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Re: EFRAG Draft comment letter on ED Lease

Dear Françoise,

The OIC is pleased to provide its comments on your letter about the IASB Exposure Draft (ED) Lease project.

In line with our position put forward in our response to the 2009 Discussion Paper, the OIC believes that the new right of use approach may enable the overcoming of the problems in terms of application and interpretation relating to the current distinction in IAS 17 between operating leases and finance leases.

In order to provide the EFRAG with the widest-ranging contribution possible, in October 2010, the OIC gathered the opinions of preparers, auditors and users, asking them a series of questions on the main features of the IASB project. Therefore, the OIC's comment letter takes into account also this national-level consultation.

In summary, the main findings are:

- The definition of lease and the criteria proposed for distinguishing a lease from a service require further study and clarification. We are not convinced that the criteria proposed in IFRIC 4 enable a ready distinction between leases and services, with significant consequences for the accounting treatment to be applied.
- The criteria put forward in the ED to distinguish between lease and purchase/sale operations do not appear consistent with those in the ED on Revenue Recognition, which requires only the transfer of control as a condition for the recording of a sale. The different conditions required could lead to the same operation being classed in different ways.
- The OIC is especially appreciative of the fact that the ED deals with both the lessee and the lessor, as this enable the IASB's proposals to be assessed holistically; any approaches that considered

only one side of the equation would be unacceptable. However, we do not agree with the hybrid approach proposed in the ED for the accounting treatment for lessors; supporting, instead, adoption of only the derecognition approach as the only accounting model, it being consistent with the right-of-use model envisaged for lessees. We also note that the proposed hybrid model repeats in substance the current model of IAS 17.

- We believe that in valuing the lease liability (lessee) and the lease asset (lessor) one should consider solely and exclusively the contractually bound unavoidable obligations/rights. Therefore, we do not support the proposal to include in the lease asset/liability the amounts deriving from the exercise of renewal options or contingent rentals. Moreover, the proposal seems to run counter to the objectives of simplifying the accounting treatment and facilitating comparisons of financial statements.

In conclusion, in the light of the above, the ED contains considerable issues, such as to put in question, on the one hand, the objective of overcoming the interpretational uncertainties of the current IAS 17 and, on the other, the goal of simplifying lease accounting and enable greater comparability of financial statements.

As explained more fully below, we believe that the proposals contained in the ED may lead to significant costs and effects for entities. In this regard, we would recommend to the Board the carrying out of specific field tests to assess the impacts of the new proposals. On the basis of our own survey, we would stress that the ED's proposals could have significant effects on the regulatory own funds requirements for banks and insurance companies.

Please find our comments on the specific questions attached below.

Question 1: Lessees

Do you agree that a lessee should recognise a right-of-use asset and a liability for its obligation to make lease payments? Why or why not? If not, what alternative model would you propose and why?

Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on its liability for lease payments? Why or why not? If not, what alternative model would you propose and why?

The OIC believes that the model proposed for lessees has conceptual merits. The OIC believes that the new right-of-use approach may enable the overcoming of difficulties in terms of application and interpretation relating to the current distinction in IAS 17 between operating leases and finance leases.

The OIC agrees that, if the right-of-use model is applied, lessees should recognize amortization of the right of use and interest on its liability for the lease payments. In addition, it agrees that neither the right of use nor the liability for lease payments should be measured at their fair value.

It is essential that the ED clarify more fully the criteria for distinguishing a lease contract from a services contract. Moreover, as detailed in later comments (below), the model proposed presents many issues in relation to specific aspects, including the treatment of renewal options and contingent rentals.

For the sake of completeness, we would point out that from the research conducted in October it emerges that some users and preparers have expressed doubts about the right-of-use approach.

In their view, the accounting model proposed in the ED cancels the differences in the business models that are actually applied by the entities, standardizing, under the “heading” of a single accounting principle (which applies similar accounting treatments to substantially different matters), significantly different management choices (purchase of a good or finance leases on the one hand, and pure lease on the other).

