The Corporate Reporting Users' Forum

European Financial Reporting Advisory Group
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2 September 2014

Re: Additional consultation on Revised IASB Exposure Draft *Leases*

The Corporate Reporting Users' Forum welcomes the opportunity to respond to the European Financial Reporting Advisory Group's (EFRAG) additional consultation on the IASB's revised Exposure Draft (ED) *Leases*. Our response to the July 2014 questionnaire for users of financial statements is set out below.

It is worth noting that CRUF has engaged on numerous occasions over the last few years on this topic both with the IASB and with EFRAG through the participation of a number of members on the User Panel. In all cases we have stated that all asset leases should be on balance sheet and we welcome the fact that the IASB and FASB continue to make proposals which have this unchanged. We consider the project to be important for the efficiency of capital markets to enable investors to allocate capital appropriately and we therefore encourage all parties to ensure that the remaining steps to completion are dealt with expeditiously.

Many CRUF participants have consistently stated that they believe that asset leases are largely a combination of financing and risk management in nature and that they would have preferred a "whole asset" model for leases with the obligation to return the asset at the end of the lease shown as a liability in addition to the obligation to make payments over the lease term. It has been clear for some time that this approach would not be acceptable to preparers and that the non-cash nature of the obligation to return the asset was considered to fail the accounting test for liability recognition although the economic substance of the obligation might result in it being considered an economic liability by users of accounts.

To the extent that there has been disagreement within CRUF it tended to be from participants who believed that leases were a unique asset and liability and they tended to favour the single model which the IASB has reverted to. These included CRUF participants analysing credit instruments but also some of the equity analysts.

Subsequent commentary from CRUF has tended to evaluate proposals in this context to enable users to see through the reporting to a better understanding of the business model where assets are used to provide goods and services. In particular those supporting a whole asset model have sought to have the information to bifurcate lease costs between consumption (a proxy for depreciation) and finance cost (a proxy for interest).

We therefore supported the prior version of the IASB proposal on the basis that the property lease cost (rent) would be separately shown as a single line and therefore could be treated as entirely financing from an income statement perspective if a user chose to make the adjustment. We concluded that the other asset (e.g. equipment) leases would, in aggregate, be "close enough" to our preferred split to be materially accurate.

Clearly the latest proposal to move back to a single model is a step further away from the optimal model advocated by some CRUF participants. To mitigate this loss of data on the face of the income statement they would encourage disclosure of lease asset and liability balances, income statement items (interest and amortisation) and cash payments by class of underlying asset in the notes to ensure that we are able to make the necessary economic adjustments. For example, for long-term property leases some of us would treat all of the income statement expense as a financing cost, and attempt to convert the charge back to a straight line expense if the impact of discounting materially skews net income over time.

When comparing the current IASB and FASB models, we have collectively come to the conclusion that the IASB approach, with appropriate disclosure referred to above, is the preferred alternative for the following reasons:

1. IASB approach is internally consistent for all leases once the definition of the right of use asset and the associated financial obligation are accepted, and this is supported for conceptual purity on liability definition by some CRUF participants, particularly credit analysts. This should make it operationally easier for companies to apply the requirements.
2. CRUF participants tend to agree with the IASB that all recorded liabilities from leases are financial liabilities, unlike the FASB that regards the operating lease liability as a non-financial liability.
3. CRUF participants therefore tend to fundamentally disagree with how the FASB designates operating lease costs as non-financial costs.

Our response to the IASB's consultation on the *Leases* ED is available at: http://cruf.com/cruf-lease-300913.pdf.

Our responses to the specific questions are set out below. If you would like to discuss our comments and views further, please do not hesitate to contact us.

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Responses to specific questions

25 *Assume that the Boards maintain the current scope of application of the proposals, do you prefer:*

	Yes	No
The IASB approach, that recognises all leases on the balance sheet and in substance treats all leases as finance leases	X	
The FASB approach, that recognises all leases on the balance sheet but, after commencement as follows: • for leases that are in substance purchases: separate finance and amortisation costs in the income statement and right-of-use assets and liabilities in the balance sheet • for leases that are not in substance purchases: a single lease expense in the income statement and right-of-use assets and lease liabilities, separately presenting these liabilities from the liabilities for leases that are in substance purchases, in the balance sheet		

26 *Please provide your reasons for supporting one or the other approach:*

	Yes	No
It provides more relevant information	X	
It is easier to understand	X	
It improves comparability of similar transactions	X	
Other reasons (please explain)		
Please explain the basis of your conclusion: See the introductory comments in this letter.		

39 *The current definition and criteria to identify a lease are explained above in paragraphs 27 to 30. Based on your knowledge, do you think that some transactions should be excluded from the scope of the Standard and treated*

as service contracts (i.e., no asset and liability are recognised by the lessee)? If so, please describe the transaction and provide your reasons.

We reviewed the definition provided in paragraphs 27-30 and the examples cited as creating problems. CRUF participants have concluded that they are comfortable that the proposed definition as applied does deliver the right accounting and should ensure that there is an appropriate split between asset leases and service contracts, consistently with the view noted in our comment letter to the IASB in 2013.

If there were one criticism we might make of the proposed definition it is that there is a lack of discussion specifically around risk transfer (it is not clear in the ED whether risk is covered by the "right to control" condition and the link to the definition of control in IFRS 10 *Consolidated Financial Statements*). If the supplier retains all the risk of asset availability then there is probably not an asset lease even if the customer has the other characteristics present. Generally it will be unlikely that a customer would have unfettered right to direct the use of the asset and the supplier would retain an obligation to ensure that it is available but if that is the case then the contract is probably a service. In the shipping example who pays if the boat sinks, who ensures the activity continues with alternative transport and who has bought insurance? Similarly, in the pipeline example who is responsible for getting the gas from point A to point B if the pipeline breaks, and would this differ depending on whether the volume transported is 50% versus 100%?

About the Corporate Reporting Users' Forum (CRUF)

The CRUF was set up in 2005 by users of financial reports to be an open forum for learning about and responding to the many accounting and regulatory changes that affect corporate reporting. In particular, participants are keen to have a fuller input into the deliberations of accounting standard setters and regulators. CRUF participants include buy and sell-side analysts, credit ratings analysts, fund managers and corporate governance professionals. Participants focus on equity and fixed income markets. The Forum includes individuals with global or regional responsibilities and from around the world, including Australia, Canada, France, Germany, Hong Kong, Japan, New Zealand, South Africa, UK and USA.

The CRUF is a discussion forum. Different individuals take leadership in discussions on different topics and in the initial drafting of representations. Participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer organizations. Accordingly, we sign this letter in our individual capacity as participants of the Corporate Reporting Users' Forum and not as representatives of our respective organizations. The CRUF does not seek to achieve consensus views. However, it would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative. The participants in the Forum that have specifically endorsed this response are listed below.

Jed Wrigley
Portfolio Manager
Director – Accounting and Valuations
Fidelity Worldwide Investments

Norbert Barth
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Peter Elwin

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