



Room 525, 5/F., Prince's Building, Central, Hong Kong
Telephone: 2521 1160, 2521 1169 Facsimile: 2868 5035
Email: info@hkab.org.hk Web: www.hkab.org.hk

香港中環太子大廈5樓525室
電話：2521 1160, 2521 1169 圖文傳真：2868 5035
電郵：info@hkab.org.hk 網址：www.hkab.org.hk

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By email: commentletters@hkcipa.org.hk & post

Mr. Steve Ong
Director, Standard Setting
Hong Kong Institute of Certified Public Accountants
37th Floor, Wu Chung House
213 Queen's Road East
Wanchai
Hong Kong

Exposure Draft – Leases

Dear Steve

We refer to your letter dated 19 August 2010 and would like to set out our comments on the International Accounting Standards Board's Exposure Draft – Leases.

Our comments on the specific questions raised in the exposure draft are attached. We would be happy to further clarify or discuss any of the above points should you so wish.

Yours sincerely

Rita Liu
Secretary

Enc.

Chairman Standard Chartered Bank (Hong Kong) Ltd
Vice Chairmen Bank of China (Hong Kong) Ltd
The Hongkong and Shanghai Banking Corporation Ltd
Secretary Rita Liu

主席 渣打銀行（香港）有限公司
副主席 中國銀行（香港）有限公司
香港上海匯豐銀行有限公司
秘書 廖碧瑩

Attachment

Lessees

Question 1

- (a) **Do you agree that a lessee should recognise a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?**
- (b) **Do you agree that a lessee should recognise amortization of the right-of-use asset and interest in the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?**

The proposed IFRS will result in giving balance sheet treatment to all leases within the scope of the IASB's exposure draft *Leases* ("Leases ED"), including leases that are currently accounted for as operating leases. The complexity and judgments necessary to measure such leases under the proposed IFRS will result in a significant amount of initial and ongoing effort by most reporting entities. We believe that the required effort to account for leases is significantly in excess of any possible benefit to the users of financial statements.

While we understand that the Board rejected comments on the leases discussion paper that suggested that the right-of-use model only apply to core assets, we continue to believe that a distinction can be made between core assets that are directly used in revenue generating activities and non-core assets that are used in support operations. The relevance of the information proposed to be provided differs between the two. In the basis for conclusions for the ED, the Board noted that many users of financial statements adjust the amounts presented in the statement of financial position to reflect assets and liabilities arising from operating leases. However, we believe this practice is most commonly performed for entities in industries where leasing is a significant factor in how the business is operated (e.g., airlines) and where the lease would typically relate to core assets. Applying the proposed lease accounting model to only core assets would significantly reduce the burden to reporting entities and avoid providing information that is not useful to users. Concerns regarding consistency in practice could be addressed through disclosure whereby an entity identifies the types of assets it considers to be core versus non-core.

Lessors

Question 2

- (a) Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term, and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?
- (b) Do you agree with the board's proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

We do not support the use of a dual approach for lessors as proposed in the Leases ED. For lessees, the Leases ED takes a components approach towards lease accounting in that an asset and liability is recognised for a lessee's rights and obligations to use an underlying asset, regardless of the period of time over which the underlying asset is leased. However, for lessors, the ED makes a distinction as to whether the lessor retains exposure to significant risks or benefits associated with the underlying asset – resulting in the performance obligation approach if the lessor does retain significant risks or benefits and the derecognition approach if the lessor does not retain significant risks or benefits. We believe that applying a single derecognition approach to lessors is consistent with the components approach applied to lessees. While we recognise that gains or losses on partial derecognition would necessarily result, we do not believe this is problematic as it is entirely consistent with the proposed components approach to leasing applicable to lessees.

