

Hans Hoogervorst
Chairman
IASB
30 Cannon Street
London
EC4M 6XH

December 2012

Dear Hans

We are writing to you jointly in response to your recent speech at LSE on the leasing project.

We support the overall aims of the project. In principle, we agree that IAS 17 could be replaced so as to provide better information to users on the liabilities associated with leases, and that enhancing the disclosures required by IAS 17 may not provide an optimal solution. However, we remain to be convinced that the current proposals would provide benefits which outweigh their cost and complexity. We therefore urge the IASB to consider simplifying the proposals, and to justify its view that the benefits of the new standard would outweigh the costs. In considering the benefits, the IASB should provide evidence on what information users need about leases and demonstrate how the proposals will enable them to improve their analysis.

More specifically, we would note the following:

Leases where an insignificant proportion of the asset is consumed

One source of complexity is the different accounting treatment for leases where the lessee consumes an insignificant proportion of the leased assets (low consumption leases). The introduction of this distinction, together with short-term leases, results in three different models for lease accounting. In order to reduce complexity and maintain conceptual consistency, we consider that the IASB should reach one of the following views:

(i) *Low consumption leases are more akin to financing than a service:*

Low consumption leases should be capitalised in the balance sheet and should have a front-loaded P&L expense, reflecting their financing nature.

(ii) *Low consumption leases are more akin to a service than financing:*

Low consumption leases should not be capitalised in the balance sheet and should have a straight-line P&L expense.

If the IASB wishes to retain a different accounting treatment for low consumption leases in its Exposure Draft, the Basis for Conclusions must provide a robust justification for this, with evidence that it brings benefits to users of financial statements.

Classification of the ROU asset

Leases that are recognised in the balance sheet (which will exclude low consumption leases under view ii above) could be described as being PPE (with separate disclosure in the notes), as this is their substance. This classification avoids the creation of a new unfamiliar asset and minimises clutter on the balance sheet.

New bright lines

The proposed distinctions between short-term leases, leases where the lessee consumes an insignificant proportion of the leased assets, and other leases are likely to become "bright lines". Past experience shows that this will lead to structuring and abuse. Whilst the middle category will now be on balance sheet, there will still be advantages in the income statement and therefore pressure on lessors to develop structures that will achieve the desired outcome.

There is another very significant bright line between service contracts and leases which could result in a fundamentally different treatment for contracts with relatively similar outcomes for the parties. It will also require many contracts—such as vehicle leases—to be disaggregated into a service component and a lease component, adding further to cost and complexity.

Many small leases

It appears that the cost of implementing the standard may be particularly great where a company has a large number of relatively small leases. We appreciate that short leases will be exempt from the capitalisation requirement. Nonetheless it may be that, even with a sensible application of materiality, some companies may face disproportionate burdens in preparing the information for hundreds or thousands of individually small transactions. It is possible that estimation techniques of the kind that are routinely used for fixed assets and inventory could help in this connection, but preparers may find it challenging to develop appropriate techniques; we wonder whether the IASB could help by providing illustrative examples of suitable techniques. The problem of the leased asset is compounded when the leases are of assets where an insignificant proportion is consumed since there the accounting model requires the amortisation of the asset to be linked to the liability, a major systems challenge.

Costs and benefits

It will be important that the Exposure Draft contains a detailed analysis of the costs and benefits expected to result from the new standard, which convincingly justifies IASB's view that the benefits are likely to exceed the costs. If the Exposure Draft proposes introducing requirements for businesses to prepare information that is different from that which would be required by management to run the business, it should clarify why this is necessary in order to meet user needs.

Transitional arrangements

The cost of implementing the proposals for companies (including the reassessment of existing leases) is likely to be disproportionately high. One suggestion is that the IASB

should consider grandfathering existing leases, or at least developing proportionate transitional arrangements.

Field testing and outreach

Adequate field-testing of the proposals is essential. This should be led by the IASB but might involve assistance from national standard setters and other relevant organisations. We are prepared to assist the IASB in this regard. The field testing should be designed, in particular, to ensure the objective of the project is achieved and to test the costs of the proposals, and should include companies with many small leases. It should also encompass a variety of users to ensure that they welcome the new accounting model and that it provides the information they desire.

Ideally, some field-testing should be carried out before publication of the Exposure Draft so that it may include quantified cost-benefit case studies for companies that have field-tested the proposals. The Exposure Draft should also contain a commitment to further detailed field-testing.

We should, of course, be very happy to discuss these or any other matters relating to the proposed Exposure Draft with you.

Yours sincerely

Roger Marshall
Chairman, Accounting Council

Liesel Knorr
Deutsches Rechnungslegungs
Standards Committee e.V.