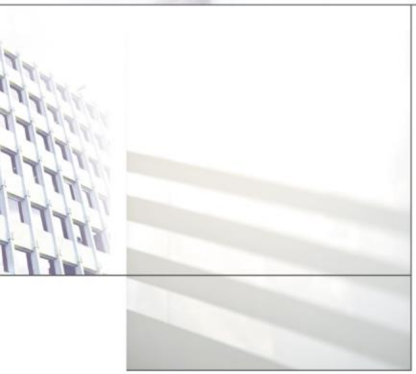

EFRAG

European Financial Reporting Advisory Group

Summary of Feedback from Users Outreach Events
Revised Exposure Draft Leases – ED 2013

1. Introduction and outline

Introduction

On 16 May 2013 the IASB and the FASB issued the revised Exposure Draft Leases (ED 2013). ED 2013 was significantly changed compared to the original exposure draft published in October 2010, including measurement models for lessees and lessors, and recognition of lease options and variable lease payments.

Meetings and outreach events

EFRAG organised and took part in a number of activities to collect the views of European users of the financial statements on the new proposals for accounting guidance on lease agreements. These activities included meetings, conference calls and field-tests.

EFRAG discussed the new proposals for leases during EFRAG User Panel meetings in Brussels in March and June 2013.

EFRAG staff participated as observers in outreach events for users organised by the IASB in June 2013 in London, Paris and Stockholm.

EFRAG staff conducted also several meetings and conference calls with individual preparers and users.

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2. Feedback from the IASB outreach events

Outreach events organised by the IASB

In June 2013 in Europe the IASB held a number of outreach events and was invited by several investing entities. EFRAG staff participated as observers in the following meetings:

- In London on 3 June, a meeting with users of financial statments;
- In Stockholm on 5 June, three meetings with users of financial statements;
- In London on 24 June, two meetings with users of financial statements;
- In Paris on 10 July, a meeting with SFAF members led by Jacques de Greling and Bertrand Allard.

EFRAG held also in its offices in Brussels on 26 June 2013, together with the IASB, a meeting with investors that was organised by Serge Pattyn (EFRAG TEG member).

The structure of the outreach events

In each of the meetings the IASB team consisted of at least one Board Member and one member of the IASB staff. Investors received an update in a form of presentation including examples on the results of application of the proposed guidance.

The investors were asked for to provide input on the following questions and aspects of the proposed guidance for leases:

- Do leases create assets and liabilities;
- If yes, should they be presented on the face of balance sheet, and how;
- Income statement presentation; and
- Disclosure package.

The investors provided a broad range of inputs, however, in general they agreed that operating leases should be brought onto the face of balance sheet.

The message received

EFRAG received very diverse messages. The majority of participants supported recognition of lease assets and liabilities and presenting them on the face of balance sheet. However, only a few of them supported the Type-A and Type-B split. Some of them would also prefer the whole asset approach instead of the right-of-use model. Some participants, disagreed with the proposals and suggested that improvement of disclosure package in IAS 17 will be much more useful.

2. continued

London, 3 June 2013

Topic	Comments
Participants	Investors in non-food retailers, food retailers, transportation and inventors liaisons
Recognition of assets and liabilities	- All participants agreed that all leases should be recognised on the balance sheet and that the quality of analysis would improve. - They would rather see whole asset approach however they see the proposal as cost trade-off.
Measurement	- Change of strategy would affect the carrying amount of the RoU assets.
Income statement presentation	- It was argued that if single lease expense is derived from a whole asset approach then the cost should be presented as finance cost.
Disclosures package	- Suggested additional disclosures as: summary of all rentals, average remaining lease term by asset class, more detailed payment scheme.
Other comments	- The rate lessor charge the lessee may be zero for real estate leases.

2. continued

Stockholm, 5 June, first meeting

Topic	Comments
Participants	A group of 16 investors: equity and credit analysts, and asset managers
Recognition of assets and liabilities	- Only one of the equity investors disagreed that lease assets and liabilities should be on the balance sheet. The rest of participant generally agreed with the proposal. - Some objected that assets will be double-counted in lessors' and lessees' accounts. - Some were concerned that entities will structure contracts with 11-months lease terms to avoid recognition. - Contractual commitments and obligations could be disclosed in the notes.
Balance sheet presentation	- Right of use asset are not self-explanatory as owned of property, plant or equipment.
Measurement	- In-substance fixed payments may be easily circumvented resulting in fixed payments of 1 EUR and the rest called variable. - There should be single treatment for all leases.
Income statement presentation	- Debt liability should result in appropriate interest charge in profit or loss.
Disclosures package	- Information on termination clauses would be useful.
Other comments	- Single lease expense approach seems to be in between – not really in full asset approach and not in operating lease approach. - Users typically adjust using a multiplication of the annual rental cost.