We believe that a single derecognition approach should be used by lessors for all leases, for the following reasons:

- (a) The performance obligation approach requires the continued recognition of the asset being leased out and the recognition of a right to receive lease payments related to the very same asset. This approach results in a double counting of assets, which is not supported by the Conceptual Framework for Financial Reporting 2010 or found anywhere else in IFRS.
- (b) The ED proposes to require the presentation of the underlying asset, the right to receive lease payments and the lease liability together on the balance sheet when a lease is accounted for under the performance obligation approach. Such a linked presentation is not found elsewhere in IFRS and raises conceptual issues such as whether the lease liability represents a liability or a contra-asset, which may create interpretation issues for regulatory capital, debt covenant calculation and other uses of financial statements.

- (c) The performance obligation approach will frequently result in an initial net increase in assets when both the underlying asset and the lease liability amortise over a straight line period (which would typically be consistent with the lessee's usage of the underlying asset) while the right to receive lease payments decreases initially at a slower rate consistent with a typical loan amortization schedule.

However, if a single derecognition approach is adopted, that means an asset leased out would be partially derecognised even though the lessor still retains exposure to significant risks or benefits associated with that underlying asset (i.e., the residual assets may have a substantial value left). The proposed IFRS should clearly stipulate the accounting treatment, subsequent measurement, derecognition and balance sheet classification (i.e., whether the residual asset continues to fulfill the definition of property, plant and equipment under IAS 16 or should be classified as "other assets" in the balance sheet) of the residual assets under this context.

Short-term leases

Question 3

The exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is twelve months or less:

- (a) At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognise lease payments in profit or loss over the lease term (paragraph 64).
- (b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognise assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit or loss over the lease term (paragraph 65).

Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

As discussed above, the proposals in the Leases ED will require significant effort to implement and maintain on a continuing basis. The proposals for short-term leases held by lessees provides little preparer relief other than eliminating a need for discounting,

while the more significant effort will be in compiling the data including estimating contingent rentals where applicable. We do not understand why relief is granted for lessors but not lessees. The basis for conclusion states that short-term leases could give rise to material assets and liabilities but then concludes that for lessors the short period may make the assets and liabilities insignificant. The logic is inconsistent. It is reasonable to conclude that such information is unlikely to be material for either lessee's or lessors. The current disclosure requirements in IAS 17 *Leases* require both the lessor and lessee to disclose future minimum lease payments under non-cancellable operating leases. We would suggest that if balance sheet recognition must be given to these short term leases that the measurement basis be limited to the minimum lease payments which would allow reporting entities to leverage existing information already required to be disclosed under IAS 17.

In addition, we have concerns with applying the proposed derecognition and performance obligation approach to small value leases that have lease terms in excess of twelve months including when renewal options are considered. For example, under the proposed IFRS, the provision of safe deposit boxes could be interpreted as effectively representing a lease of property and would require financial institutions to give such leases balance sheet recognition. We believe that such arrangements are primarily service arrangements in that a financial institution is providing a security function and should be accounted for consistent with the current accounting for operating leases.

Definition of a lease

The exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1 – B4 and BC29-BC32). The exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59 – BC62) and on distinguishing a lease from a service contract (paragraphs B1-B4 and BC29-BC32).

Question 4

- (a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?**

The Leases ED defines a lease as a contract in which the right to use a specified asset (the underlying asset) is conveyed, for a period of time, in exchange for consideration. While it is generally understood that the reference to asset excludes service contracts, we believe that the proposed IFRS should explicitly state this. In addition, we believe the definition of a lease should reflect that the right to use an asset reverts back to the lessor at the end of the lease term, as discussed in our response to Question 4(b).

We also suggest that the IASB include sales and leaseback transactions under the scope section in order to make the scope of application clear at the beginning of the proposed IFRS.

