The Quoted Companies Alliance
6 Kinghorn Street
London EC1A 7HW
Tel: +44 20 7600 3745
Fax: +44 20 7600 8288

Web: www.quotedcompaniesalliance.co.uk
Email: mail@quotedcompaniesalliance.co.uk

The Quoted Companies Alliance

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
Email: commentletters@iasb.org

31 July 2009

Dear Sirs,

Discussion Paper DP/2009/1 – Leases – Preliminary Views

INTRODUCTION

The Quoted Companies Alliance (QCA) is a not-for-profit membership organisation dedicated to promoting the cause of smaller quoted companies (SQCs), which we define as those 2,000+ quoted companies outside the FTSE 350 (including those on AIM and PLUS) representing 85% of the UK quoted companies by number. Their individual market capitalisations tend to be below £500m.

The QCA is a founder member of European**Issuers**, which represents over 9,000 quoted companies in thirteen European countries.

This has been produced by our Financial Reporting Committee. A list of Committee members is detailed at Appendix A.

RESPONSE

Please find below our response to the consultation questions:

Chapter 2: Scope of lease accounting standard

Question 1: *The boards tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards. Do you agree with this proposed approach?*

If you disagree with the proposed approach, please describe how you would define the scope of the proposed new standard.

Yes, our members are familiar with this scope and therefore will find it simpler to apply

Question 2: *Should the proposed new standard exclude non-core asset leases or short-term leases?*

Please explain why.

A number of our member companies have assets which are leased on behalf of employees as part of their remuneration packages, e.g. company cars, but which are not essential to the operations of the business, and can become quite large when aggregated across the business. In our view, the costs associated with recognising and measuring the assets and liabilities in relation to such non-core assets outweigh the benefits and should be excluded from the proposed new standard.

Due to the extra burden associated with bringing all leases on balance sheet, mainly the determination of the value of the asset and liability, in our opinion short-term leases, which would not have a significant effect on the balance sheet, should also not be included in the revised standard. Treating all leases in the way proposed by the standard would cause a considerable burden on our members without providing a tangible benefit to the reader of the financial statements.

In order to improve comparability, we would suggest that the proposed new standard include a requirement to disclose the type of assets which have been excluded, together with details of the supporting obligations.

Please explain how you would define those leases to be excluded from the scope of the proposed new standard.

We would propose that the definition of such items is left to management judgement and agreed with the auditors based on materiality.

Chapter 3: Approach to lessee accounting

Question 3: *Do you agree with the boards' analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract?*

If you disagree, please explain why.

Yes, although we would agree that such simple lease contracts as outlined in the example are rare.

Question 4: *The boards tentatively decided to adopt an approach to lessee accounting that would require the lessee to recognise:*

(a) an asset representing its right to use the leased item for the lease term (the right-of-use asset)
(b) a liability for its obligation to pay rentals.

Do you support the proposed approach?

We would agree with the proposed approach.

Question 5: *The boards tentatively decided not to adopt a components approach to lease contracts. Instead, the boards tentatively decided to adopt an approach whereby the lessee recognises:*

(a) a single right-of-use asset that includes rights acquired under options

(b) a single obligation to pay rentals that includes obligations arising under contingent rental arrangements and residual value guarantees.

Do you support this proposed approach? If not, why?

Yes, we would support this approach. Due to their limited accounting resource, further componentisation of the assets would require further cost for our members to monitor and account for each of the assets on an ongoing basis. Furthermore, extra complexity for our members results in extra complexity for their auditors, and a subsequent increase in audit fees.

Chapter 4: Initial measurement

Question 6: *Do you agree with the boards' tentative decision to measure the lessee's obligation to pay rentals at the present value of the lease payments discounted using the lessee's incremental borrowing rate?*

Yes, we would agree with this approach. The liability valuation at the outset should be specific to the business, reflecting the cost of borrowing of the entity.

Question 7: *Do you agree with the boards' tentative decision to initially measure the lessee's right-of-use asset at cost?*

If you disagree, please explain why and describe how you would initially measure the lessee's right-of-use asset.

We would accept that a cost-based approach will be easier for our members to apply.

