TO: The IFRS Foundation Trustees

By email

30 March 2011

Re-exposing comprehensive proposals for international lease accounting

Dear Vice-Chairmen Fujinuma and Glauber,

The **global leasing industry**, represented by the US Equipment Leasing and Finance Association (ELFA), the American Automotive Leasing Association (AALA), Leaseurope (the European leasing and automotive rental federation)1, 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), **is calling for re-exposure of the IASB/FASB Exposure Draft Leases**.

The Leases ED – constituents express concern

On 17 August last year, the IASB and FASB (the "Boards") issued an Exposure Draft Standard on accounting for leases (the "ED") for public comment. Given the pervasive nature of lease accounting, it is not unsurprising that almost 800 comment letters from an extremely broad range of constituents across the globe were submitted to the Boards. In particular, many of these letters expressed significant concerns on the cost/benefit balance of the proposals.

Recent deliberations may lead to improvement, but re-exposure is necessary

Aiming to address issues raised by constituents during the comment period, the Boards have begun re-deliberating their proposals and have recently taken a number of new tentative decisions. Some of these represent a welcome improvement over the ED proposals[2]. We are also encouraged to see that the Boards have started to examine the key conceptual areas (e.g. definition of a lease, whether there are different types of leases that require different accounting treatments) on which the accounting for leases must be built.

This being said, there are still several areas of the proposals where it is not clear that conceptually sound principles or sufficient simplification have been achieved[3]. Our individual associations will directly provide the Boards with further feedback on these issues at technical and conceptual levels.

[1] Leaseurope represents 45 leasing and automotive rental associations in 32 European countries

[2] For instance, the recently proposed changes to the treatment of lease extension options are likely to alleviate a certain amount of the complexity inherent in the initial proposals for such features.

[3] For example, recent tentative decisions on the treatment of variable rental payments seem to fall short of addressing constituents' concerns.

While we are fully supportive of the Boards developing a robust definition of a lease and clarifying whether all leases are of the same nature, we note that the Boards appear to be moving towards an accounting model for leases that is conceptually very different to the model exposed in August. We are also concerned that the pace of re-deliberations is making it extremely difficult for the vast majority of constituents to follow and understand recent decisions and analyse their potential implications. Consequently, we are of the view that it is necessary for the IASB and FASB to re-expose their proposals for lease accounting before issuing a final standard.

Constituents need to be given the opportunity to assess the implications of a very different model and rationale to that exposed in the Leases ED

Much of the concern expressed over the existing accounting model for leases has been on the classification of leases (finance and operating leases). The Boards consider these classification requirements to be complex and have said that they give rise to structuring opportunities. The model exposed in the ED therefore proposed to remove lease classification and treat all leases in the same way. Indeed, under this approach, known as the right to use model, lessees are said to have acquired an asset, the right to use the underlying leased asset for a period of time, which they finance with an obligation to make payments to the lessor.

However, the Boards are now suggesting that not all leases are the same and are consequently re-introducing classification very similar to that in IAS 17[4]. This would involve some leases ("finance leases") being considered to be the equivalent of financing a purchase of an underlying asset, while others ("other than finance leases") would give rise to a right to use asset, but would not be financing transactions. For this latter category, because there is no financing element, subsequent measurement would change significantly from the ED proposals and would lead to different right of use values and P&L patterns being reflected in lessee financial statements.

The fact that some leases may now not be considered to be financings is a complete departure from the model discussed and presented by the Boards over the life of their joint Leases project. It is not simply a matter of "presentation"; rather, it represents an entirely different way of thinking about leases compared to the ED where all leases were considered to be financial transactions. We think it is necessary for the Boards' to inform constituents of such a fundamental change to the ED model through re-exposure of their proposals. This is particularly important as the ED did not envisage such an approach and constituents were therefore not in a position to consider its relative merits and disadvantages.

Although the model under consideration could provide a practical alternative to the ED proposal, the approach is largely equivalent to the existing lease accounting model in IAS 17, with the additional requirement to capitalise operating leases. The Boards still need to explain what the conceptual basis for putting operating leases on lessees' balance sheets is. While we acknowledge that the Boards are now working to draw a line between service contracts and leases, it remains crucial for them to clarify the rationale for why operating leases qualify for capitalisation, whereas as other contractual commitments do not. Re-exposure of the new proposals will give them the opportunity to do so and will enable constituents to provide feedback.