- (b) Do you agree with the criteria in paragraph B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?**

As proposed, the criteria for identifying a purchase or sale in the Leases ED is inconsistent with the revenue recognition criteria in the IASB's Exposure Draft *Revenue from Contracts with Customers* ("Revenue ED"). We believe that the criteria for identifying a contract as representing a purchase or sale must mirror the criteria for revenue recognition otherwise inconsistency in reporting and structuring opportunities will result. However, as discussed in the following paragraphs, we do not see irreconcilable differences between the two EDs. We do not believe it is necessary or desirable to establish separate criteria in the Leases ED to distinguish a contract between the purchase and sale of an asset and a lease of an asset. The application guidance in the Revenue ED could incorporate much of the relevant guidance from the Leases ED. Our view is consistent with our comment letter on the Revenue ED that the revenue recognition criteria could be applied to gains or losses on the sale of some non-financial assets such as intangibles and property, plant and equipment.

Paragraph B9 of the Leases ED indicates that a contract represents a purchase or sale (i.e., income or revenue should be recognised) of an underlying asset (as opposed to a lease) if, at the end of the contract, an entity transfers to another entity control of the entire underlying asset and all but a trivial amount of the risks and benefits associated with the entire underlying asset.

The Revenue ED proposes that revenue or income be recognised (i.e., there is a purchase and sale) when a performance obligation is satisfied by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service. A customer obtains control of a good or service when the customer has the ability to direct the use of and receive the benefit from the good or service. The customer's ability to direct the use of a good or service (i.e., an asset) refers to the present right to use the asset for its remaining economic life (which we believe includes the period held without utility pending realization of salvage value) or to consume the asset in the customer's activities. The customer's ability to receive the benefit from an asset refers to its present right to obtain substantially all of the potential cash flow from that asset (either an increase in cash inflows or a decrease in cash outflows).

In regards to the ability to direct a good or service as a criteria for revenue recognition, for a contract to represent a sale/purchase (i.e., recognise revenue) of an underlying asset, the Leases ED requires that the customer obtain control over

the entire underlying asset by the end of the contract. The Revenue ED requires that the buyer have the ability to direct the use of the asset at the time revenue is recognised and throughout its useful life. We believe that the criteria should be that a sale involves the transfer of control over the remaining economic life of an asset, which is consistent with the Revenue ED, and that a lease is a right to use an underlying asset for a given period of time after which control of the underlying asset would probably revert to the lessor. If control under a lease probably does not revert back to the lessor then the transaction is presumably a sale and the asset should be derecognised. We believe that the definition of lease should be revised to reflect this. The current definition of lease states: "A contract in which the right to use a specified asset (the underlying) is conveyed, for a period of time, in exchange for consideration." This definition should be modified to reflect that the right of use reverts back to the lessor at the end of the lease term.

In regards to benefits, the Revenue ED requires that the buyer obtain the present right to obtain substantially all of the potential cash flow from the underlying asset. The Leases ED requires that the seller not retain more than a trivial amount of the risks and benefits from the asset. There is an inconsistency between substantially all and trivial (i.e. it is not clear that the economics of an asset beyond substantially all are in fact trivial). In addition, the Revenue ED refers to benefits while the ED refers to the risks and benefits, although the Revenue ED also refers to either an increase in cash flow or a decrease in cash flow. We believe that the criteria should be that substantially all of the risks and benefits of the underlying asset have been transferred.

Notwithstanding our comments above, in our comment letter on the Revenue ED, we raise concerns regarding a revenue recognition trigger that looks to whether or not the customer obtains control. We remain of that view. We believe that if the ultimate revenue recognition criteria is based on the extent to which the seller has transferred the risks and benefits of an asset, such criteria will also serve to distinguish between contracts that represent sales of assets rather than leases.

- (c) **Do you think that the guidance in paragraphs B1-B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?**

We believe that the guidance should focus on the substance of the transaction and whether it is primarily a service contract or a lease. The criteria are overly focused on the physical characteristics associated with the use of the underlying assets. A lease of a revolving pool of similar assets represents a right to use a particular type of asset and should be accounted for similar to a lease.

Scope - Exclusions

Question 5

The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraph 5 and BC33-BC46).

Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and why?

We agree with the scope exclusions. While we believe that in some cases a lease of an intangible asset is not conceptually different than the lease of a physical asset, we believe that the accounting for the leasing of intangible assets should be dealt with as part of a broader project on the accounting for intangibles. In addition, we also agree that a lessor should apply IAS 40 to leases of investment properties that are measured at fair value in accordance with IAS 40 but not the proposed IFRS.

