Grupo Latinoamericano
de Emisores de Normas
de Información Financiera

Group of Latin-american
Accounting Standard Setters

September 13, 2013

**International Accounting Standards Board**
30 Cannon Street
London EC4M 6XH
United Kingdom

**RE: Exposure Draft (ED/2013/6) on Leases**

Dear Board Members,

The "Group of Latin American Accounting Standard Setters" – GLASS[1] welcomes the opportunity to comment on the recent Exposure Draft on Leases (the "2013 ED").

This response summarizes the primary views of our country-members, in accordance with the following due process.

**Due-process**

The discussions in regard to the 2013 ED were held within a specified Technical Working Group (TWG) created in May 2013. All country-members had the opportunity to designate at least one member to participate in this TWG, and the following countries did so: Argentina, Bolivia, Brazil, Colombia, Ecuador, Mexico (coordinator of this TWG), Uruguay and Venezuela.

Each country decided the most effective way to obtain the input from local interested parties, which included presentations to specific interest groups, as well as written and verbal communications.

Individually, all TWG members summarized the general comments and specific responses from their respective countries. Subsequently, the answers presented in each country's summary were compared and discussed before preparing a consensus response.

**Overall comments**

The vast majority of the countries that participated in this TWG are convinced that changes to the existing lease accounting models are required, primarily to have lessees recognize their obligations under significant and non-cancellable lease agreements in the statement of financial position. On the other hand, we observed divergent opinions with respect to the use of the two accounting models proposed in the 2013 ED. In each of our responses to the specific questions raised in the 2013 ED, we present the consensus response, followed, as applicable, by the exceptions to the consensus response.

[1] The general objective of the Group of Latin American Accounting Standard Setters (GLASS) is to present technical contributions in respect to all documents issued by the IASB. Therefore, GLASS aims to have a single regional voice before the IASB. GLASS is constituted by: Argentina (Chairman), Bolivia, Brazil (Board), Chile, Colombia (Board), Dominican Republic, Ecuador, El Salvador, Guatemala (Board), Honduras (Observer), Mexico (Vice Chairman), Panama, Paraguay, Peru, Uruguay (Board) and Venezuela (Board).

GLENIF believes that the IASB has responded very positively and constructively to the comments and observations it received on the first leasing project issued in 2010 (the 2010 ED). We observe that many recommendations were included in the revised project.

We are particularly pleased that the IASB included a substantive and substantial "Effects analysis for leases" beginning with paragraph BC329 of the Basis for Conclusions. We applaud the IASB for this effort and believe it will prove very useful for all interested parties.

In the attachment you will find our responses to the specific questions raised in the 2013 ED. These responses represent the consensus of groups throughout Latin America interested in the development of International Financial Reporting Standards (IFRS). Where some countries expressed exceptions to the consensus response, those opinions and responses are briefly addressed.

A brief summary of our more significant observations and comments is as follows:

- There was a consensus to strengthen the definition of a lease as indicated in our response to Question 1.
- Various local interest groups in different countries expressed a preference for a single accounting model for lessees, generally with a preference for Type A lease accounting model, in which a financing component is recognized apart from the amortization of the right-of-use asset.
- There is concern regarding the lack of symmetry between the accounting by lessees and lessors for Type B leases, where the consumption of the underlying asset is expected to be insignificant. Various alternatives are presented in our response to Question 3.
- There is a recommendation to include the possibility of considering expected future changes in relevant factors related to the existence of significant economic incentives when there is sufficient competent evidence to support such change. See our response to Question 5.
- There is concern about the practical application of the concepts of "insignificant" and "more than insignificant" consumption. Additional guidance is requested.
- Although there are examples of economic incentives included in the 2013 ED, many believe that additional guidance is required to determine their significance and consequent applicability.

If you have any questions about our comments, please contact us at glenif@glenif.org.

Yours sincerely,

**Jorge José Gil**
Chairman
Group of Latin American Accounting Standard Setters (GLASS)

Attachment

## GLASS' Comment Letter on the IASB Exposure Draft on Leases

### Scope

| **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:<br><br>(a) fulfilment of the contract depends on the use of an identified asset; and<br><br>(b) the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.<br><br>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.<br><br>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. |

Consensus-

We found general support for the definition of a lease, with a recommendation to include some key elements of paragraphs 7 to 18 to provide a more robust definition of a lease. Many believe that the two key required elements in the transfer of the right to control the use of an asset included in paragraph 12 should be added to the definition. Additionally, almost all believe that reference to non-cancellable should also be added to the definition, as follows:

> A lease is a contract whose fulfillment depends on the use of an identified asset (the *underlying asset*) and that conveys the ability to direct the use of, and derive substantially all of the potential economic benefits from, the underlying asset for a non-cancellable period of time in exchange for consideration.

Exceptions-

One country believes that the examples of decisions that could most significantly affect the economic benefits to be derived from use of an asset should focus on paragraph 14(b) regarding the lessee's ability to determine how the asset is operated during the term of the contract. Further, the same country believes that the guidance in Example 3 of the *Illustrative Examples* suggests that certain contractual restrictions could be irrelevant, for which it requests clarification of the accounting in those circumstances.

