20 September 2013

IFRS Foundation
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir/Madam,

Re: Exposure Draft: Leases

The Polish Accounting Standards Committee (PASC) is pleased to respond to the request for comments on the *Exposure Draft on Leases.*

Generally, we support IASB efforts to improve lease accounting. We agree with the IASB that more lease arrangements than today's finance leases are in substance purchases of assets, albeit for the term shorter than the useful life of the assets. It remains however debatable whether the proposal is a sufficient improvement over current lease accounting to justify the costs in terms of new complexity and operational difficulty.

We appreciate that many of the proposed changes stem from attempts to improve information for users of the financial statements - increasing transparency into future cash flows, comparability in reporting of similar transactions. They are aimed as well at mitigating current structuring opportunities. The IASB emphasized that the project was to recognize financial liabilities that are currently left off balance sheet. Nevertheless we remain concerned that without clear articulation of the conceptual basis why lease contracts and other non-lease executory contracts are differentiated it will be a struggle to make consistent and appropriate judgments in application of the principle based standard. We would urge the Board to undertake on conceptual basis the recognition, measurement and presentation of all executory contracts. We are also concerned that the proposed model, based on the notion that the asset is a bundle of rights with one of them being right of use is inconsistent with two measurement basis and different accounting for lesee and lessor.

We remain unconvinced by the arguments supporting in Board's view the long-term leases of land not being excluded from the scope of the standard. We are of the view that the distinction between levies, or other akin to tax charges and lease payments should have been explored when one of the parties to the long-term land lease contract is a state or a government. IFRIC 21 *Levies* defines a levy as an outflow of resources embodying economic benefits that is imposed by governments on entities in accordance with legislation (ie laws and/or regulations). In relation to the long-term leases of land where the lessor is a state or a government the payments might be both regulated by the contract and by the legislation i.e. laws and/or regulations. IFRIC 21 *Levies* states that "*an entity does not have a constructive obligation to pay a levy that will be triggered by operating in a future period as a result of the entity being economically compelled to continue to operate in that future period*" [IFRIC 21.8] what if applied to long-term leases of land with government would lead to different treatment that proposals contained in current Exposure Draft.

So called "perpetual usufruct of land" is a common type of contract for long term land leases between state and entities/ individuals in Poland. Although there is a contractual relationship between the state and the entity/individual there are also legal acts issued by the Parliament that govern e.g. maximum payments under such contracts – these acts if changed, might change unilaterally (solely upon discretion of the Parliament) the contractual relationships between parties. Payments under perpetual usufruct contracts are determined in the decisions issued periodically by the local authorities and can be appealed through court by the entity/ individual. Currently a diversity in relation to measurement and presentation of such perpetual usufruct of land exists and the proposals contained in the Exposure Draft will not eliminate this diversity.

We note that in certain circumstances, in particular when (i) a lessor is a state or a government and (ii) based on the observable market data, the fair value of the perpetual / usefruct is insignificantly different from the fair value of the land and (iii) lessor cannot prevent the sale or transfer of the perpetual leasehold / usefruct title due to credit standing or other economic characteristics of the lessee, a long-term lease of land might be perceived as economically similar to the purchase or sale of the land and, therefore, and hence such leases should be excluded from the scope of this Exposure Draft. In such a case, the accounting applied by the lessee and lessor would be similar to accounting for the purchase or sale of the land.

The more detailed comments are enclosed in the Annex.

Yours sincerely,

Joanna Dadacz

Chairman

Polish Accounting Standards Committee

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Cc: EFRAG

ANNEX

Specific questions

The following replies and comments are provided on the assumption that the IASB proceeds to issue a Lease Standard based on the proposals in the Exposure Draft. They are not intended to express unconditional support for the right-of-use model as explained above.

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) fulfilment 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.

- Identifying a lease is one of the most crucial issues when applying a standard. The definition of a lease must capture only such contracts that are in not in substance service arrangements. This is difficult as provision of services often involves some use of assets and "service" is not a defined term in current IFRSs.
- The IASB should consider explaining how the factors that need to be assessed when determining the ability to direct the use of the asset align or align not with the concepts in IFRS 10 *Consolidated financial statements* and proposed revenue standard. Also how to identify the decisions "that most significantly affect" the use of asset need to be clarified. It should be noted that we are not convinced that indicators of control as currently expressed in IFRS 10 *Consolidated financial statements* in relation to entities/investments are equally applicable to assets.
- Paragraphs 19 and 20 are confusing in similarity of conditions listed. Also concept of "ability to derive the benefits from use" is not clearly articulated. Determining whether the customer is seeking the asset versus the output from the asset is judgmental and without more clarity the diversity might arise.
- We agree with the requirement to identify and separately account for lease and non-lease component. We also agree that observable prices should normally be used when they are available for all components.

