

March 31, 2004

Kevin Stevenson  
Chairman IFRIC  
30 Cannon Street  
London EC4M 6XH  
UK

Dear Kevin,

**Re: IFRIC Draft Interpretation D3 *Determining whether an Arrangement contains a Lease***

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the draft of the IFRIC Interpretation D3 *Determining whether an Arrangement contains a Lease* ("D3"). This letter is submitted in EFRAG's capacity of contributing to IASB's and IFRIC's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive IFRIC on the issue.

*Objective and Scope of D3*

We support the objective of D3 to apply IAS 17 *Leases* for arrangements which convey a right to use an item for a specified period of time in return for payments even if the contract does not take the legal form of a lease. D3 particularly provides guidance on how to determine whether an arrangement is, or contains, a lease and when the (re-)assessment should be made. We further agree with D3 that the core of such arrangements is the right to use rather than the underlying asset itself. We expect that the additional information provided by the application of IAS 17, particularly in cases of finance leases, will be of great use for readers of financial statements.

However, we expect that many arrangements such as outsourcing, take-or-pay contracts or service concessions, which were thought to be outside IAS 17 are coming back via this interpretation, which we consider an extension of the scope of IAS 17. Since we expect that it will be difficult in practice to distinguish between lease and executory contracts, we ask IFRIC to clarify the scope of D3 and add examples to those provided in E1 to E9 including different types of transactions, e.g. take-or-pay contracts involving telecom or IT systems.

#### *Use of the term “item”*

We understand that IFRIC decided to use the term “item” instead of the term “asset” in order to distinguish the right to use from the property, plant or equipment, etc. being used. However, since IAS 17 uses the term “asset” for this purpose, we believe that use of the term “item” without further explanation could cause confusion, particularly in translation. We would therefore recommend IFRIC to give its reasons for using “item” in preference to the IAS 17 term “asset” and explain its relationship to the real asset, which is the right of use.

#### *Components of larger items*

We see this draft interpretation as only an interim step towards a full revision of IAS 17. We recognise that within the limited scope IFRIC did not intend to deal with further aspects such as a components approach and its consequences, because there is still some work to be done. We agree with the view expressed in the last sentence of paragraph 3 and amplified in BC4 that in some cases a right to use a component of a larger item gives rise to an item that should be treated as a lease consistent with D3, e.g. the right to use half of the capacity of a pipeline in a throughput arrangement.

However, IFRIC clarifies in BC4 that questions of identifying components of larger items raise issues which are beyond the scope of D3. Although we acknowledge that it is difficult to draw the line in an interim measure such as this draft interpretation, we should like to see some further guidance with regard to rights to use components of larger items.

#### *Separation of payments*

We agree with D3 paragraph 8 that IAS 17 has to be applied only for the lease element and that other elements should be accounted for in accordance with other standards. As a consequence, we agree with the separation of payments for the lease from other payments as required in paragraph 9 if the payments are of material amounts. However, we have concerns that in cases where the fair value of the lease element can not be identified through existing market transactions there is broad discretion as to which estimation technique to use and therefore we see the risk that assumed fair values for identical lease contracts may vary substantially. Since the separation of payments may be of high relevance in practice, we ask IFRIC to provide further guidance and examples of reference contracts which might be considered for the identification of the underlying fair values.

We agree with the proposal in paragraph 10, which in our view deals appropriately with those cases where it is not possible to separate the payments reliably, but we believe that this will be the case for more than only “rare cases” as stated in the draft interpretation (paragraph 10).

Further we note with approval that IFRIC intends to consider addressing disclosure of executory contracts more generally in a separate project.

### *Convergence*

Our commentators expressed dissatisfaction that D3 does not fully converge with EITF 01-8 (or vice versa) and that the consequent assessments of contracts are similar rather than identical. We understand that the underlying standards, IAS 17 and SFAS 13 (including related standards), are different in fundamental respects so that convergence of interpretations cannot be achieved without introducing amendments to the underlying standards themselves and we therefore can accept the fact that the two interpretations do not converge yet.

However, D3 differs from EITF 01-8 in respects which are not included in the items highlighted in BC27. For example “the right to control the use of the underlying property, plant, or equipment” is one of the criteria in EITF 01-8 used to determine whether an arrangement conveys a right to use but it is not one of the criteria used in D3 paragraph 6. For the sake of clarity, we recommend IFRIC to enhance the Basis for Conclusions by highlighting that there are more deviations between the two, D3 and EITF 01-8, than just those addressed in BC27.

### *Transitional requirement*

Although the proposed application of this draft interpretation from 2005 onwards to all existing contracts will probably not be easy for preparers, we believe that it is more desirable to have the same accounting requirements for the same contract types and we therefore agree with the proposal in the draft interpretation.

Since many entities will be first-time adopters in 2005, the application of D3 to all existing contracts is in line with the spirit of IFRS 1 *First-time adoption of IFRSs* (paragraph 7) to apply accounting policies in compliance with each IFRS effective at the reporting date.

If you would like further clarification of the points raised in this letter, Paul Rutteman or myself would be happy to discuss these further with you.

Yours sincerely

Johan van Helleman  
**EFRAG, Chairman**