CIPFA The Chartered Institute of Public Finance & Accountancy

Exposure Draft ED/2012/6
Leases

response to exposure draft

13 September 2013

the people in public finance

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
Submitted electronically to www.ifrs.org
September 2013

Dear IASB secretariat

Exposure Draft ED/2013/6
Leases

CIPFA is pleased to present its comments on the matters discussed in this Exposure Draft, which have been reviewed by CIPFA's Accounting and Auditing Standards Panel.

General Comments

While CIPFA has an interest in financial reporting generally, we have a specific interest in both public sector and wider not-for-profit reporting. We therefore have a particular interest in questions relating to the use of IASB standards by these entities.

We note that the ED responds to the many points made by CIPFA and other respondents to the 2010 Exposure Draft. This ED represents significant progress and is, in our view, much closer to a workable standard.

Responses to the Questions for Respondents

Responses to the questions in the exposure draft are attached in an annex to this letter.

If you have any questions about this response, please contact Steven Cain (e:steven.cain@cipfa.org, t:+44(0)20 7543 5794).

I hope this helps the Board in its development of this important standard.

Yours faithfully

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ANNEX

Responses to Questions for Respondents

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) fulfilment of the contract depends on the use of an identified asset; and
(b) the contract conveys the right to control the use of the 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.

CIPFA agrees with the definition of a lease and 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?

In responses to consultations in 2009 and 2010, CIPFA agreed that recognising a right-of-use asset and a corresponding liability to pay rentals seems to better capture the economic substance of lease arrangements than reporting under IAS 17. As well as making comments on areas where the model might need to be improved, CIPFA also commented on cost benefit issues, and possibly onerous costs which might arise for many entities in the 'middle ground' of entities where leasing is neither mission critical nor immaterial.

We still consider that the right-of-use model captures key elements of leasing arrangements, and we expect that it could be modified to address stakeholder concerns in areas where it might be considered not to capture the economic substance of leasing arrangements. Whether this could be done in a manner which provides a basis for practical standard setting is less clear.

The 2013 ED has moved in a somewhat different direction, having regard to the points made by respondents to the 2010 exposure draft. The right-of-use model remains important, and on this basis all leases (other than short term leases) are to be capitalised. However, the ED proposes making the degree of asset consumption a key determinant of the accounting approach for subsequent balance sheet movements and related income and expenditure flows. Arrangements with significant consumption will be accounted for under 'Type A', broadly in line with the 2010 proposals. 'Type B' arrangements will involve a discounted cash flow calculation but will subsequently mainly be accounted for on a straight line basis. 'Type A' and 'Type B' arrangements are also associated by default with equipment and property leases respectively.

The degree of consumption of the underlying asset is of course relevant to the accounting treatment for a lease, and through its effect on residual value consumption is one of the factors which influences the IAS 17 finance/operating lease split.

Against this background, we have some reservations about the adoption of a dual model. The accounting for Type B flows is relatively straightforward, and this seems to be the primary rationale, rather than a more specific modelling of economic substance.

We accept that IASB has reached a compromise in the development of this model, which seeks to balance the views of stakeholders engaged in a wide variety of leasing approaches.

Notwithstanding our concerns, we can see some benefits. And while the use of a more rules based approach may leave opportunities for structuring, we would expect the scope for abuse to be reduced.

On balance we support this approach.

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?

CIPFA agrees that lessor accounting should reflect the same concerns as lessee accounting.

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?

CIPFA agrees with the base observation that a large proportion of property leases do not involve significant consumption of the underlying asset, while most leases of equipment or vehicles do involve consumption.

We do have some concern over the use of the 'Type A', 'Type B' terminology. While we appreciate that the boards are attempting to draw a line under the old model and start afresh, we have some concerns that this abstract 'A' and 'B' terminology may not be helpful and may confuse both preparers and users. It would be helpful if the boards could provide more meaningful names. There may be risks if preparers coin their own terminology, which may result in different entities adopting different terminology for the same type of arrangement.

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?
CIPFA agrees with the proposals on lease term. We agree that lease payments due in optional renewal periods should be included in the measurement of lease assets and liabilities if – and only if – the lessee has a significant economic incentive to exercise that option. However, lessors may face difficulties in making these assessments and in determining the need for reassessment, as they may not in general be aware of the individual circumstances of lessee entities to which they lease assets.
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?
CIPFA agrees that variable lease payments should be included in the measurement of lease assets and liabilities if – and only if – those payments are in-substance fixed payments or variable only inasmuch as they are linked to an index or rate. We also agree that the variable lease payments should be reassessed when there is a change in the index or rate used to determine such payments.
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 the boards should consider? If yes, what are they and why?
CIPFA agrees with the proposed transitional measures.

Question 8: disclosure

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 those proposals? Why or why not? If not, what changes do you propose and why?

CIPFA agrees the overall objectives at 58 and 98, that relevant quantitative and qualitative information should be disclosed to enhance users' understanding of the amount, timing and uncertainty of cash flows arising from leases.

CIPFA also acknowledges in principle the usefulness of each of the individual disclosures, although the totality of disclosure requirements is quite significant. We had hoped that improving the balance sheet presentation of leases would reduce the need for disclosure, but this may have been a casualty of the dual presentation approach.

Crucially we note that paragraphs 59 and 99 require the reporting entity to 'consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of these disclosures'. This may ease the reporting burden and serve to reduce the level of 'clutter', thereby improving the readability of the financial statements.

CIPFA has no comments to make on Question 9 (FASB only)

CIPFA has no comments to make on Question 10 (FASB only)

CIPFA has no comments to make on Question 11 (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?

CIPFA agrees with the proposed consequential amendments to IAS 40 *Investment Property*.