2. continued

Stockholm, 5 June, second meeting

Topic	Comments
Participants	A group of ten financial and credit analysts led by the research director
Recognition of assets and liabilities	- Generally agreed that the recognition would be much closer to real life than IAS 17 however new standard will influence individual stocks in consumers' sector. - Some anaylst challenged recognition of leases for retailers because the stores are not owned.
Measurement	- It would be an issue if the discount rate was continuously re-assessed during the lease term. - Some expressed concern about the impact of front-loading effect for EBIT.
Disclosures package	- Some suggested that disclosures should be provided on a quarterly basis. - Some asked how covenants will be impacted.

2. continued

Stockholm, 5 June, third meeting

Topic	Comments
Participants	A group of 23 financial, equity and credit analysts
Recognition of assets and liabilities	- New guidance will cause double accounting (double asset recognition) - Other assets as “broadcasting rights” should be also recognised on the balance sheet . - In general participants supported recognition of equipment (airplanes) leases, but were not sure about real estate. - Some real estate locations could be considered as assets, but some could not be easily sold so economically should be rather treated as liability.
Balance sheet presentation	- Right-of-use assets should be presented separately.
Measurement	- Some noted that typical lease terms differ from country to country (as example in Finland it could be 3 months and in London 20 years) so proposals will create incomparability of financial statements. - Entities will be “punished” for long-term operating leases. - Some agreements are not comparable to purchase agreements due to significant side effects (e.g. tax).
Income statement presentation	- Financial liability should bear interest.
Other comments	- Measuring the residual net of unearned profit in lessors’ accounts is complicated. - Analysts usually do not restate real-estate leases of retail industry entities and usually restate for operating leases of airlines.

2. continued

London, 24 June, Investors’ meeting

Topic	Comments
Participants	A group of seven investors / users

Recognition of assets and liabilities	- Three participants disagreed with the proposal, because more extensive disclosures (like in IAS 19) would provide sufficient information; extension periods should not be recognised because they are contingent on the exercise.
	- The dissenters also noted that
	    - these assets will gross up balance sheets, and right-of-use assets are similar in quality to goodwill;
	    - Only leases at unfavorable terms should be presented as liabilities ;
	    - Historical ratios will be disrupted .
	- Other participants rather agreed with the proposal as they concentrate on risks i.e. on liabilities.

Measurement	- The real value of the residual asset is very important e.g. for aircraft leases.
Disclosures	- Detail of rent to underlying asset value. - A payment schedule up to year 25 would be useful.
Other comments	- Complexity of the new regulations will overweigh the benefits. - Financial accounts are only a basis of economic assessment.

2. continued

London, 24 June, second meeting

Topic	Comments
Participants	Four financial/equuity analysts
Recognition of assets and liabilities	- In general supported the recognition of lease assets and liabilities however rather supported whole asset approach as some companies do not own the assets and there is a need to do a "what-if" simulation. - Advanced users could manage with only disclosures, but other analysts do not adjust the figures for operating leases and ignore the issue.
Measurement	- There will be asymmetry as commitments on the income side in real-estate could be 6 months and on the cost side could be 20-25 years.
Disclosures	- Average remaining lease term.
Other comments	- One of the analysts adjust the statemnts with an annuity discounted cost or using multiplication method with specific multipliers for different businesses. - Break clauses and options to extend are different .

2. continued

Paris, 10 July 2013

Topic	Comments
Participants	Approximately 25 users
Recognition of assets and liabilities	- Only one participant expressed support for recognition - Rather, flexibility should be removed from existing IAS 17 and lease arrangements clearly distinguished from service arrangements.
Measurement	- Most retail leases include variable payments, so proposed measurement does not improve on existing information - General opposition to dual measurement, that create structuring opportunities and impair comparability. - Concern was expressed over option to fair value right of use assets. - The amounts recognised on the balance sheet based on the proposals do not provide the correct picture of the assets needed to operate. So improved disclosures would be superior to the proposed measurement.
Other comments	- There was concern that recognition would have consequences for prudential capital. - Interest charge should be presented also for Type-B leases.

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3. Feedback from EFRAG User Panel

Brussels, 20 June 2013

Topic	Comments
Recognition of assets and liabilities	- The majority of User Panel members supported the proposal and advocated that the meaning of the right-of-use asset is clear. - Supporters noted that it is urgent to move forward and to start recognising the relevant or important operating leases as a minimum. - Other members disagreed with the recognition of lease asset and liabilities and argued that improvement of the disclosures in IAS 17 will be much more useful and that abuse of the rules should not lead to introduction of a new standard.
Measurement	- Supporters noted that any measurement has advantages and disadvantages, but the proposals are better than the current lack of information. - Dissenters noted that recognising only a part of carrying amount of the underlying asset leads to incomparability of financial statements. - Some noted that buying and renting of core assets constitute different business models.
Disclosures	- Possible additional disclosures are more detailed payment schedule, maximum payments, payments expected under options, rate, fair value of underlying assets.