This attempt, far from enhancing the comparability of financial statements, has the objective of rendering the same (exclusively in accounting terms) management choices and risk allocation models that in reality are profoundly and substantially different, thereby making the financial statements less understandable as only the more expert readers will be able to separate, distinguish and weigh the entries recorded on the basis of the application of the new principle from those typical of substantially different contract situations.

Question 2: Lessors

Do you agree that a lessor should apply the performance obligation approach when the lease exposes the lessor to significant risks and benefits associated with the underlying asset, and a derecognition approach otherwise? Why or why not? If not, what alternative model would you propose and why?

Do you agree with the boards' proposals for recognition of assets and liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

The OIC does not agree with the hybrid approach proposed in the ED with regard to lessors. In fact, it supports adoption of only the derecognition approach, as the sole accounting model for lessors, as this is consistent with right-of-use model envisaged for lessees.

The OIC is, therefore, against the performance obligation approach as it contains a contradiction that runs counter to the underlying idea of the whole ED (and that is that every asset is a "bundle of rights"), as, if there is a lessee that has recorded in its financial statements the right to use a given asset and correspondingly the obligations to meet the payments for that use, one cannot understand what accounting logic would allow the lessor the option to keep the entire corresponding asset in his financial statement.

Moreover, the performance obligation approach would lead to a duplication of the asset (retaining the asset in the financial statements and at the same time giving rise to a credit receivable for the lease payments), such as to compromise the clarity of the financial statements.

Furthermore, the proposing of two different accounting models for lessors would only implicitly leave open the distinction between operating and finance leases. Indeed, the models envisaged for lessors basically reflect the current IAS 17, but while in that principle the accounting of the lessor/lessee is characterized by the accounting symmetry that must exist whenever the substance of the matter is the same, with the ED as it is, this symmetry would be lost without there being a situation of different matters in terms of economic substance.

Question 3: Short-term leases

The exposure draft proposes that a lessee or a lessor should apply simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term is twelve months or less:

- (a) At the date of inception of a lease a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognise lease payments in profit and loss over the lease term (paragraph 64).*
- (b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognise assets and liabilities arising from short-term leases in the statement of financial position, nor derecognise any portion of the right to use the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit and loss over the lease term (paragraph 65). (See also paragraphs BC41-BC46.)*

Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

The OIC believes that the simplified accounting proposed in the ED for short-term leases brings undoubted benefits in the financial statements of the lessor as the lessor need only record the lease payments as per the current treatment envisaged for operating leases in IAS 17.

With regard to the financial statements of the lessee, the OIC hopes for further simplifications compared with those currently envisaged in the ED. More in particular, it hopes that the simplifications adopted in regard to the financial statements of the lessor will be extended also to those of the lessee, bearing in mind the short-term nature of the lease contracts involved and the aim of avoiding needless additional burdens. Therefore, it proposes that also lessees be allowed to measure short-term leases on the basis of the current treatment provided for operating leases in IAS 17.

Question 4: Definition of a lease

- (a) *Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?*
- (b) *Do you agree with the criteria for distinguishing a lease from a purchase or sale in paragraphs B9 and B10? Why or why not? If not, what alternative criteria would you propose and why?*
- (c) *Do you think that the guidance provided for distinguishing leases from service contracts in paragraphs B1-B4 is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?*

In general terms, the OIC agrees with the definition of a lease as given in the ED and with the criteria for determining whether a contract represents a lease or contains a lease (IFRIC 4). However, we believe that the guidance provided in the ED should be clarified and improved in various areas.

According to the ED, a contract counts as a lease, or contains a lease, when both the following conditions are met: a) the fulfilment of the agreement depends on the use of one or more specific assets; and b) the agreement conveys the right to control the use of the specified asset (or assets) for a period of time agreed between the parties.

In regard to the first condition (letter a), we believe that the principle of specifying the asset to be leased is the most effective criterion for recognizing a lease. On the other hand, a criterion based on the presumed interest of the lessee to receive a service rather than a good is likely to be controversial and discretionary.

