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2010 OCT 21 PM 12:39

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19 October 2010

Dear Mr. Ong

Response to IASB Exposure Draft of Leases

We refer to your letter on 16 September 2010 which invites comments on the Exposure Draft of Leases issued by International Accounting Standards Board (IASB) in August 2010.

We are pleased to respond to the IASB Exposure Draft. Our major concerns on the proposed lease accounting model are:

- the proposed recognition of “right-of-use” for current operating lease arrangements;
- the proposed new measurement of minimum lease payment, especially the inclusion of contingent rentals and residual value guarantees, and
- the proposed accounting models for lessors.

Our views on the Exposure Draft are set out below:

1. We do not support the right-of-use model in accounting for all leases

We do not agree with the proposed lease model which requires lessees to recognise lease assets and liabilities for all leases other than short-term leases initially at the present value of future lease payments.

The nature of an operating lease contract is similar to an executory contract. The obligation to pay arises over the lease period for the use of the leased asset but not upon an inception of a lease. In real world, most of the operating leases allow early termination without the obligation to pay for the remaining lease term. Hence, the lease asset and liability recognised under the proposed standard are not sustainable. In addition, recognising “operating lease commitments” as assets would confuse users the concept of “commitments” as disclosed in other part of a balance sheet. If such “right-of-use” contracts have to be recognised on a balance sheet, we should also consider those contracts which are committed and are expected to continue for a period of time, such as an EPC contract (a right to receive the engineering, procurement and construction services from the contractor and a committed liability to make payment). Currently, these contracts are disclosed as “capital commitment” instead of recognised as assets on a balance sheet.

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Moreover, the proposed calculation of the initial cost of “right-of-use” is significantly more complex than the current accounting model for operating lease. Complexity of calculation is escalated in our business as substantial portion of our lease arrangement makes up of contingent rentals. This proposal needlessly raises the complexity of the measurement.

Furthermore, the proposed expected outcome approach on initial cost measurement is inconsistent with the cost measurement methods applied to other assets on a balance sheet, such as intangible assets (the cost of an intangible asset is measured at its purchase price and any directly attributable expenditure on preparing the asset for its intended use). While the nature of “right-of-use” is similar to an intangible asset, their initial cost measurement methods are different. This would mess up the concept of initial cost measurement among different accounting standards.

We consider that if the proposed “right-of-use” method is to be applied to lease contracts, a standard should be developed or revised to cater for other committed contracts. Also, the inconsistency on cost measurement methods between different standards should be addressed.

2. We do not support the proposed measurement approach

We do not agree with the proposed inclusion of contingent rentals in the measurement of a lease liability, the use of a probability-weighted approach for estimating contingent rentals, and the requirement to reassess those estimates.

We believe that the proposed approach would result in amounts being recognised as liabilities which do not turn out to be liabilities. As the occurrence of contingent rentals is always subject to certain conditions, there would be no unconditional obligation for the lessee. We consider that in such circumstances, an obligations to pay contingent rental only arises when the contingent event has occurred instead of upon an inception of a lease.

Also, there are too many uncertainties in estimating contingent rentals which may undermine the objectivity and reliability of financial statements. The proposed probability-weighted approach for estimating contingent rentals usually involves estimation based on specific parameters for very long period of times, which are highly uncertain and difficult to estimate. Since the actual outcome of the parameters are highly likely to differ from the estimates significantly, lessees may be required to make adjustments continually to account for the difference between the estimates and actual contingent rentals for both the current period and future periods. This on-going reassessment on the estimates will require significant implementation efforts. Also, changes in the estimates of contingent rentals may lead to significant volatility in recognised assets and liabilities. This proposed approach will jeopardize the comparability of the financial statements.

We suggest retaining the current measurement approach.

3. We do not support the proposed accounting models for lessors

We do not agree with the proposed performance obligation approach which requires lessors to recognise a receivable for the expected rental payments, and a corresponding liability.

Similar to our comments on the proposed ‘right-of-use’ model in accounting for all leases as mentioned in point 1 above, we doubt that both the receivable and the performance obligation can meet the definition of an asset or a liability as set out in the framework as the lessee may have no unconditional obligation for future rental payments.

We are confused by the introduction of two accounting models for lessors – the performance obligation approach and the derecognition approach. These two approaches just applying the concepts of operating and finance leases classification under the existing standard. While the proposal removes the classification between operating and finance leases for lessee, it introduces back a similar classification criteria to lessors. We find it hard to understand the rationale of such changes.

We suggest retaining the current accounting model for lessors.

We welcome the opportunity to comment on the Exposure Draft.

Yours sincerely



Doris Chan
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