." to be included in initial direct costs of a lease. We believe the staffs' paper suggests there is no difference between IFRS and US GAAP currently, which is consistent with our observations in practice. Therefore, we believe the Interpretations Committee's tentative agenda decision as drafted would create an IFRS/US GAAP difference.

We believe the tentative agenda decision is inconsistent with the decision published in the September 2008 *IFRIC Update* on IAS 32 in which "... the IFRIC also noted that the terms 'incremental' and 'directly attributable' are used with similar but not identical meanings in many Standards and Interpretations. The IFRIC recommended that common definitions should be developed for both terms and added to the Glossary as part of the Board's annual improvements project." These definitions were not added to the Glossary and new standards are being developed that rely on these concepts, for example, the proposed new revenue and insurance standards. For standards developed jointly by the IASB and FASB, consistent definitions become more important. For example, the joint revenue standard, which is expected to be issued in Q1 2014, will not only create another standard that uses the term 'incremental costs', but also will provide a converged definition of incremental costs for the purpose of a single standard. A common definition of 'incremental costs' that would apply to all the standards that use the concept of 'incremental costs' would result in greater consistency in the application of its meaning among IFRS standards and among lessors reporting under IFRS and US GAAP.

Paragraph 38 of IAS 17 indicates that some internal costs are incremental and directly attributable to negotiating and arranging a lease: "Initial direct costs are often incurred by lessors and include amounts such as commissions, legal fees and *internal costs* (emphasis added) that are incremental and directly attributable to negotiating and arranging a lease. They exclude general overheads such as those incurred by a sales and marketing team." Some preparers consider certain internal costs as incremental or variable costs (not as fixed costs). These costs are directly related to specific activities performed by the lessor that would not have occurred but for that successfully executed lease. Those activities may include: evaluating a prospective lessee's financial condition, evaluating and recording security arrangements, negotiating lease terms, preparing and processing lease documents and closing the lease transaction. These activities are initiated upon the prospective lessee's desire to enter into a lease, on behalf of the lessor and they relate directly to entering into the successfully executed lease. Therefore, they are integral to leasing. These companies typically have a time-tracking system in place to allocate time (and costs) to a specific lease arrangement and capitalise certain internal costs that relate to successful leases.

In its tentative agenda decision, the Interpretations Committee noted that "... internal fixed costs do not qualify as 'incremental costs'. Only costs that would not have been incurred if the entity had not negotiated and arranged a lease should be included in the initial measurement of a finance lease receivable" and "... in the light of the existing IFRS requirements, neither an Interpretation nor an amendment to IFRSs was necessary." However, the Interpretations Committee does not indicate where in existing IFRS it is stated that internal fixed costs do not qualify as 'incremental costs' and, in turn, how this reconciles to the language in paragraph 38 of IAS 17, quoted above. Therefore, it is not clear why the Interpretations Committee concluded that the issue is clear in IFRS. It appears the Interpretations Committee may have reached such conclusion based, in part, on a perceived lack of diversity as indicating that it believes IFRS is clear on the issue when it noted that, "... there does not appear to be diversity in practice on this issue." However, we have observed diversity spanning multiple geographic areas (i.e., Australia, Europe and North America).

Without further explanation as to why certain internal fixed costs do not qualify as 'incremental costs', it would appear that the application of the agenda decision by these companies would be treated as a correction of an error in accordance with IAS 8.

In summary, we do not agree with the Interpretations Committee's tentative agenda decision. We do not believe IAS 17 is clear that certain internal fixed costs do not qualify as incremental costs as paragraph 38 clearly indicates that some internal costs are incremental and directly attributable to negotiating and arranging a lease. Clarification is needed to provide guidance on what costs the Board had in mind, as we believe a reasonable interpretation of paragraph 38 is that capitalising certain internal costs would be appropriate. In addition, the IASB has not acted upon the Interpretations Committee's September 2008 recommendation that common definitions of 'incremental' and 'directly attributable' be developed. Because the Interpretations Committee previously has been asked to clarify the definition of 'incremental', we recommend that the Interpretations Committee add the issue to its agenda. However, if the Interpretations Committee decides to uphold its November 2013 tentative agenda decision, we recommend that it clarify why it made its decision and how the application of that decision should be treated under IAS 8.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 (0)20 7951 3152.

Yours faithfully

*Ernst + Young Global Limited*