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Mr Hans Hoogervorst, Chairman
International Accounting Standards Board (IASB)
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Mr Hoogervorst,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, we appreciate the opportunity to comment on the Exposure Draft *ED/2013/6 Leases* (May 2013).

Principal authors of this comment letter were Werner Fleischer, Christoph Fröhlich, Peter Geyer, Michael Komarek, Gerhard Marterbauer, Aslan Milla, Harald Podoschek, Alexander Schiebel and Günter Schmidt. In order to provide a balanced Austrian view on the topic, the professional background of these authors is diverse (academics, auditors and preparers).

GENERAL REMARKS

There has been extensive criticism of the accounting model put forward in IAS 17, especially with respect to accounting by lessees. In practice, users today commonly adjust the balance sheets of lessees to get a better picture of the real gearing. Therefore we approve of the IASB's working on a project which intends to recognise financial liabilities for future lease payment obligations even though they are the consequence of an executory contract.

In the current ED the IASB proposes – as in the first ED – a right-of-use model. In general, we support the proposed right-of-use model. However we are concerned that the whole ED has as yet no conceptual underpinning. The leases project as a whole would probably have benefited had the Conceptual Framework been finalised first.

The current ED maintains a two model approach for both lessees and lessors. This reflects that the underlying economics of leases are heterogeneous. However, one of the main criticisms of the current standard was that its dual accounting model led to bright lines and structuring opportunities. We therefore believed that one of the major objectives of the lease project would be to create a single lease accounting model. In addition, we have operational concerns regarding the application of the model proposed in the ED. The current proposal, for example, requires an entity to assess whether the lease term is an insignificant part of the total economic life or whether the present value of the lease payments is insignificant relative to the fair value of the underlying asset, when classifying a lease contract for an underlying asset that is not property. For lease contracts where the underlying asset is property, the entity has to assess whether the lease term is for the major part of the remaining economic life of the underlying asset, or whether the present value of the lease payments accounts for substantially all of the underlying asset's fair value. We believe these classification criteria are no improvement over the classification criteria of IAS 17 and could in fact lead to greater complexity for users and preparers. In our view, if a dual approach really is unavoidable, the classification could just as well be made on the basis of the classification criteria of IAS 17.7 *et seqq.*, as these classification criteria have the relative advantage of being widely known and understood. Retaining these criteria would therefore be more cost-beneficial than introducing the proposed requirements.

SPECIFIC REMARKS

Question 1: identifying a lease

This revised Exposure Draft defines a lease as "a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration". An entity would determine whether a contract contains a lease by assessing whether:

a) **fulfillment of the contract depends on the use of an identified asset; and**

b) **the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.**

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.

Do you agree with the definition of a lease and the proposed requirements in paragraphs 6-19 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

We agree with the proposed requirements.

Question 2: lessee accounting

Do you agree that the recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

We feel that one of the main disadvantages of the current standard is that its dual accounting model leads to bright lines and structuring opportunities. It appears that the original ED *Leases* (published in 2010) proposed that lessees apply a single accounting approach for lease contracts. The lessee would recognise the right-of-use asset at cost less depreciation and the liability at amortised cost. It seems that many stakeholders opposed this proposal on the basis that the economics of different types of leases are different. Therefore, the current Exposure Draft proposes a dual approach. We see merits to both sides of the argument. On the one hand, we understand that the IASB believes that a dual accounting approach for lessees is necessary. On the other hand, we think that the proposed introduction of a new classification system is not an improvement. We do not support the idea that there should be different classification criteria based on the nature of the underlying asset. Because in Austria a very high proportion of property leases are also calculated on an interest

margin basis just like product leases, we oppose the assumption that property leases should be treated differently from other lease contracts. If a dual approach truly is necessary, we believe that the classification criteria should at least be applied uniformly. We would also suggest that the Board consider including qualitative factors in the classification criteria. We believe, e.g., that there is an inherent difference between a lessee renting one floor in a large office building downtown and a lessee renting a large warehouse that is built on a green field site and constructed entirely according to the lessee's specifications. We believe that such qualitative differences should be taken into account when considering how to classify a lease contract.

Question 3: lessor accounting

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

As explained in our answer to Question 2, we understand that the Board felt it was necessary to propose a dual approach. However, we do not support the classification criteria proposed in the ED. Furthermore, we are concerned that property leases that are calculated on an interest margin basis, such as leases of factories or warehouses, might have to be classified as Type B leases, as there seems to be a strong bias in favour of classifying property leases as Type B leases. This would have very negative consequences for the profitability of lessors of real estate, as – in the first years of the contract – their declining finance expense could not be covered by the lease income that has to be recognised over the lease term. Thus, the Type B accounting model does not in our opinion adequately reflect the underlying economics of property leases where the payments are calculated on an interest margin basis.

Question 4: classification of leases

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 28-34, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

As mentioned above, we do not support the proposed classification criteria. In our opinion the proposed classification system is not an improvement, and we question how the entities will determine what the terms 'insignificant', 'substantially all' and 'major part' mean. We also believe that it is arbitrary to have different classification criteria for property leases and for leases of assets other than property. We understand the Board's argument that the land element has an indefinite life and is therefore different to most other assets. In our opinion, however, this idea would be better reflected by evaluating land and building separately when classifying property. When it comes to property, we believe that there are different kinds of property leases, depending on the significance

of the land in relation to the rest of the property involved. For example, a lease contract for a downtown office building has different underlying economics from a lease contract for a newly constructed warehouse outside an urban agglomeration, where the value of the land is often an insignificant part of the total investment. So we think that whenever the value of the land is insignificant compared to the total investment of the lessor, the land should be classified together with the building. However, if the land portion is a significant part of the total investment of the lessor, the land should normally be classified as a Type B lease because the economic benefits embedded in the land would usually not be expected to be consumed by the lessee. The building component of a property lease incorporating land and a building could on the other hand be classified by using the same criteria as for any other asset. A uniform classification principle that could be applied here is the one in IAS 17. This approach is familiar to all users of IFRS, which would not only simplify transition but also increase acceptance.