Chapter 5: Subsequent measurement

Question 8: *The boards tentatively decided to adopt an amortised cost-based approach to subsequent measurement of both the obligation to pay rentals and the right-of-use asset. Do you agree with this proposed approach?*

Yes, from a liability perspective, this would model the way in which a loan would unwind, and the amortisation of the asset would reflect the way in which the asset generates economic benefits. In addition, it is a concept with which our members are familiar.

Question 9: *Should a new lease accounting standard permit a lessee to elect to measure its obligation to pay rentals at fair value?*

Please explain your reasons.

We would not object to a lessee measuring its obligation in this way, although we would not expect many of our members to utilise it.

Question 10: *Should the lessee be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate?*

Please explain your reasons.

No, this requirement would be more complex and costly for preparers and put an even greater strain on the limited accounting resource available to smaller quoted companies.

If the boards decide to require the obligation to pay rentals to be revised for changes in the incremental borrowing rate, should revision be made at each reporting date or only when there is a change in the estimated cash flows?

Please explain your reasons.

Re-determining the value of the obligation at each reporting date would create a significant burden on the accounting function of our members. We would expect revision when there is a change in the estimated cashflows to occur less frequently, but as outlined above we do not support this approach.

Question 11: *In developing their preliminary views the boards decided to specify the required accounting for the obligation to pay rentals. An alternative approach would have been for the boards to require lessees to account for the obligation to pay rentals in accordance with existing guidance for financial liabilities. Do you agree with the proposed approach taken by the boards?*

If you disagree, please explain why.

We agree with the proposed approach, as in our view, this is likely to result in a more consistent approach to accounting for the obligation to pay rentals from our members than if they were using existing guidance.

Question 12: *Some board members think that for some leases the decrease in value of the right-of-use asset should be described as rental expense rather than amortisation or depreciation in the income statement. Would you support this approach? If so, for which leases?*

Please explain your reasons.

The underlying reason for bringing leased assets on to the balance sheet is to reflect their value to the business, and the economic benefits that they generate. In our opinion, referring to the decrease in value of the right to use the asset as a rental expense is not logical and we would not support that approach.

Chapter 6: Leases with options

Question 13: *The boards tentatively decided that the lessee should recognise an obligation to pay rentals for a specified lease term, ie in a 10-year lease with an option to extend for five years, the lessee must decide whether its liability is an obligation to pay 10 or 15 years of rentals. The boards tentatively decided that the lease term should be the most likely lease term.*

Do you support the proposed approach?

We would support the proposed approach, as it is a practical concept that our members should be able to readily apply.

Question 14: *The boards tentatively decided to require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances. Changes in the obligation to pay rentals arising from a reassessment of the lease term should be recognised as an adjustment to the carrying amount of the right-of-use asset. Do you support the proposed approach?*

Yes, we would agree with this approach. An income statement adjustment in the year where the reassessment of the lease term arises would not reflect the fact that an additional right to use the asset has been purchased. We would not endorse a retrospective restatement of the asset balance, as this would increase the burden on the accounting functions of our members. In our view, adjusting the asset prospectively is the most reasonable treatment in terms of the cost relative to the benefit.

Question 15: *The boards tentatively concluded that purchase options should be accounted for in the same way as options to extend or terminate the lease. Do you agree with the proposed approach?*

Yes, we would agree that dealing with these components in a consistent way would reduce complexity in accounting for them.

Chapter 7: Contingent rentals and residual value guarantees

Question 16: *The boards propose that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements. Do you support the proposed approach?*

If you disagree with the proposed approach, what alternative approach would you recommend and why?

We would not support this proposed approach, as it adds further complexity to the standard and these payments are likely to be highly judgemental, which are likely to increase audit costs.

We would suggest retaining the current requirements with which our members are familiar.

Question 17: *The IASB tentatively decided that the measurement of the lessee's obligation to pay rentals should include a probability-weighted estimate of contingent rentals payable. The FASB tentatively decided that a lessee should measure contingent rentals on the basis of the most likely rental payment. A lessee would determine the most likely amount by considering the range of possible outcomes. However, this measure would not necessarily equal the probability-weighted sum of the possible outcomes.*

Which of these approaches to measuring the lessee's obligation to pay rentals do you support?

Please explain your reasons.

As noted above, we would not support this approach. If however the Boards decide to include these amounts, we would support the FASB approach to measuring the obligation. This method of calculation is more straightforward and less time consuming for our members, than calculating the obligation under several different scenarios and probability weighting the outcomes.