One country does not agree with allowing lessees to optionally apply the proposed new standards to leases of intangible assets. That country believes such application should be mandatory.

## The accounting model

| **Question 2: lessee accounting** |
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| 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? |

Consensus-

We did not reach a consensus response for this question. One half of the countries that participated in the TWG agree that the recognition, measurement and presentation by a lessee of expenses and cash flows arising from a lease should differ depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset.

However, the other half of the countries expressed a strong preference for a single accounting model for lessees, generally with a strong preference for Type A lease accounting, in which a financing component is recognized apart from the amortization of the right-of-use asset. This is based on their assessment that from the lessee's point of view, there is little difference between the lease of property or an asset other than property. They do not agree with the combining of the unwinding of the discount on the lease liability with the amortization of the right-of-use asset into a single lease cost to be recognized on a straight-line basis. The primary reason for opposing the single total rent expense line item presentation is because interest and rent represent two expenses of very different nature, for which IFRS generally requires separate presentation, especially when the asset and liability are recorded at their present value. The dissenting countries believe that the existence of a single lease accounting model for lessees would greatly facilitate implementation of the new standard with a significant impact on financial statements.

There is also a general uneasiness about how to apply the concepts of "insignificant" and "more than insignificant" consumption in practice. To the extent possible, the majority would like to see additional guidance from the IASB regarding how to evaluate the level of consumption of the economic benefits embedded in the underlying asset. We believe that general guidance on the evaluation of the significance of the consumption of the underlying asset could be added. One suggestion might be for the lessee or lessor to ask himself the following question "If I were to sign a new lease agreement for the same asset, considering the use during the initial lease term, would I be willing to pay/collect the same rent?" This question should be answered ignoring the effects of inflation. If the answer is "No", which would be the case for most leases of assets other than property, one can assume there was "more than insignificant" consumption of the underlying asset. If the answer is "Yes", which would be the case for most leases of property, one can assume there was "insignificant" consumption of the underlying asset.

Exceptions-

One country suggests that the presentation of right-of-use assets and related lease liabilities separately from the entity's other assets and liabilities in the statement of financial position always be required and not alternatively be allowed only as a disclosure on the notes to the financial statements. Additionally, that country would also suggest disclosure of the types of assets under lease (equipment, property, etc.), if not already disclosed with the general description of the leases. This same country also proposes that the amortization of right-of-use assets always be included with depreciation and appropriately disclosed in the notes to the financial statements.

Finally, one of the countries that prefers a single accounting model for lessees also would like to see all lease payments included in investing activities in the statement of cash flows, under the basis that Type A leases effectively represent investments in property, plant and equipment.

| **Question 3: lessor accounting** |
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| 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? |

Consensus.

Most of the countries that participated in the TWG agree with the application by the lessor of 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.

Despite general agreement with the different accounting by lessors based on the expected consumption of the underlying assets by the lessee, several interested parties expressed concern regarding the lack of symmetry between the accounting by lessees and lessors for Type B leases. The lack of symmetry arises because regardless of whether the lease is classified as a Type A or a Type B lease, the lessee always recognizes a right-of-use asset and lease liability, while the lessor recognizes a lease receivable only in the case of Type A leases. The 2010 ED proposed that a lessor recognize a lease receivable for all leases, offset by either the removal of the leased asset from its statement of financial position (the derecognition approach) or a leasing liability for the obligation to allow use of the leased asset by the lessee (the performance obligation approach). While most of the participants in our TWG agree with the elimination of the requirement to recognize a liability for the obligation to allow use of the leased asset by the lessee, we are not convinced that a lessor should not recognize a lease receivable for Type B leases.

We had considerable debate about what the offsetting credit would be if a lease receivable is recorded for Type B leases. We recognize that if the leased asset is not removed from the statement of financial position of the lessor, the lessor's assets become inflated, as observed with the original performance obligation approach in the 2010 ED. We considered the following alternatives:

1. Recording a reduction of the leased asset recorded by the lessor. Since the consumption of the underlying asset by the lessee is expected to be insignificant for a Type B lease, the reduction of the leased asset on the books of the lessor would be relatively insignificant. Over the term of the lease, the lease receivable and the asset reduction would be amortized, thereby restoring the asset to its undepreciated residual value at the end of the lease term.

2. Recording a performance obligation, but requiring its presentation as an offset to the lease receivable.

3. Recording deferred income, reflecting the present value of the obligation to place the underlying asset at the disposition of the lessee

4. The use of Type A accounting by lessors for all leases.

The participants in our TWG were completely divided as to which is the best alternative.

Exceptions-

One of the countries that opposes the single total rent expense line item for the presentation interest and the amortization of the right-of-use asset by lessees under Type B leases also opposes combining interest income with rent income for Type B lease accounting by lessors.

