Dear Sir/Madam,

EFRAG Draft Comment Letter regarding IASB Exposure Draft ED/2013/6 Leases

The Danish Accounting Standards Committee set up by "FSR - danske revisorer" is pleased to submit the following comments:

We support IASB’s efforts to establish a model under which all leases are brought to the balance sheet. We do not find it appropriate to initiate yet another lease project leaving uncertainty among preparers and users in respect of the possible outcome of such a project. This is due to the fact that - on balance - the right of use model in our view is an appropriate model to reflect rights and obligations under lease contracts. Further, it seems that Danish entities in general have acknowledged that lease contracts give rise to rights (assets) and obligations (liabilities) which should be reflected in the financial statements.

We do, however, not support the classification model proposed by the IASB. We prefer a single model under which all leases are treated as type A leases by lessees but would accept that in rare cases it is clear that there is no consumption of the underlying asset where a type B classification might be appropriate. These rare cases though should not be limited to properties as we find that there might be other assets where it is clear that there is no consumption of the underlying asset.

Alternatively, we could accept a lease classification based on current IAS 17, i.e. where leases which would be classified as finance leases under IAS 17 are classified as type A leases under a new model while all other leases are classified as type B leases. While this may not be a conceptually strong solution, it is operational while still meeting the overall objective of bringing rights and obligations under lease contracts on to the balance sheet.

In respect of lessor accounting, we do not support the proposed model for type A leases. We are not convinced that up front recognition of a gain is appropriate. In addition, the model is far too complex. Therefore, we propose to retain current IAS 17 requirements in this respect.

Regarding identification of a lease, we generally support EFRAG’s observations. We do not, however, support EFRAG’s proposal that in a combined contract, it
should be presumed that there is no lease if no observable prices exist for rental of the underlying assets as further explained in our response to specific questions attached.

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We would be happy to elaborate further on our comments should you wish so.

Kind regards

Jan Peter Larsen
Chairman of the Danish Accounting Standards Committee

Ole Steen Jørgensen
Chief consultant
FSR - danske revisorer
Response to specific questions

**Question 1: Identifying a lease**

We agree with EFRAG’s comments on the identification of a lease. It is important that the definition of a lease captures only lease contracts that include an asset where the right to use the asset is transferred to the lessee.

We agree in the application of a control concept even though it may include some judgment when assessing whether a contract includes an asset where the right of use is transferred. At the same time, we agree with EFRAG that more guidance is needed around the concept of defining a lease contract and how to split other services from the leased asset if the contract is deemed to include an asset where the right of use is conveyed to the lessee.

**EFRAG’s question to constituents regarding identifying a lease (cf. 28, 37 and 38)**

*Do you agree that a better distinction is needed between the conditions in paragraph 19 and 20 of the ED?*

We agree with EFRAG. The principle is not clear and more guidance is needed. Furthermore, paragraphs 19 (a) and 20 (a) seem to be almost identical. We have considered whether paragraph 19 (a) is actually needed in defining whether a contract includes a right to use a specified asset because the dividing line should be the design of the asset. The concept of incidental might also need further exploration and explanation before it can be applied in practice.

We think more examples are needed and that the IASB needs to work on the current examples as, in our view, they are not always clear and understandable. It seems that the only difference between examples 2 and 3 is that in example 3 it is possible to observe external prices on the asset and other goods/services, and due to that single observation, the conclusion is different from example 2. It strikes us as peculiar that the question whether external prices for an asset or other services exist or not can change the conclusion on whether the contract includes an asset where the right of use is transferred. See above regarding paragraph 19 (a). Furthermore, we also find it too burdensome for lessees to have to investigate whether observable prices exist for the leased asset and other services bundled in a lease agreement. Put differently, we believe it is in general burdensome for a lessee to have to investigate on the existence of conditions from the perspective of the lessor.

We do not support EFRAG’s suggestion of a new criterion under which - in a combined contract - a lease contract only exists if observable prices for the underlying asset are available. As set out above, we do not think that this affects whether the lessee controls the underlying asset. Furthermore, such a criterion will also require too much work for lessees investigating whether observable prices exist.

**Do you agree that observable prices for separate components may on occasion be not fully relevant in allocating the total payments to different components? If so, what types of adjustments should be made?**

No comments, we have not seen the issue in practice.
**Do you agree that lessees should be allowed to use reasonable estimates to allocate the price to lease and non-lease components in the absence of observable stand-alone prices?**

Yes, we agree. In our view, it should be possible to use estimates when there are no observable prices. We believe that estimating the prices on the leased asset and the non-lease components is more appropriate than recognising both the leased asset and the non-lease components in the balance sheet as suggested by the ED. Furthermore, the concept of basing an allocation of estimated prices is already known from the ongoing revenue recognition project in respect of splitting a contract into separate performance obligations. In our view, the issue is exactly the same in this standard: a matter of splitting a bundled contract into the different goods and services included in it.