Furthermore, we also believe that the ED should focus its attention on the fact that the leased asset may be readily exchanged with or substituted by another good. Therefore, when a transaction concerns non-specialized assets or assets that are not closely linked to the business of the lessee, we believe it to be more probable that the transaction has been undertaken in order to obtain a service rather than to have the right to use the asset. Moreover, we agree that the capacity of the lessor to substitute the leased asset is a key element in understanding whether the lessee is interested in the asset as such or whether instead the asset is only a vehicle for receiving a service.

In regard to the condition of control (letter b), we believe that the ED should provide further guidance so as to facilitate the practical application of the definition of lease, with particular reference to the concepts of fixed price and fixed price per unit of output.

The reference to fixed price per unit of output (B4) requires clarification and examples, given the various cases that could arise. For example, it is not clear for what reason a contract on the basis of which an acquirer receives the substantial totality of the outputs of an asset (a situation in which it could have implicit control of the asset) should be excluded from the category of lease contracts. Moreover, it is not clear what is meant by “market price as of the time of delivery”.

Therefore, we believe that the issuing of a new principle on leases could provide a good opportunity for the IASB to overcome the application problems evidenced with IFRIC 4.

In regard to the distinction between a lease contract and a purchase or sale, a first point to note is that the guidance given in the ED refers only to the transfer of the control (automatic transfer of title and existence of a bargain purchase option) and not to the transfer of the risks and rewards of the underlying asset, which de facto is the requirement that most represents the substance of the purchase or sale.

Hence, the proposal is not consistent the ED on Revenue Recognition, which requires only transfer of control as a condition to indicate a sale. In some circumstances, this could lead to important accounting inconsistencies; for example, a lease contract that envisages contingent payments would not be classed as a sale on the basis of the ED on Leases but would be under the ED on Revenue Recognition.

Furthermore, it should be noted that, although one of the objectives of the ED is to overcome application uncertainties relating to the current distinction between finance leases and operating leases, that objective appears to be contradicted by the same proposal, as the ED explicitly introduces the sole requirement of the bargain option to indicate a purchase or sale but refers (without making it explicit) to the aspect of risk and rewards that is covered in the current model contained in IAS 17.

In order to avoid the above inconsistencies, the OIC believes it is appropriate to redefine purchase/sale operations, better clarifying the concept of transfer of control and that of risks and rewards.

Last, we would point out a possible contradiction in the wording used between para. 8.b of the principle proposed and the Basis for conclusion (para. B10, letter b). The latter provides that the identification of a lease vs. a purchase must be made at the inception of the contract and that said identification must not be subsequently modified. B10 says: "If the exercise price is significantly lower than fair value, it would be reasonably certain at the inception of the lease that such options will be exercised. An entity that has a bargain purchase option is in an economically similar position to an entity that will automatically obtain title to the underlying asset at the end of the lease term". Therefore, if there is a bargain option, then at inception the lessee is able to evaluate the existence of a purchase and similarly that is equivalent to a transfer of the legal title. However, this means that the recognition of the purchase must be made at inception and not when the option is exercised, as para. 8.b appears to indicate.

Question 5: Scope and scope exclusions

The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33-BC46).

Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and why?

The OIC does not agree with the proposal presented in the ED to exclude intangible assets from the scope of application as it does not see any conceptual reason that would justify such exclusion.

Furthermore, exclusion of intangible assets would entail:

- an unjustified accounting asymmetry between the lessor and the lessee; indeed, the lessor could apply the guidance contained in the ED on Revenue Recognition for the intangible assets, whereas the document does not provide any guidance for the lessee.

- for lease contracts that contain tangible and intangible elements (a very frequent case in the area of IT leases), entities will be forced to duplicate the accounting procedures following the “segmentation” of the contract between tangible and intangible elements, thereby adding to management complexity. This does not appear to be justified by any real benefit for users.

We believe that the ED should exclude service concession arrangements regulated by IFRIC 12 from the scope of application.