One country believes that the classification of leases as Type A and Type B leases should be based on the life of the underlying asset. That country indicated that conceptually leases of assets with finite useful lives should be accounted for as Type A leases, and that leases of assets with indefinite useful lives should be accounted for as Type B leases. However, due to the complexity of the accounting for residual assets under Type A leases, that country recommends returning to the performance obligation approach for all lessor accounting.

| **Question 4: classification of leases** |
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| 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? |

Consensus-

Although the majority of the participants in our TWG agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should differ depending on the nature of the underlying asset, others believe that a single accounting model is preferable and that such distinction is unnecessary.

Exceptions-

Two countries suggested that paragraphs 29 and 30 be reworded to describe the conditions for classification as Type A or Type B, as opposed to describing what they are not.

## Measurement

| **Question 5: lease term** |
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| 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? |

Consensus-

In general, we found agreement with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors.

Various countries indicated that they would like to see additional guidance on what constitutes "significant" as used in paragraph 25 relating to economic incentives. They believe that different entities could have very different interpretations as to how to measure the significance of the economic incentives.

Additionally, significant concern was expressed regarding the abuse of unilateral options for the lessee to terminate the lease agreement. In this regard, out TWG had considerable discussion about the ability of a lessee to take into account anticipated changes in relevant factors that are expected to eliminate significant economic incentives not to terminate the lease that exist at the beginning of the lease term.

For example, assume a lessee has a 10-year lease with a unilateral option to terminate such lease at any time, with a three-month notice and without any economic sanctions. Also assume that the entity makes leasehold improvements, the investment in which, based on considerable experience, it expects to recover in a maximum of two years. A literal reading of paragraph 27(a) of the 2013 ED suggests that the lessee should record a liability for the full 10 years at the beginning of the lease, and, if the investment in leasehold improvements is in fact recovered in two years, subsequently eliminate the liability for the 8 remaining years after two years have elapsed. We believe that makes little economic sense and does not provide useful or meaningful information to financial statement users. Accordingly, we suggest that paragraph 27(a) be revised to include the possibility of considering future changes in relevant factors when there is sufficient experience and appropriate documentation, resulting in the recording of the right-of-use asset and lease liability for a maximum of two years.

Exceptions-

One country did express concern over the administrative burden of recording all leases with maximum terms of more than one year. It suggests increasing the maximum lease term for qualification as a short-term from 12 to 24 or 36 months. This country believes that alternatively the definition of a short-term lease could also be determined by each entity based on the nature of its business and leasing arrangements, with appropriate disclosure of its criteria for determining which leases are considered short-term. That same country also believes that an entity should have the option to record the additional asset and liability related to an option to extend a lease if the entity has not only an economic incentive to exercise such option, but also the intention and financial capacity to do so at the start of the lease.

| **Question 6: variable lease payments** |
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| 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? |

Consensus-

We found unanimous support for the proposals on the measurement of variable lease payments. We also found the illustrative examples to be very useful in explaining some concepts, such as in-substance fixed lease payments.

## Transition

| **Question 7: transition** |
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| 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?<br><br>Are there any additional transition issues the boards should consider? If yes, what are they and why? |

Consensus-

We found significant resistance to retrospective application of these proposals. While most recognize the benefits of a retrospective approach, the majority consider the costs of such an approach to outweigh the related benefits.

Various alternatives were proposed, including:

- Using the approach described in paragraph D9 of IFRS 1, *First-time Adoption of International Financial Reporting Standards*, which would treat the effective date of the new standard as the transition date and apply the new standard prospectively.

- Allowing application as of the effective date of the standard with adjustments to retained earnings at that date, without restatement of comparative periods presented for retrospective application.

- Establishing only one transition approach, with that being an expanded modified retrospective approach, wherein comparative periods presented are adjusted by recognizing the appropriate lease assets and liabilities as of the beginning of the earliest period presented using the information available and conditions existing at that date.

- Clarifying the proposed modified retrospective approach to better understand how to apply it.

Country preferences for the various alternatives were mixed.

## Disclosure

| **Question 8: disclosure** |
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| Paragraphs 58–67 and 98–109 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments; reconciliations 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? |

Consensus-

We found unanimous support for the proposed disclosure requirements set out in the 2013 ED.

**NOTE: Questions 9, 10 and 11 only apply to responses to the FASB.**

## IAS 40 *Investment Property*

| **Question 12: consequential amendments to IAS 40** |
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| 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.<br><br>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? |

Consensus-

All countries agree with the proposed amendments to IAS 40.

**Other comments**

*Discount rate –*

Some concern has been expressed over the determination of the appropriate discount rate to be used for recognition of the lease assets and liabilities. We understand that the 2013 ED proposes that a lessee should discount the lease liability using the rate the lessor charges the lessee (which would often be the rate implicit in the lease), if that rate can be readily determined. If the rate the lessor charges the lessee cannot be readily determined, the lessee would use its incremental borrowing rate. Our concern arises from the fact that the lessee's incremental borrowing rate could be drastically different from the rate implicit in the lease. Additionally, it should be noted that in some countries it is very difficult, if not impossible, to determine discount rates for prolonged periods.  Accordingly, we request clarification of what is considered to be "readily determinable" to ensure that lessees do not utilize their incremental borrowing rate in all cases for purposes of convenience.