Scope – Contracts that contain service components and lease components

Question 6

The exposure draft proposes that lessees and lessors should apply the proposals in Revenue from Contracts with Customers to a distinct service component of a contract that contains service components and leases components (paragrapg 6, B5-B8 and BC47-BC54). If the service component in a contract that contains service components and lease components is not distinct:

- (a) the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.**
- (b) the IASB proposes that:**
 - (i) a lessee should apply the lease accounting requirements to the combined contract.**
 - (ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.**
 - (iii) a lessor that applies the derecognition approach should account for the lease components in accordance with the lease requirements, and the service components in accordance with the proposals in *Revenue from Contracts with Customers*.**

Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

We are concerned that the presence in a contract of an underlying asset that has a value significantly less than the value of the services (or even de minimis in itself) to be provided could result in the entire contract being classified as a lease. For example, a cable television subscription might include a cable box that is not separately priced. The guidance in the ED would indicate that the entire cable contract should be accounted for as a lease even though the cable box has a very small value compared to the estimated life of the cable contract. We believe that the components should be separated based on their relative fair values and not on whether the services or underlying assets meet the distinct criteria in the Revenue ED, which is intended to serve a different purpose. Services and physical assets are clearly distinguishable, and they should not be accounted for under the same model merely because separate pricing is not transparent.

Purchase Options

Question 7

The exposure draft proposes that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraphs 8, BC63, and BC64).

Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?

The Basis for Conclusions to the Leases ED states that exercise price of the option is not a lease payment and should not be included in the measurement of assets and liabilities arising from a lease. As discussed below in our response to Question 8, we do not believe that options to purchase an underlying asset or extend the terms of a lease should be considered in measuring a lease asset or liability. However, if options to extend are considered in measuring assets and liabilities then we believe that options to purchase should also be considered because, in effect, an option to purchase is not substantially different than an option to extend for the remaining life. If options to extend and options to purchase are treated differently, we believe the resulting information will not be comparable and structuring opportunities will arise. A lease with an option to extend could result in an asset or liability that is greater than an asset or liability for a lease that does not have an extension option but has a purchase option.

Measurement

The exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that:

- (a) assumes the longest possible terms that is more likely than not to occur, taking into account the effect of any options to extend or terminate the lease (paragraph 13, 34, 51, B16-B20 and BC114-BC120).
- (b) includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21, and BC121-BC131). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be measured reliably.
- (c) is updated when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments, including expected payments under term option penalties and residual value guarantees, since the previous reporting period (paragraphs 17, 39, 56 and BC132-BC135).

Question 8

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

We believe that the lease term should be limited to the minimum contractual lease term and exclude consideration of options to extend or terminate. We do not support including options to extend the lease because to do so would require making highly subjective estimates of management's future actions. In addition, the model proposed would require the recognition of an asset and corresponding liability. We strongly believe that optional extension periods do not meet the definition of an asset or liability. An option represents an asset or liability only when it has value. Options to renew lease terms would typically be at fair value at the inception of the lease. Options to terminate leases raise questions as to what the actual period of the lease is. However, an option to terminate would typically require the lessee to pay a penalty, which at the inception of the lease would indicate that the option is out-of-the money. Consequently, we do not believe lessee's nor lessors should consider such termination options.

On the other hand, a purchase option needs to be considered when determining whether the transaction is a lease or a purchase (i.e., whether the leased asset would probably be reverted to the lessor or not).