Question 6: Contracts that contain both service and lease components

The exposure draft proposes that lessees and lessors should apply the proposals in Revenue from Contracts with Customers to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B6-B8 and BC47-BC54). If the service component in a contract that contains service components and lease components is not distinct:

- *The FASB proposes that the lessee and lessor should apply the lease accounting requirements to the combined contract.*
- *The IASB proposes that (i) a lessee should apply the lease accounting requirements to the combined contract; (ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract; (iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements and the service component in accordance with the proposals in Revenue from Contracts with Customers.*

Do you agree with either approach to accounting for leases that contain service and lease components appropriate? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

The OIC believes that it is useful to introduce the distinction between lease contracts and service contracts in order, mainly, to simplify the accounting treatment proposed.

The OIC supports the proposal in the ED whereby entities have to assess whether the services are distinct on the basis of the criteria given in the ED on Revenue Recognition. However, we believe that the entity should consider only its own business practices in determining the performance obligations relating to the contract.

In regard to the accounting treatment, in general terms, the OIC favours a symmetric approach between lessee and lessor. However, in the case of contracts that include both a lease component and a non-distinct service component, the OIC believes it appropriate to allow differentiated treatments given the fact that the two subjects are unlikely to possess the same information on the non-distinct service component.

For these reasons, we believe that the lessee should not separate the two components unless it has reliable information. However, we do not agree with the ED of treating the whole contract as a lease, as we believe it more appropriate that the lessee first identify the predominant component of the contract (between lease or service) and then subsequently account for the whole contract in a consistent fashion.

However, regardless of the accounting model adopted, the lessor must separate the lease component from the service component, as the lessor is generally in possession of reliable information.

Question 7: Purchase options

The exposure draft proposes that a contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus a contract is accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraph 8 and BC63 and BC64).

Do you agree that a lessee or a lessor should account for purchase options when they are exercised? Why or why not? If not, when do you think that a lessee or a lessor should account for a purchase option and why?

The OIC does not discern any conceptual reasons for different treatments for purchase options and renewal options. A lease contract that contains a bundle of renewal options that come to cover the whole economic-technical life of the leased good is no different, in substance, from a contract that contains a purchase option.

Therefore, it is necessary to guarantee consistency between the accounting treatment of renewal options and that of purchase options. The OIC thus believes that options, be they for renewal or purchase, should be accounted for separately and not included in the value of the asset (right of use) or the liability (lease payment).

Question 8: Lease term

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

The OIC believes that the determination of the lease term should be based on the rights that the lessee holds on the basis of the contractual conditions and/or the law and not defined on the basis of the likelihood of exercising the renewal options.

The OIC does not agree with the proposal of the IASB to consider in the estimate of the lease term the options for renewal or termination and, consequently, to include in the value of the liability (lessee) or the asset (lessor) the amounts payable or receivable stemming from the lease renewal options.

To do so would run counter to the current definitions of liability and asset contained in the Framework, as: a) the lessee does not have an unconditional obligation to make the payments in the period of extension until the renewal option is exercised; and b) the lessor has neither an unconditional right to receive nor the control of the lease payments in the extension period until the lessee exercises the option.

Furthermore, in order to determine the lease term, the ED requires an estimate of the probability of exercising the options. This requirement appears particularly complex and leaves a broad margin for discretion to both parties (especially for renewals not in the near future). Indeed, the lessee may not possess reliable information at every reference date of the financial statements about the future economic conditions and, hence, may not be able to assess the profitability stemming from the possible exercising of the options. The lessor may not know the lessee's decisions about the probability of exercising the renewal options.

Last, it should be noted that taking account of the renewal options would cause a significant increase in the volatility in the accounting results as well as a reduction in comparability among entities operating in the same conditions with similar lease contracts.

Question 9: Lease payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease contract should be included in the measurement of lease assets and lease liabilities using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?

Do you agree that lessors can only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the lease receivable if they can be measured reliably? Why or why not?