As mentioned in question 1, we disagree with EFRAG in the last sentence in paragraph 35. In our view, it is not always evident that when an asset can be used also without additional goods and services provided by the supplier, there will always be an observable price for lease of the asset without the related service. In our view, this is not always the case. Further, such a criterion will require too much work for lessees investigating whether observable prices exist.

**Question 2: Lessee accounting**

First of all, we support the leasing project and the efforts to recognise more obligations to make lease payments on the balance sheet. Secondly, we support the efforts in developing a right of use model and the concepts behind such a model.

We do not agree with EFRAG that the leasing project should be delayed further until more investigations have been made and the framework project has been concluded. We believe the current proposal from the IASB should be improved in certain important areas. But we also think that the work should continue and that all efforts should be allocated to develop the right of use model into a final standard. In our view, preparers and users will be satisfied with a short-term disclosure solution to IAS 17 followed by additional years of refinement to the right of use model.

Even though we support the right of use model, we do not agree with the IASB in the dual approach. In our view, the dual approach proposed to address issues regarding recognition in the income statement is overly complex and much too burdensome for preparers. Furthermore, we do not believe that the proposed dual model is much better than the current dual model in IAS 17 when it comes to reducing or even removing complexity. Therefore, we prefer a single model where all contracts (except short-term contracts) are recognised in the balance sheet and all contracts are recognised in the income statement in the same way as type A lease contracts in the IASB proposal.

Based on the fact that we support a right of use model, we do not support EFRAG’s alternative where all type A contracts are recognised in the balance sheet and all type B contracts are off-balance sheet items similar to operational leases in IAS 17. If one has accepted to apply a right of use model as the conceptual basis behind recognition of leases, we believe one must also accept that the right to use a property will have to be recognised in the balance sheet.

Furthermore, we also do not support that the classification into type A and type B should be based on the type of asset (property vs. non-property) as further explained below.
If a single approach to lease classification is not acceptable or supportable, we would prefer a dual measurement model where the classification is based on a principle rather than the type of asset - i.e. property or non-property - with guidance indicating that type B is intended for assets which are truly not consumed such as land. In this respect we note that the guidance in the ED might actually lead to classification of some leases of land as type A leases. The classification principle could be the same as in paragraph 29 of the current proposal’s but without the first sentence. This would imply that all leases are type A leases unless one of the two criteria in para’s 29 (a) or 29 (b) is met, and then paragraph 30 could be deleted. Another classification criterion for a dual measurement model could be the current one in IAS 17. We acknowledge that there may not be strong theoretical merits behind such a model. But the model is well known to users and prepares and hence easy to apply while still meeting the overall objective of bringing lease assets and liabilities on to the balance sheet. But from an overall perspective, we prefer a single model as this would be much less complex.

EFRAG’s question to constituents regarding lessee accounting (cf. 50)

Do you agree that the proposed distinction between Type-A and Type-B leases should lead to different recognition, and not just different measurement?

No, we do not think that the proposed distinction between type A and type B leases should lead to different recognition. If they do, the proposed new model will be almost similar to the current IAS 17 model, just having a different approach to the diversification of lease types. Such a model will still be complex, and it does not result in all leases being recognised in the balance sheet. Hence, one of the main objectives behind the project would not be fulfilled since a significant difference in the accounting treatment between the different types of leases would still exist. In addition, it also neglects what we think must be an overall objective when developing new standards in replacement of existing standards; that is to reduce complexity.

Question 3: Lessor accounting

Overall, we find the proposed model regarding lessor accounting much too complex. The dual model where the asset is partly derecognised requires significant judgment in respect of determining the portion of the asset derecognized and the associated gain/loss recognition.

We therefore support a single and much simpler approach for lessors, where we are ready to sacrifice the symmetrical recognition between lessee and lessor. We prefer a model where the lessor recognises lease income in the income statement over the lease term, instead of recognising an upfront profit as a partial sale of the leased asset. We acknowledge that this will not establish a symmetrical approach but we believe a more simple model for lessors which is understandable - and does not involve significant judgment - should take precedence. In such a model, the lessor will continue to recognise the leased asset and amortise the asset over its useful life similar to current IAS 17.
EFRAG’s question to constituents regarding lessor accounting (cf. 60 and 61)
If the IASB confirmed Type-B accounting for lessees, do you agree that lessors should also derecognize part of the underlying asset?

As mentioned above we find the suggested model for lessors far too complex and therefore we suggest a more simple and single approach. We do not agree with the proposed partial derecognition model.

If the IASB confirmed Type-B accounting for lessors and lessees, do you support an exception for back-to-back leases?

If the IASB confirms the current dual model, we support an exception for back-to-back leases. But as mentioned in question 3 – we support a more simple approach for lessor accounting.

**Question 4: Classification of leases**

Overall, we support a single approach where no classification of leases is needed.