[4] IAS 17 classifies leases according to the level of risks and rewards an entity has in the underlying asset

Comprehensive proposals, including lessor accounting must be re-exposed

While the comments above focused on accounting from the perspective of lessees, we feel that it is equally important for lessor accounting proposals to be re-exposed. As the Trustees are aware, the leasing industry has in the past expressed concerns on the due process for lessor accounting[5]. In spite of this, consideration of lessor accounting still appears to be of relatively low priority for the Boards and, with the Boards working towards an official target deadline of June 2011, there is a risk that lessor accounting will be neglected, or even abandoned at the last minute.

Many constituents, including local standard setters, audit firms, as well as the leasing industry, take the view that it is necessary to complete both sides of accounting for leases simultaneously. Indeed, many firms are both lessees and lessors, or enter into sub-leases. Maintaining existing lessor accounting requirements would imply that these firms have to deal with two very different accounting approaches for leases, for an indefinite period of time. In particular, firms using US GAAP would be required to apply a rules-based approach on the lessor side along with a principles-based model on the lessee side. Moreover, by not dealing with lessor accounting, the Boards run a significant risk of having to make further revisions to lessee accounting at a later point in time. Any future leases standard must therefore include accounting from the perspective of lessors and revised lessor accounting proposals must be re-exposed along with those for lessees to ensure that the overall accounting model for lease transactions is coherent.

Re-exposure is necessary to achieve high quality accounting for leases

We recognise the benefits of the targeted outreach exercises recently carried out by the Boards' staff on some of the potential changes to the ED model and applaud those efforts. However, while targeted outreach will undoubtedly help inform the Boards' future decisions, it cannot be a substitute for full re-exposure of proposals. Indeed, all constituents have to be given the same opportunity to assess whether the new model is effectively an improvement over the ED and does not give rise to any unintended consequences. The lack of a comprehensive consultation document makes it near to impossible for the vast majority of preparers and users of accounts who will be affected by the proposals to consider the new model in full, particularly as they may lack the resources to track the many recent developments and provide the Boards with regular, unsolicited feedback.

We understand that the decision to re-expose the proposals will ultimately be made according to criteria set out in the IASB's Due Process Handbook. However, as the Trustees are undoubtedly aware, these criteria lack clarity and may require revision in the future[6]. Key ongoing projects such as Leases[7] should not get caught in a due process loophole.

We also consider it is important that constituents be given a clear signal on the timing of re-exposure, the subsequent issuance of the final standard and its effective date (which should be adapted accordingly) as soon as possible. Many preparers are currently faced with a significant amount of uncertainty and are unable to proceed with systems development or plan implementation any further at this stage.

[5] See for instance Leaseurope's letter to the Trustees dated 24 March 2009
[6] See for instance EFRAG's response to the Trustees' Strategy Review
[7] Others include revenue recognition

Lastly, it is important to point out that re-exposure of the proposals would not imply a delay beyond the end of 2011, the G-20 deadline for MoU projects. We note that this timing is consistent with the views of EFRAG and the European Commission who have encouraged the IASB to privilege quality over speed in the standard-setting process[8]. Additionally, re-exposure of the proposals will also provide the Boards with the opportunity to undertake the effects analysis requested by many constituents and supported by the European Commission[9].

In conclusion, without re-exposure of the Leases ED, there is a significant risk that the Boards issue a new standard that has not been well thought out and gives rise to unintended consequences, implying that additional changes to lease accounting may have to be made in the short term. This would represent a missed opportunity to develop a high quality international accounting standard for leases, which we fully support.

Yours sincerely,

The global leasing associations

ELFA
EQUIPMENT LEASING AND FINANCE ASSOCIATION

Leaseurope
The Voice of Leasing and Automotive Rental in Europe

CF AC & LA FL

CLBA
租赁业委员会
中国外商投资企业协会

Japanese Leasing Association

TRALA

American Automotive Leasing Association

AELA

AFLA

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A copy of this letter has been sent to:

David Tweedie, Chair, International Accounting Standards Board
Leslie Seidman, Chair, Financial Accounting Standards Board
Michel Barnier, Commissioner for the Internal Market & Services, European Commission
Françoise Flores, Chair, European Financial Reporting Advisory Group
James Kroeker, Chief Accountant, Securities and Exchange Commission

[8] See for instance EFRAG's letter to the Trustees: "Meeting G-20 Requirements"
[9] See for instance the European Commission's response to the Trustees' Strategy Review