In general terms, the OIC believes that, in the value of the lease liability (lessee) and of the lease asset (lessor), one should consider solely and exclusively the unavoidable rights and obligations of the contract. Therefore, the OIC does not agree with the proposal to include in the lease asset/liability the amounts stemming from the exercising of renewal options or contingent rentals.

The inclusion of should components appears, in our opinion, debatable and inappropriate in terms of burdensomeness and complexity. Moreover, it would inevitably introduce a discretionary evaluation that we consider inappropriate. Last, the lease asset/liability derived from including renewal options and contingent rentals would not satisfy the definition of asset/liability under the Framework (see response to Question 8). These components should be recorded and measured separately.

In regard to contingent rentals, the OIC believes it appropriate to make a distinction between: a) contingent rentals that relate to the use or performance of the asset; and b) contingent rentals that are linked to price indices.

The former do not meet the definition of a liability as they are under the control of the lessee, as they depend on a future decision by the lessee or are linked to the occurrence of future events; such values should not be included in the value of lease liability/asset. The latter, however, do meet the definition of a liability as the uncertainty concerns only the amount to be paid.

Should the IASB continue to deem valid the above proposal (which the OIC does not agree with), the OIC would not agree with the approach proposed for the measurement of the aforementioned variable components of the lease payments. We would prefer an approach based on the “best estimate” of the expected cash outflows, whose application would not necessarily imply the allotting of degrees of probability for the hypothesized scenarios.

Furthermore, we believe that the possibility of limiting the estimate of the “reliably measurable” amounts envisaged for lessors could be extended to lessees.

Question 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the obligation or receivable arising from changes in the lease term or contingent payments since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

The OIC does not support the IASB proposal to include in the value of the lease credit or debit options to extend the lease and contingent rentals that are based on the performance or use of the leased good (see responses to Questions 8 and 9).

However, should the IASB continue to deem valid the above proposal, the OIC believes that a periodic reassessment of the value of the asset or liability due to contingent rentals and renewal options

would be particularly burdensome for entities. We agree that the reassessment should be conducted only when there are facts or circumstances that indicate that there has been a significant change in the value of the lease liability/asset originating from changes in the lease term or contingent payments.

Question 11: Sale and lease back

Do you agree with the criteria for classification as a sale and leaseback transaction? Why or not? If not, what alternative criteria would you propose and why?

The OIC believes that, also for sale and leaseback transactions, the application of the derecognition approach remains valid for the buyer/lessor when a previously purchased good is leased out and, more in general, as the sole accounting method of the lease transaction for the lessor. Indeed, the accounting treatment of a sale and leaseback transaction should be linked to the conceptual premise of the ED, that is, the underlying asset is a bundle of rights that can be separately negotiated or exchanged. In this light, the seller/lessee: a) transfers the residual asset to the buyer/lessor, b) and finances that portion of the asset (the right to use) that it still uses. This approach is consistent with the derecognition approach that the OIC supports for all lease transactions.

The OIC further believes that the ED should provide clarity about the indicators used for identifying a sale. Some indications given in the basis for conclusion (BC 162) propose that the criteria to be used for a sale are the same as those for distinguishing a lease from a purchase/sale transaction. However, this does not appear consistent with the reference to paragraph B31 made in the standard; this latter paragraph gives some examples of conditions that the parties have to assess in order to understand if the transfer constitutes a sale.

Furthermore, we would like to highlight the following issues that warrant further consideration and/or clarification by the Board:

- from the reading of paragraph B31 of the ED it appears that the existence of even only one of the circumstances envisaged would mean it impossible to record the sale;
- paragraph B31 letter a) does not seem consistent with the ED on Revenue, which precluded the recording of a sale in the situation where the seller retains a purchase option, even if the price is determined at fair value;
- it is necessary to clarify what is meant by the term “transfer” mentioned in paragraph 66 of the ED and, in particular, whether one is referring to transactions as understood in the legal sense of the term (legal sales) or to a broader meaning of the term;
- it is not clear how to treat non-monetary transactions, such as exchange leasebacks, spin-off leasebacks and contribution leasebacks.