But if a classification is introduced in a coming new lease standard, we do not support that the classification is based on type of asset, i.e. whether it is property or not. In our view, there is no difference between the lease of a property and the lease of, say, a ship or an airplane, cf. our response to question 2. In our view, classification should be based either on consumption of the asset or application of the current classification criteria in IAS 17. Introducing a new classification will introduce additional complexity.

EFRAG’s question to constituents regarding classification of leases (cf. 71)
Which view (A or B) on the classification criteria for leases do you support?

Overall, we support a single approach where no classification is needed. If this goal is not obtainable and therefore a classification is introduced in the new lease model, we support view B. As stated above in response to question 2, we do not believe that the type of the asset should be the decisive factor behind classification of leases.

**Question 5: Lease term**

EFRAG’s question to constituents regarding lease term (cf. 91 and 95)
Do you support view A or view B in relation to the recognition of payments due under optional periods?

We support view A. We acknowledge that it is not a pure liability approach. It does, however, reflect the substance of the lease arrangement, and separate accounting for options would be too complex.

We support EFRAG’s proposal to amend the term “significant economic incentive” to the well-known IAS 17 notion of “reasonably certain”.

Do you support the definition of short-term leases in the ED? Or do you think that the exemption should be applicable also when the possible duration of the contract is more than 12 months but the lessee has no significant economic incentive to stay in the contract for 12 months or more?
We support the proposal set out in the ED. Contrary to EFRAG’s proposal to allow inclusion of extension options for which there is not significant economic incentive we believe the proposal set out in the ED is easily applicable and cases where a lease is originally not capitalized but needs to be capitalized subsequently is avoided. Furthermore, we find it appropriate to include the provision as a measure to avoid structuring opportunities.

**Question 6: Variable lease payments**

We overall agree with EFRAG.

In relation to variable lease payments based on a rate or an index, we are not convinced that the approach proposed by IASB is the right one. The approach would result in a re-assessment of the lease liability every time the index changes. This is opposite to the treatment of inflation linked payments in financial liabilities and provisions such as decommissioning costs where the expected changes in the payments arising from inflation would be either treated as expenses when incurred or incorporated into the expected cash flows. Further, most lessees would be unable to derive the rate implicit in the lease and would apply the incremental borrowing rate. This is a nominal rate, and hence, the discount rate would be inconsistent with the underlying cash flows.

**EFRAG’s question to constituents regarding variable lease payments (cf. 104)**

*Do you agree that more guidance is needed for in-substance fixed payments? If so, do you have suggestions on how to develop it?*

We agree that the notion of "substantially fixed" should either be explained better or deleted from the guidance.

**Question 7: Transition**

We agree with EFRAG’s comments.

**EFRAG’s question to constituents regarding transition (cf. 109)**

*Are there additional transitional relief that the IASB should consider?*

We have not identified any at this time.

**Question 8: Disclosures**

Overall, we support EFRAG’s comments. As a general comment we wonder why additional disclosures are necessary in light of the fact that the proposal will bring more leases on to the balance sheet. We think this should be reconsidered also in light of the current debate about the voluminous disclosure requirements in general.\(^1\)

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\(^1\) We refer to the comments in our letter of 30 November 2010 to EFRAG regarding exposure draft ED/2010/9: “The proposed disclosure requirements have increased significantly compared to the current requirements in IAS 17. We have not been able to trace from where in Europe the request for such increased disclosure emerge. It is not a request we hear from analysts and other user groups in our jurisdiction. We reiterate previous comments on other exposure drafts that we find it important for the IASB to develop a disclosure framework in which they establish criteria for when a specific disclosure is needed. We appreciate in this respect the proactive work initiated by EFRAG.”

We also refer to the comments in our letter of 14 January 2013 to EFRAG regarding the discussion paper: “Towards a Disclosure Framework for the Notes”.

We also agree that in light of the fact that they are measured in the same way, it is not obvious why there is a need to separate disclosure of type A and type B lease obligations. In general, we prefer that details of this nature are governed by the general disclosure standards applicable, i.e. IFRS 7.

OTHER COMMENTS

In respect of presentation prescribed for type B leases, we find it complex to understand for users because the presentation in the balance sheet is de-coupled from the presentation in the income statement and also to some extent from the cash flow statement. As set out above, we prefer a single model under which this issue does not arise.

**Question 12: Consequential amendment to IAS 40**

EFRAG’s question to constituents regarding consequential amendment to IAS 40 (cf. 121)

Do you support View A or View B on fair value measurement of the right-of-use assets classified as investment property?

We would not expect this to be a significant issue. We generally support limitation of accounting policy choices and hence, we support view A.

Further EFRAG questions to constituents

What is your view in relation to the accretion of the discount on the residual asset? (cf. 129)

As we do not support the proposed lessor model, the residual asset accretion issue would not arise.