

**Organismo Italiano di Contabilità – OIC  
(The Italian Standard Setter)**

Italy, 00187 Roma, Via Poli 29  
Tel. +39 06 6976681 fax +39 06 69766830  
e-mail: [presidenza@fondazioneoic.it](mailto:presidenza@fondazioneoic.it)

EFRAG  
35 Square de Meeûs  
B-1000 Brussels  
BELGIUM  
[commentletter@efrag.org](mailto:commentletter@efrag.org)

30 September 2013

**Re: EFRAG draft comment letter on Exposure Draft Leases**

Dear Françoise,

We are pleased to have the opportunity to provide our comments in order to contribute to the finalization of the EFRAG comment letter on the Exposure Draft Lease (the ED).

While we support the IASB's efforts thus far to investigate the nature and appropriate accounting treatment for lease contracts, and the distinction between lease and service contracts, we believe that the IASB should continue to investigate these concepts further.

We have performed a lot of activities on this project to collect the widest and most diverse number of inputs (e.g. field-tests, questionnaires, physical meetings; with preparers, users, auditors, academics, associations).

In addition to our comments provided in your request for early input, our main comments on the ED are as follows:

- The distinction of two types of lease (type A and type B) is not really useful. This is because we believe that this distinction increases the complexity and the confusion of the model and misrepresents the conceptual basis of the right of use model. In particular, on this point, also the field test underlines this issue. Please see our answer to question 4 for more details.
- As highlighted in the field test we carried out, we note that our constituents have found difficulty in identifying if a contract is a lease or a service contract. Therefore, taking into account that in the IFRS requirements there is no clear definition of a service contract, we would ask the IASB to work further on these concepts to clarify the distinction between lease and service contracts.

- As already said in our response to the 2009 DP and 2010 ED, we believe that the right of use model has conceptual merits and therefore we strongly suggest that the IASB limits the scope of this standard to the "real" non-cancellable leases and develops a standard that is easier to apply.

More in particular, we believe that the IASB should consider the following simplifications/suggestions in the final development of the model:

- a. With reference to the lease term, in the ED, the IASB states that if both the lessor and the lessee have the right to terminate the lease contract without permission from the other part with no more than an insignificant penalty, it is considered "cancellable", otherwise not. In the case in which only the lessee has the ability to cancel the contract, it is considered "non-cancellable". In fact, we believe that this requirement is inconsistent with the rights and obligations of the individual parties. For the lessee, it is completely indifferent to know that the lessor has an option to terminate the lease before the end of the lease period. For the lessor, a contract is cancellable if he has that option and can exercise it with an insignificant penalty (e.g. penalty versus the total lease payments or value of the right of use asset on the total assets).
- b. As a result of the field test, one of the application issues of the standard is the magnitude of calculation that the standard requires for items that singularly are of insignificant amount (e.g. photocopiers). On this point, we believe that the IASB could provide preparers with a simplification in the event that the financial effect of discounting of the lease liability is not material. When the leased items are not material, we expect that the effect of discounting of the lease liability will be insignificant in respect to the total amount of indebtedness (for example, for a liability with a duration of 2-3 years). In these circumstances, the IASB could allow, as a practical expedient, lessees not to discount the lease liability, recognizing it in the financial statements for an amount equal to the nominal value. In this case only, therefore, the lessee could recognize a constant amount in the income statement equal to the lease payments payable to the lessor, rather than recognize two separate components (i.e. interest expense and amortization of the right of use asset). This would eliminate the burden of numerous calculations.
- c. The materiality concept may be useful also in determining the classification of a contract containing both lease and service components, when the impact on the financial position would be insignificant. In these circumstances, it would be better to classify the contract as a service, rather than require complex calculations. This would also reduce the administrative burden of recognizing lease contracts of very small value.

Our detailed responses to the ED questions are in the Appendix.

Should you need any further information, please do not hesitate to contact us.

Yours sincerely,

Angelo Casò

(Chairman)

### **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 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.**

We support the IASB's efforts to develop more guidance on the definition of a lease and the alignment of the definition of control to the revenue recognition project and IFRS 10. However, as pointed out from the field test performed, we note that our constituents have found difficulty in identifying if a contract is a lease or a service contract. Therefore, taking into account that in the IFRS requirements there is no clear definition of a service contract, we ask the IASB to work further on these concepts to clarify the distinction between lease and service contracts.