Question 12: Statement of financial position

- (a) *Do you agree that a lessee should present its liability to make lease payments separately from other financial liabilities and present right-of-use assets as if they were tangible assets within property, plant and equipment, or investment property as appropriate, but separately from other assets that the lessee does not lease (paragraphs 25-27, 42-45, 60-63 and BC142-159)? Why or why not? What alternative presentation do you propose and why?*
- (b) *Do you agree that a lessor applying the performance obligation approach should present its underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? What alternative presentation do you propose and why?*

- (c) *Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? What alternative presentation do you propose and why?*
- (d) *Do you agree that lessors should distinguish assets and liabilities that arise under a sublease separately (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?*

The OIC agrees with the IASB's proposal to present, in the lessee's statement of financial position, the liability stemming from the obligation to make lease payments separately from the other financial liabilities, and to separate the right of use from other own property, plant and equipment.

On the one hand, the new accounting will enable a clearer reading of the lessee's financial statements, distinguishing between lease and own goods, an innovation compared with IAS 17, which allows the unseparated recording of the latter two classes of assets in the financial statements of the lessee. On the other, it will evidence the real financial exposure of the lessee to the lessor.

For lessors applying the derecognition model, the ED requires a different presentation in the statement of overall profit and loss according to the entity's business model. The OIC agrees with the approach proposed.

The OIC does not agree with the presentation provisions for lessors applying the performance obligation approach. This relates, in our opinion, to the ambiguity of the approach itself. As said, the OIC believes there should be only one accounting model for lessors, that is, the derecognition approach.

Question 13: Statement of comprehensive income

Do you think that lessees and lessors should present lease income and expense separately from other income and expenses in the statement of comprehensive income (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

The OIC agrees with the IASB's proposals; they will provide useful information for the users of financial statements.

Question 14: Statement of cash flows

Do you think that cash flows arising from lease contracts should be presented on the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

For lessees, we do not support the proposal to necessarily classify cash payments for leases as financing activities in the statement of cash flows. In our opinion, the model proposed by the IASB treats the lease as a purchase of assets financed with a specific debt. For this reason we believe that classify cash payments for leases as investment activities it is more consistent with proposed model.. The interest component, if identified, should be treated like any other interest flow.

For lessors, the lease payments related to the good should appear as an investment asset, and not as an operating asset.

Question 15: Disclosure

Do you agree that lessee and lessors should disclose quantitative and qualitative information that:
(a) identifies and explains the amounts recognised in the financial statements arising from lease contracts; and
(b) describes how lease contracts may affect the amount, timing, and uncertainty of the entity’s future cash flows? (paragraphs 70-86 and BC168-BC183) Why or why not? If not, how would you amend the objectives and why?

The OIC believes the disclosure required to be overly extensive and in, some cases, inorganic. Moreover, bearing in mind that the disclosure would presumably entail a significant burden in terms of management costs in situations with multiple lease contracts, the OIC believes it appropriate to define a more precise and concise disclosure than that being proposed.

However, the OIC welcomes the principle contained in paragraph 71 of the ED, whereby an entity should provide the level of detail in the disclosures appropriate to satisfy the two objectives set out in paragraph 70, that is: a) identify and explain the amounts derived from the lease in the financial statements; and b) describe how the lease may affect the amount, timing and uncertainty of the entity’s future financial flows.

In order to strengthen this concept, the OIC believes it would be useful for the ED specify more clearly that the list of information required is not obligatory in all situations.

Question 16: Transition

The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88-96 and BC186-BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?

Do you think that full retrospective application of lease accounting should be permitted? Why or why not?

Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

The OIC agrees that mandatory full retrospective application of the ED requirements should not be permitted because this would be too onerous, especially for long-term leases. Therefore, we are in favour of the relief given to preparers on the transition requirements.

However, we believe that there are not conceptual reasons to prohibit full retrospective application when entities have the relevant information.