Question 18: *The FASB tentatively decided that if lease rentals are contingent on changes in an index or rate, such as the consumer price index or the prime interest rate, the lessee should measure the obligation to pay rentals using the index or rate existing at the inception of the lease. Do you support the proposed approach?*

Please explain your reasons.

We would not support this proposed approach, as it adds further complexity to the standard and is inconsistent with the current requirements with which our members are familiar.

Question 19: *The boards tentatively decided to require re-measurement of the lessee's obligation to pay rentals for changes in estimated contingent rental payments. Do you support the proposed approach?*

If not, please explain why.

We would not support this proposed approach, as in our opinion, it would result in a more complex standard and a significant additional cost to preparers.

Question 20: *The boards discussed two possible approaches to recognising all changes in the lessee's obligation to pay rentals arising from changes in estimated contingent rental payments:*

(a) recognise any change in the liability in profit or loss
(b) recognise any change in the liability as an adjustment to the carrying amount of the right-of-use asset.

Which of these two approaches do you support? Please explain your reasons. If you support neither approach, please describe any alternative approach you would prefer and why.

In our view recognising any change in the liability in profit or loss would be easier for our members to apply, but also note that this will result in significant volatility of their results.

Question 21: *The boards tentatively decided that the recognition and measurement requirements for contingent rentals and residual value guarantees should be the same. In particular, the boards tentatively decided not to require residual value guarantees to be separated from the lease contract and accounted for as derivatives. Do you agree with the proposed approach? If not, what alternative approach would you recommend and why?*

We would agree that dealing with these components in a consistent way would reduce complexity in accounting for them.

Chapter 8: Presentation

Question 22: *Should the lessee's obligation to pay rentals be presented separately in the statement of financial position? Please explain your reasons.*

Given that the accounting is driven by a separate standard, in our view, the lessees' obligations should be separately presented in the statement of financial position.

What additional information would separate presentation provide?

This would highlight to users what element of the liabilities of the company relate to specific right-of-use assets, and hence the level of liability on the balance sheet that is effectively securitised by these assets.

Question 23: *This chapter describes three approaches to presentation of the right-of-use asset in the statement of financial position. How should the right-of-use asset be presented in the statement of financial position? Please explain your reasons.*

We agree with the board's tentative decision to disclose the right-of-use asset in its appropriate category, based on its nature. This will give the user the most insight into what the asset relates to, and aid them in understanding and analysing the underlying performance of the business.

What additional disclosures (if any) do you think are necessary under each of the approaches?

As part of the note where the right-of-use asset is disclosed, an analysis of the amounts relating to leased assets should be provided to enable the users to understand the distinction in ownership of the related assets.

Chapter 9: Other lessee issues

Question 24: *Are there any lessee issues not described in this discussion paper that should be addressed in this project? Please describe those issues.*

The IASB noted in the discussion paper that there is currently no guidance in relation to the following items which are of most relevance to our members:

- The treatment of sale and leaseback transactions;
- How to determine the impairment of a right-of-use asset;
- Disclosures about leases in the financial statements;
- Effective date and transition guidance

In regard to transition, we note from the June IASB update that the Board have tentatively decided to recognise and measure all existing lease contracts at the date of initial application. We would highlight that full retrospective application will create a considerable workload for our members and would ask the Board to consider further the benefit to users of adopting this approach.

Chapter 10: Lessor accounting

Our response does not address lessor accounting as it is not relevant to the majority of our members.

If you wish to discuss these issues with us, we will be pleased to attend a meeting.

Yours sincerely,

John Pierce

John Pierce
Chief Executive

APPENDIX A

THE QUOTED COMPANIES ALLIANCE FINANCIAL REPORTING COMMITTEE

Anthony Carey (Chairman)	-	Mazars LLP
Peter Chidgey	-	BDO Stoy Hayward LLP
Sarah Cox*	-	Ernst & Young LLP
Chris Goscomb	-	Cyril Sweett Group plc
David Gray	-	DHG Management
Shane Horsell	-	Ultimate Finance plc
Chris Ogle	-	SQC Consultant
Paul Watts/Bill Farren	-	Baker Tilly LLP
Nick Winters/James Lole	-	Vantis plc
John Pierce	-	The Quoted Companies Alliance
Kate Jalbert	-	The Quoted Companies Alliance

*Main Author