Question 5: lease term

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

We support the approach that options should only be included if there is a significant economic incentive to exercise the option. On the one hand, not recognising options that are most likely to be exercised would not depict the entities economic situation correctly. On the other hand, if the threshold for the inclusion of options is too low, the economic flexibility of the lessee arising from his right not to exercise the option would not be reflected in the financial statements.

We do, however, believe the principle of the significant economic incentive should also be applied to the exemption for short-term leases. The ED proposes that an entity can use the short-term leases exemption only if the lease has a maximum possible term of 12 months or less under the contract, including any options to extend. Whether there is a significant economic incentive to exercise these options is irrelevant for the applicability of the exemption for short-term leases. If a contract has a fixed term of 7 months and an option to extend the lease for another 6 months, the entity would not be able to use the exemption, even if there is no economic incentive and no intention to exercise the option. Nevertheless, the entity would measure the lease payments etc. based only on a lease term of 7 months. It seems illogical that such a contract cannot be treated as a short-term lease but has to be measured as such.

Question 6: variable lease payments

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

We support the proposals regarding variable lease payments. However, we would like the Board to clarify in the standard whether foreign exchange rate differences can lead to a reassessment.

Question 7: transition

Paragraphs C2-C22 state that a lessee and a lessor would recognise and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not what transition requirements do you propose and why?

Are there any additional transition issues that the boards should consider? If yes, what are they and why?

The guidance regarding transition states that the lessee should measure the lease liability using the lessee's incremental borrowing rate. While we understand that this was supposed to be a relief for lessees, we would prefer that an entity could also apply the interest rate that is implicit in the lease, if available. In Austria, the lessee is usually informed about the interest rate that is implicit in the lease, and the lessor usually provides the lessee with an amortisation table. Thus, it might be easier for an Austrian entity to measure the liability using the rate that is implicit in the lease.

Furthermore, we would suggest revising the wording of the transition guidance in paragraph C8(b), which is not clear to us and seems to contradict the illustrative example no. 24. We agree with the method applied in that example.

Question 8: disclosures

Paragraphs 58-67 and 98-109 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments; reconciliations of amounts recognised in the statement of financial position; and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with these proposals? Why or why not? If not, what change do you propose and why?

We agree with the proposed requirements in paragraphs 59 and 99 that oblige an entity to consider the level of detail necessary to satisfy the disclosure objective and the amount of emphasis to place on each of the various requirements in order to avoid obscuring useful information by including a large amount of insignificant detail. We believe, however, that it would be useful to exempt short-term leases from disclosure requirements, or at least to significantly reduce the required disclosures for short-term leases.

Questions 9–11 are left out, as they are FASB-only.

Question 12 (IASB-only): Consequential amendments to IAS 40

The IASB is proposing amendments to other IFRSs as a result of the proposals in this revised Exposure Draft, including amendments to IAS 40 *Investment Property*. The amendments to IAS 40 propose that a right-of-use asset arising from a lease of property would be within the scope of IAS 40 if the leased property meets the definition of investment property. This would represent a change from the current scope of IAS 40, which permits, but does not require, property held under an operating lease to be accounted for as investment property using the fair value model in IAS 40 if it meets the definition of investment property.

Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

We are concerned that the costs of this requirement might outweigh the benefits. Lease contracts of investment property might include options or variable payments. Applying IAS 40 measurement requirements would then involve measuring the market value of the options. This is highly complex and in our opinion not cost-beneficial. We would therefore prefer to permit accounting for investment property in the manner proposed, but not to require it.

ADDITIONAL REMARKS

Lessor accounting: variable lease payments

We should be grateful if the Board would include an illustrative example showing how the lessor accounts for variable lease payments and how the lessor's adjustment of the residual asset is calculated, because it is not entirely clear to us how to apply the requirements of paragraph B20 in practice.

Type B accounting model and foreign exchange rate differences

We would suggest including an explanation in the Standard or adding an illustrative example showing how to deal with exchange rate differences when applying the Type B accounting model. We assume that it would be necessary to calculate the amortisation of the right-of-use asset based on a liability calculated at historic exchange rates. However, we should be grateful if the Board would include further guidance on how to proceed in such a case.

Put options of the lessor

As it is very common in Austria for the lessor to have a put option that can be exercised at the end of the lease term, we should be grateful if the Board could clarify the treatment of such put options of the lessor in the final Standard.

Sale and leaseback transactions before the beginning of the earliest comparative period presented

AFRAC would appreciate it if the Board would add an illustrative example that explains how to deal with sale and leaseback transactions that under IAS 17 were classified as sale and leaseback transactions that were classified as operating leases, as we believe that the requirements in the ED are not entirely clear in this respect.

Please do not hesitate to contact us if you wish to discuss any aspect of our comment letter in more detail.

Kind regards,

Romuald Bertl, Chairman