Comments of the Polish Accounting Standards Committee (KSR) on the Exposure Draft "Leases" ED/2010/9

The Polish Accounting Standards Committee monitors closely the developments in the area of lease accounting and appreciates the efforts made by the IASB and FASB aimed at developing a common exposure draft on leases. The Committee is aware of the obstacles in preparing a common, unified and globally acceptable solution to this issue and therefore we support all the efforts made by the IASB and FASB in this area.

We generally agree with the arguments leading to the conclusion that there is a need for a change in the approach towards lease contracts and we appreciate very much the fact that the IASB and FASB managed to achieve a common approach in this regard. In principle we support the proposed new approach, however, we have some concerns as to the detailed solutions proposed in the Exposure Draft.

In particular our doubts concern the following issues:

1) The application of a hybrid model to the lessors' accounting whereas one consistent model will be applied to the lessees' accounting. We are especially concerned about the double accounting for the recognition of the lease as a fixed asset by the lessor (in the case of a performance obligation approach) and parallel as a right-of-use-asset by the lessee. The majority of the Committee members is of the opinion that the proposed performance obligation approach would unnecessarily duplicate the resources. In consequence it would lead among others to the doubling of economic resources from the perspective of the market that will be created only by accounting solutions, not by actual activity in the market. Therefore we suggest that the Boards rethink the reasoning behind the lessors' accounting model and that only the derecognition model should be maintained. Our remark on the duplication of resources (assets) and liabilities may be the result of misunderstanding/misinterpreting of the principle laid down in paragraph 42 of the ED. The proper application guidance would clarify this presentation principle and it would facilitate the right understanding and the proper implementation of the proposed principle how to present the effects of lease contracts in the financial statement of the lessor in the case of the performance obligation model (if that model despite our concerns would be maintained).

2) From the point of view of the lessee our concerns focus on the proposals concerning the requirement that the lessee (when estimating the liabilities under the lease and accordingly the right-of-use-assets) should take into account the longest possible term of the lease, that might not be the real lease term and therefore it might not be connected with the actual amount of the liability resulting from the lease and the actual value of the right-of-use-asset under this lease. We are especially concerned as the lease term and corresponding amounts recognised in the statement of financial position and in the statement of comprehensive income may significantly differ between the lessee and the lessor. We understand the rationale behind the solution proposed in the ED. Nevertheless, we are of the opinion that too wide discretion in the decision concerning the estimated lease term on the part of the lessee and lessor might lead to unnecessary area of speculations and to the value creation. In our view this problem will not be solved by the planned requirement of a periodic reassessment of the lease term and accordingly of the items to be presented in the financial statement because this might also lead to further manipulations depending on the needs of a

given company. Therefore we suggest replacing the principle of estimating **the <u>longest</u> possible lease term** with the principle to estimate **the possible lease term** which would be consistent with the principle of "substance over form" and at the same time to limit – in our view - unnecessary creation of values with highly uncertain estimations. In our opinion the idea of measuring the probability of the lease term laid down in the ED should also be subject to further consideration because it seems to be justified at the conceptual level but in practical application it might result in assigning the probability levels to different lease term scenarios in line with previously expected accounting results instead of reflecting a real situation.

3) The proposed treatment of a short-term lease seems to be appropriate, but only for lessee accounting. Moreover it is not clear why the only criterion for qualifying the lease as short-term should be the estimated lease term (there is risk of manipulations here as well). We would like to suggest applying this criterion together with the materiality principle. On the one hand it would prevent the change of many current and future lease contracts into short-term lease in order to benefit from the simplified accounting treatment, and on the other hand it would limit the need for complicated accounting for lease contracts in the case of a long-term lease contracts (longer than 12 months) that are immaterial for the lessee in terms of assets, liabilities and costs as well.

4) We have some concerns as regards not clearly defined guidelines for qualifying lease contracts and their distinction from service or sale contracts. This problem is very important because some contracts qualified under the current criteria in IAS 17 as finance leases, under the new standard will not meet the criteria to be qualified as leases and hence these contracts will be qualified as sale or service contracts. Therefore we suggest the Boards add to the ED some more detailed guidelines or change the proposed qualifying criteria.

5) The Committee is also of the opinion that in the case of combined contracts that contain both service and lease components, arguments, proposed criteria and treatment are not sufficiently convincing. We disagree with the proposal that a separation of these components is only possible in exceptional cases, which leads to the conclusion that the Boards de facto already agreed to treat such contracts as a whole as lease contracts, even the contracts in which the service component could be separated from the lease component. In our opinion an acceptable solution is the proposal of the FASB, but only in those cases in which the separation of these two types of obligations (services and lease) is not possible. In other cases we would support the idea of the obligatory separation of the service and lease component.

6) Moreover, in our opinion the limitation of the scope of application of the new standard only to the lease of fixed assets is not understandable. We are not persuaded by the arguments provided by the IASB, which themselves lead to the conclusion that there is no substantive basis for such limitation of scope. Therefore we suggest either including in the ED leasing of intangible assets or a statement (but not by the cross-reference to IAS 8) that in the case of intangible assets until a complex standard on intangible assets is developed the solutions in this ED could be applied.

7) We are also concerned whether the benefits would outweigh the cost of application of the new standard. In our view such a statement might be justified only after testing the

new model on some companies that would represent the group of the lessees and lessors, but the lessors in such field-testing should be divided into those who are primarily lessors and those who only additional to their main business activity provide lease services.

We would like to provide also our comments on the proposed principles concerning presentation and disclosure requirements in the financial statements of the lessee and lessor. The majority of the Committee members is of the opinion that lessees and lessors should not present the lease income and lease expenses separately from other income and expenses in the statement of comprehensive income. Such data should be presented in the notes. However, if the non-disclosure on lease income and lease expenses leads to significant distortion of the presentation of entity's business activity we would allow to present these items separately on the face of the statement of comprehensive income in line with the general principles laid down in IAS 1. Therefore we are of the view that the proposed regulations provided for in paragraph 26 of the ED as regards the lessee are appropriate, and in the case of presenting the right-of-use-asset in the statement of financial position such information should be presented separately from other fixed assets together with a detailed information on the structure of these assets under the lease contracts provided in the notes to the financial statement.

Moreover, we are of the opinion that entities should be allowed to apply the full retrospective application provided for in IAS 8 as regards mandatory changes in the accounting policy. However, in order to prevent a possible speculation or manipulation with financial data we agree with the application of the principle of impracticability referred to in paragraphs 23-27 of IAS 8. Therefore in our view a solution that would combine both the idea of maintaining the comparability and of limiting the speculative application of the new proposals is to use the application principle used previously in some new standards stating that the entity has the possibility to apply the new principles from a transaction date of the entity's choosing in a consistent manner to other further transactions without exemption (for example by analogy to the application provisions laid down in IFRS 3 (2004) in connection with paragraph B1 of IFRS 1).