We agree with the IASB requirement to identify and separate the lease and non-lease components in a contract because it is consistent with the principles in the new (draft) standard on revenue. However, we believe that the materiality concept should also be applied in determining the classification of a contract containing both lease and service components, when the impact on the financial position would be insignificant. In these circumstances it would be better to classify the contract as a service, rather than require complex calculations. This will also reduce the administrative burdens of recognizing lease contracts of very small value.

In addition, contrary to the requirements of FASB, we note that the IASB ED does not allow lessors (and does not require lessees) to apply the lease proposal to the leasing of intangible assets. We can understand the reason for excluding leases of intangible assets for the lessor side from the scope of the lease proposal; however, we do not see any conceptual reason to leave an accounting choice to the lessee.

### **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?**

As already said in the covering letter, we are not in favour of the introduction of the dual model for accounting for leases for the lessee. More in particular, we believe that this distinction (Type A and Type B) increases the complexity and the confusion of the model and misrepresents the conceptual basis of the right of use model. In fact, all the firms involved in the field test are concerned about this point.

### **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?**

Regarding the lessor side, as already said in our comments on the 2010 ED, we support the (partial) derecognition approach although we are not convinced about the measurement method of the portion of the carrying amount of the underlying asset to be derecognized. Regarding this measurement method, we are working to provide you with some useful input in order to better address the issues that arose appeared during the consultation period of the 2010 ED.

#### **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 already said, we do not support the distinction of leases between Type A and Type B because this would be too complex. This proposal still leaves room for structuring opportunities and maintains a classification based on bright lines. This does not make sense taking into account that one of the goals of the IASB was to eliminate the bright line distinction between operating and finance leases.

Difficulties have been highlighted when determining the fair value of the underlying asset in order to accomplish, at the commencement date, the verification of the criteria provided by paragraphs 28-30, to distinguish between Type-A and Type-B leases.

In particular, the application of the lease classification principle based on the lessee's expected consumption of the economic benefits embedded in the underlying asset, is not always verified. This could be the case where property assets that would be classified as Type-A due to the present value of the lease payments account for substantially all of the fair value of the underlying asset at the commencement date. On the other hand, there are also some non-property assets that have also been classified as Type-B leases because the lease term is for an insignificant part of the total economic life of the underlying asset or because the present value of the lease payments is insignificant relative to the fair value of the underlying asset at the commencement date.

#### **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?**

As already said in the covering letter, we believe that for the lessee it is completely indifferent to know that the lessor has an option to terminate the lease before the end of the lease period. For the lessee, a contract is cancellable if he has that option and can exercise it with an insignificant penalty (e.g. penalty versus the total lease payments or value of the right of use asset on the total assets).

Moreover, with regard to the assessment of the significant economic incentive to exercise, or not, a renewal option, taking into account that the results from the field test performed highlighted a

difficulty in this assessment at the commencement date, we believe that those options should be accounted for separately.

#### **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?**

As already said in our comments on the 2010 ED, we agree with the inclusion of variable payments based on an index or a rate in the measurement of the lease liability and lease receivable.

In addition, the IASB takes into account "in-substance fixed payments". However, we believe that the concept of "in-substance fixed payments" is not clear enough in the ED. As already said in our comments on your request for early input, in any case, we want to make sure that the IASB does not consider as fixed payments some payments based on either use or performance of the underlying asset. These contracts are not lease contracts but profit-sharing contracts and so they should be accounted for differently (more like joint operations).

#### **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?**

On the basis of the field test conducted, we underline some concerns on the transition requirements of the ED.

Considering the large number of lease agreements and due to operational complexity and data collection volume, the implementation of the Standard will require new processes and new accounting systems. It will be very time-consuming to identify, analyze, prepare an inventory, separate components (if applicable) and make calculations for measuring a large number of lease contracts, that individually considered are not significant.

The review of all the contracts, the preparation of the initial inventory of operating contracts and estimation of the measurement will be significantly time-consuming.

It will also be necessary to update and improve the IT systems to implement and completely fulfill the requirements proposed in the Exposure Draft.

Taking into consideration the interrelationship between this project and the new (draft) standard on revenue, we believe that the date of entry into force of the lease standard should be aligned with that on revenue.

#### **Question 12: 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 do not see any reason to measure the right of use asset at fair value.