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Kevin Stevenson
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International Financial Reporting Interpretations Committee
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Dear Kevin

Comment letter on IFRIC Interpretation D3

We appreciate the opportunity to comment on IFRIC D3 *Determining whether an Arrangement contains a Lease*.

We fully endorse IFRIC's aim to support the IASB in establishing and improving International Financial Reporting Standards. In this respect we support IFRIC's objective to clarify for certain contracts that they fall within the scope for lease accounting. Thus D3 will improve accounting for these contracts. However, concern has grown on the following issues:

Application of D3 for components or portions of larger items

Paragraph 3 of D3 states that the interpretation does not deal with the issue of how to determine if and how the right to use a component or a portion of a larger item should be accounted for as a lease. We understand that the IFRIC emphasises this scope limitation with regard to current IAS 17 literature which is clear about the fact that the underlying assumption of lease accounting is the existence of a right to use a physically distinguishable asset or part of an asset. However, IFRIC then states that in certain cases it may well be appropriate to consider the application of D3 for arrangements containing the right to use components of a larger item.

The current wording may give rise to misinterpretation and in this context par. 4 of the Basis for Conclusion lacks clarity as well. We agree with paragraph BC4 that components of items are physically identifiable assets or parts of assets and thus support the view that they fall within the scope of IAS 17. By contrast portions of larger items are rather rights to use items that are not physically distinguishable, e.g. a capacity and thus are outside the scope of IAS 17. We are of the opinion that with



respect to this crucial issue paragraph 3 should clarify the distinction between components of items and portions of larger items.

Introducing the term “item” rather than “asset”

We understand that D3 refers to the underlying asset in the arrangement (i.e. the subject of the lease) as an “item” rather than an “asset” because the asset that the Interpretation is dealing with is the ‘right to use’.

We do not see it as very helpful to use the term item, we would rather recommend using throughout the text physically distinguishable asset or part of an asset.

Asset criteria in paragraph 6

Under paragraph 6(a), an item ...will be considered a specific asset if it is not economically feasible or practical for the supplier to fulfil the arrangement by providing use of alternative items. We are of the opinion that the IFRIC should provide additional guidance as to the meaning of the term “economically feasible or practical”. Notwithstanding any additional guidance we are concerned that the purchaser may not have sufficient information to assess whether it is economically feasible or practical for the supplier to fulfil the arrangement by providing use of alternative items.

The interpretation emphasises an issue that raises concerns regarding the provision of decision useful information. The accounting treatment for the purchaser of arrangements within the scope of D3 depends upon the economical status of a supplier rather than the economic benefit derived from the goods or services received. Thus, the market position and economical feasibility of a supplier affect the accounting treatment of the purchaser. We acknowledge that this approach is predetermined by IAS 17. However, we recommend to the IFRIC to deal with this issue in the basis for conclusion on D3.

Separation of lease payments

Paragraph 8 proposes that the lease element of an arrangement shall be recognised according to IAS 17 whilst other elements of the arrangement shall be accounted for in accordance with other relevant Standards. For this purpose lease payments shall be allocated to lease and other elements on the basis of their relative fair values (paragraph 9). In certain cases the purchaser may estimate the lease payments by reference to comparable items or arrangements (paragraph 10).

We are concerned that the separation and allocation of lease payments on the basis of the proposed method may give the purchaser an extensive scope of discretion for determination of a comparable contract. Particularly we see the problem that this could lead to arbitrary results in view to the qualification of arrangements as finance or operating lease. Accordingly we recommend to the IFRIC to enhance guidance concerning the separation of lease payments and incorporating examples in D3.

Convergence with US GAAP, i.e. EITF 01-8

Interpretation D3 is very similar to EITF 01-8 and IFRIC considered that the assessment of whether an arrangement contains a lease is likely to be similar as well. We are of the opinion that in respect to the convergence project any risk of dissimilar as-



assessment should be prevented. However, D3 departs from EITF 01-8 in certain areas as set out under BC 25. Nevertheless we believe that the Basis for Conclusion does not contain explanation of all significant differences. Thus IFRIC should consider enhancing the Basis for Conclusion by explaining the reason for differences from EITF 01-8 and any potential effect that it might have in terms of the assessment. The AIC particularly emphasises the following:

| D3 | EITF 01-8 |
|---|---|
| D3.6(a) requires that the purchaser must be able to exclude others from using the item [<i>right to use</i>] | EITF 01-8 par. 12 requires the purchaser to control the underlying asset |
| No fulfilment is required | Fulfilment of the arrangement is dependent of the use of ppe |

The AIC welcomes the proposed approach in par. 7 that “reassessment” shall only be made if the provisions of the arrangement are changed. Thus, we strongly recommend that the IFRIC should urge the EITF to take up this issue and follow IFRIC’s proposal.

With best regards

Liesel Knorr
Chairman