Question 17: Benefits and costs

Paragraphs BC200-BC205 set out the boards “assessment of the costs and benefits of the proposed requirements. Do you agree with the boards” assessment that the benefits of the proposals outweigh the cost? Why or why not?

The OIC believes that the IASB should conduct further research in order to obtain additional information both on the implementation costs associated with the new proposal and on its potential impacts/effects.

In regard to costs, with reference to contracts currently classed as operating leases and the inclusion in the notes to financial statements of the additional information required, the proposals contained in

the ED would result in a significant increase in management costs, especially in situations of multiple lease contracts (contract-by-contract basis), often of a non-significant unit value.

Faced with such costs, entities will have to make the necessary investments in IT systems, staff training, accounting and control systems, and professional consultancies. However, above all, entities will have to make an increased effort in terms of administration in order to obtain, for the countless rental and hire contracts that typify corporate reality, the base data needed to feed the above systems.

Indeed, the OIC believes that entities will have to bear increased costs for the implementation and the management of the new accounting complexities introduced by ED, especially in relation to the method for valuing the right of use, to which are to be added also future and uncertain elements and other possible elements (optional periods, contingent rentals, residual value guarantees, penalties), and in relation to the periodic assessment of the payment commitments (both for the duration of the contract, and for the contingent rentals, residual value guarantees, and penalties).

Concerning the potential effects of the ED, the OIC believes that there should be a significant effect for all entities with operating leases and hire arrangements as it will lead to them showing a higher level of debt in their financial statements and, hence, possible difficulties in accessing bank credit. This could result in an increased cost of capital for some entities.

The measures presented in the ED will presumably have significant effects on the ratios in financial statements and on other performance indicators as well as on entities' debt covenants.

The ED's proposals could also affect the determination of regulatory own funds requirements on the basis of national regulations, depending on how the right of use is considered.

For the above reasons, we believe that the IASB's conclusions on the analysis of costs and benefits are not exhaustive. The increased costs that entities would presumably have to bear in order to implement the ED do not have, in our opinion, a true justification in terms of an improved representation of the corporate phenomenon that are leases. For these reasons, we hope that the IASB will conduct further research on the matter.

Question 18: Other comments

Do you have any other comments on the proposals?

With a view to the practical application of the provisions contained in the ED, the OIC believes that it would be opportune both to clarify or review some of the indications contained in the document and to supplement the document with new or other proposals.

Among these, we would in particular mention:

- (a) Clarify what is included under the definition of lease payment, with particular reference to the inclusion of lease incentives, key money and security deposits.
- (b) Revise the definition of incremental borrowing rate. It should be made clear that the incremental borrowing rate is the rate of interest that the lessee should pay in order to obtain finance on similar terms and with the same options as in the lease contract and is not the amount that the lessee should borrow for the period of the expected duration of the lease contract.
- (c) Include guidelines that discipline the accounting treatment of subsequent changes to existing lease contracts.
- (d) Clarify how lessors should account for restoration obligations (asset retirement obligations/rehabilitation costs).

The OIC suggests that it is opportune that the IASB define in a consistent manner the accounting treatment for the costs that have to be recorded. Indeed, we would point out that among the recent EDs

that have been issued (Revenue recognition, Insurance contracts and Leases) there are differences concerning this specific aspect.

Furthermore, we would point out the following aspects to take into consideration:

- It is not clear why the lessee may not use FVO, if the circumstances arise, to measure the lease liability.
- Paragraph 11.c) on the reassessment model mentions IAS 38. Paragraph 21 mentions the reassessment model of IAS 16; it would be appropriate to clarify which reassessment model should be followed.
- The option allowed to lessees to use FV in the measurement of the right of use, also where there is no active market, is not consistent with IAS 38.
- The reassessment model of the right of use can be used for all goods belonging to a class. There is no explanation as to what is meant by the term “class”. It would be opportune to provide a reference of the kind given in IAS 16.37.

Yours sincerely,
Angelo Casò
(OIC Chairman)