Paragraph B13 of the Leases ED states that a lessee shall determine the lease term by estimating the probability of occurrence for each possible term, taking into account the effect of any options to extend or terminate the lease. Paragraph B16 states that the lease term is defined as the longest possible term that is more likely than not to occur. Paragraph B17 provides the following illustration: An entity has a lease with a non-cancellable 10-year term, an option to renew for 5 years at the end of 10 years, and an option to renew for an additional 5 years at the end of 15 years. Assume that the entity determines the probability for each term as follows: (a) 40% probability of 10-year term, (b) 30% probability of a 15-year term and (c) 30% probability of a 20-year term. The Leases ED states that there is a 60% chance that the term will be 15 years or longer but only a 30% chance that the term will be 20 years. Therefore there is a 60% chance that the term will be 15 years, which is the longest term more likely than not to occur. We find this analysis and its conclusion flawed. It does not follow that there is a 60% chance of a 15 year term because there is a 60% chance the term will be 15 years or longer. The conclusion that there is a 60% chance that the term will be 15 years directly contradicts the explicit assumption that there is a 30% probability of a 15 year term. The analysis confuses probability of a specific term with probability that a term will be at least a certain length. Using the above example, assume there is a 30% chance of a 10 year lease, a 10% chance of a 15 year lease, and a 60% chance of a 20 year lease. Based on the logic in the Leases ED, one would conclude that there is a 70% chance of there being at least a 15 year lease; therefore, the lease term is 15 years even though it only has a probability of occurring of 10%.

We recommend that if options to renew must be considered then the lease term should be based on management's best estimate of the lease term. Requiring the type of analysis suggested by the Leases ED will simply result in the need to create documentation to support what is otherwise management's best estimate rather than a means to arrive at management's best estimate.

Lease Payments

Question 9

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?

Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the

**measurement of the right to receive lease payments if they can be measured reliably?
Why or why not?**

If contingent rentals can be measured reliably, we believe that inclusion of significant contingent rentals in the measurement of a lease asset and liability is necessary in order to portray an accurate picture of the lease arrangement. However, we do not support measuring the lease asset and liability based upon probability weighted outcomes of future events. Such amounts are not reliable and will be subject to continuous revision, which could result in recognizing very low amortization expense, or even negative amortization expense, in a period in which estimates are changed. This will not reflect a proper matching of revenues and expenses, particularly for those leases for which lease payments are directly related to sales volumes such as in certain retail store leases. Such results will be confusing to the reader of the financial statements.

We understand that the reason for requiring that lessors include such contingent amounts in the right to receive lease payments only if they can be measured reliably is to align the measurement of such assets with the revenue recognition criteria in the Revenue ED. Consistent with our earlier comments on the Revenue ED, the use of multiple probability weighted scenarios would indicate that an amount cannot be estimated reliably unless there is a single scenario that carries a very high probability of occurrence, in which case we see no value to using multiple probability weighted outcomes.

We believe that lease payments should be measured based on management's best estimate of the most likely outcome. Such an estimate is not likely to fluctuate as significantly as one derived from probability weighted outcomes.

Reassessment

Question 10

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts and circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

We believe that it would be necessary to revise such contingent amounts if it can be measured reliably and when there is an indication that there has been a significant change. The subjective nature of many of these estimates will necessitate that such measurements not be left unadjusted in the face of evidence that the estimate is incorrect.

Sale and leaseback

The exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchase or sales and leases. If the contract represents the sale of the underlying asset, the leaseback would also meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraph 66-67, B31 and BC160-BC167).

Question 11

Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?

We agree with the Leases ED that a contract for the lease of an asset should first be assessed to determine whether the asset has been sold (i.e., should be derecognised). If the asset is derecognised, the lease should be accounted for in accordance with the Leases ED. However, if the transfer does not meet the condition for a sale, we do not agree with the Leases ED that the asset should not be derecognised and the proceeds should be accounted for as a liability. We believe that a partial derecognition approach, similar to our view expressed in our response to Question 2 should be applied.

In addition, consistent with our response to Question 4(b), we believe that the sale criteria should be consistent with the Revenue ED. We agree that an evaluation of the lease terms should be part of the evaluation of whether a sale has occurred. If a sale and leaseback results in the seller/lessee having control over the underlying asset and thus substantially all of the benefits of the asset, the asset should not be derecognised.