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?

- We understand the type A leases accounting is based on the premise that such leases effectively include a financing component however we do not see a conceptual basis for the distinction between the two types of leases.

- We do not think that the subsequent measurement of the right of use asset under Type-B reflects the pattern of its consumption or that is provides relevant information. If the Board believes that Type B leases should have different expense and cash flow presentation is its unclear why the presentation in the statement of financial position would be the same as Type A leases. Moreover the periodic change in the right of use asset is a balancing figure which causes the subsequent measurement of the asset to lose its usefulness .
- The approach to Type-B leases will not be easy to apply. The record keeping burden will increase as new amortization method is introduced what might also involve changes to IT systems not be designed to carry out the proposed amortization method.
- We are concerned that the proposals for subsequent measurement of the right of use asset under Type-B might be applied by analogy in relation to amortization of certain intangibles or tangible assets whereas as indicated above we are not convinced that it reflects consumption of the asset.

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?

- We believe that the lessor accounting should be conceptually consistent with lessee accounting While recognition and derecognition requirements are not always symmetrical in IFRSs by choosing a right of use model for Type B leases, the Board would take the view that the unit of account is the right to use the underlying asset and this it is transferred to the lessee at the commencement date. In this model the logical implication is that the lessor should reflect this transfer and dercognise a portion of the asset. The approach to Type-B leases will not be easy to apply. The record keeping burden will increase as new amortization method is introduced what might also involve changes to IT systems not be designed to carry out the proposed amortization method.
- We believe that the proposed lessor approach for Type A leases is extremely complex and difficult especially when considering expected variable lease payments and multiple discount rates and requirements for periodic recalculations. We are not convinced that the benefits will outweigh the costs.

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?

- We believe that the classification based on the nature of the asset is arbitrary and that the nature of the asset does not reflect the consumption of the benefits of the asset.
- We are not persuaded that a lessee consumes more than an insignificant portion of the economic benefits of a real estate only if the duration of the lease term is most of the economic life of the asset. The guidance in the ED is not helpful in assessing whether lease of land is Type A or Type B when applied to perpetual leases with payments are based on the fair value of the underlying land.

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?

- We generally agree with the proposals on the determining the lease term.
- It is important that all factors relevant to the assessment should be taken into consideration rather than one factor in isolation what might be read from some illustrative examples e.g. Illustrative Example 16.

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?

- We generally agree with the proposals to include variable payments based on the index or rate but are very concerned that the notion of "in substance fixed payments" is not fully clear. It is not explained what circumstance the Board considers to be variable lease payments that are in substance lease payments. Analyzing the explanation of principles and illustrative examples provided we find it not conclusive whether payments based on the fair value of the leased assets (e.g. 3% of the current fair value of leased land) should be considered "in substance fixed payments". There are numerous contracts where lease payments for land are based on the fair value of such land so diversity in practice might occur.
- We believe that incorporation of the notion of variability closely related to the leased asset and non closely related to the leased asset might be helpful in determining whether variable payments should be considered or not in the determination of lease payments.

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 the 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?

- In general we are in favor of full retrospective application however taking into account long term nature of some of the lease agreements we agree with granting practical reliefs that lead to reduction of implementation costs.
- We believe the Board should consider whether additional relief for lease agreements that end before the beginning of the period in which the standard is adopted could be provided without significantly reducing the usefulness of reported financial information.

Question 8 Disclosures

Paragraphs 58-67 and 98-109 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analysis of undiscounted lease payments; reconciliation of amounts recognised in the statement of financial position; and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

- In general we would expect that a proposal requires less disclosure that under current standards whereby most leases are not recognize on the statement of financial position. The list of disclosures is extensive so we welcome the requirement that an entity should consider how much emphasis to place on each requirement to satisfy the objectives.

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 agree with proposed amendments to IAS 40. We believe that the removal of the existing accounting policy will enhance comparability amongst investment property companies.