We believe that the revenue recognition guidance in the Revenue ED can be applied to a sale and leaseback transaction without creating separate criteria in the Leases ED. The Revenue ED states that revenue should be recognised when a customer obtains control over an asset. Control is defined as the ability to direct the use of and receive the benefit from a good or service. The customer's ability to direct the use of a good or service refers to the present right to use the asset for its remaining economic life or to consume the asset in the customer's activities. The customer's ability to receive the benefit from an asset refers to its present right to obtain substantially all of the potential cash flows from the asset (either an increase in cash inflow or a decrease in cash outflow). We believe that the ability to lease an asset (even back to the seller) is indicative of the ability to direct the use over that asset. The buyer/lessor receives the benefit from the asset from, in part, the lease payments. This is consistent with the Revenue ED that states a customer can obtain cash flows from an asset directly or indirectly in many ways such as by using, consuming, selling, exchanging, pledging or holding the asset. We would add leasing to this list. Therefore, in a sale lease back transaction where the seller/lessee does not

provide any guarantees to the buyer/lessor, the seller/lessee would derecognise the asset and recognise a right to use asset.

Presentation

The exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25-27, 42-45, 60-63 and BC142-BC159).

Statement of Financial Position

Question 12

- (a) **Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment or investment property as appropriate, but separately from assets that the lessee does not lease (paragraphs 25 and BC143-BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?**

The IASB currently has on its agenda a project on financial statement presentation. We believe that all proposed changes to the face of the financial statements should be addressed in the financial statement presentation project. Therefore, we believe that any specific guidance requiring the disaggregation or separate disclosure of assets or liabilities related to leases should be required only in the notes to the financial statements and allow for presentation or disclosure on the face of the financial statements at the option of the reporting entity.

- (b) **Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totaling to a net lease asset or lease liability (paragraph 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?**

See response to (a) above.

- (c) **Do you agree that a lessor should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?**

See response to (a) above. In addition, consistent with our response to Question 2, we have concerns about the classification of residual assets, because the residual

asset is not the portion of the underlying asset which generates rental income from the lease. Most likely the residual asset is not “held for use in the production or supply of goods or services, for rental to others, or for administrative purposes” and thus it may not fulfill the definition in accordance with paragraph 6 of IAS 16 *Property, Plant and Equipment*.

Statement of Comprehensive Income

Question 13

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

See response to Question 12(a) above.

Statement of Cash Flows

Question 14

Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraph 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

See response to Question 12(a) above.

Disclosure

Question 15

Do you agree that lessees and lessors should disclose quantitative and qualitative information that:

- (a) identifies and explains the amounts recognised in the financial statements arising from leases; and**
- (b) describes how leases may affect the amount, timing and uncertainty of the entity’s future cash flows**

(paragraph 70-86 and BC168-BC183)? Why or why not? If not, how would you amend the objectives and why?

Paragraph 70 of the Leases ED states that an entity shall disclose quantitative and qualitative financial information that: (a) identifies and explains the amounts recognised in the financial statements arising from leases; and (b) describe how leases may affect the amount, timing and uncertainty of the entity's future cash flows. Paragraph 72 states that if the disclosures required by this and other IFRSs do not meet the objectives in paragraph 70, an entity shall disclose the additional information necessary to meet the objectives. We are concerned that the objective in paragraph 70 is so broad that it is not clear what level of disclosure would meet the criteria in paragraph 72. The disclosures in paragraphs 73 – 86 require extensive disclosures. We do not believe that this additional ambiguous requirement in paragraph 72 is warranted.

Transition

Question 16

- (a) The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraph 88-96 and BC186-BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?**
- (b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?**
- (c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?**

We agree with the proposed transition provisions in the Leases ED and believe that they will reduce the burden that would otherwise arise from remeasuring lease assets and liabilities from the original date of the lease, particularly for long-term leases. We believe that full retrospective application should be optionally permitted. Additional clarification should be provided as to which date (earliest date reported upon adoption, date of initial application (i.e., adoption date) or initiation of the lease) an assessment of risks and benefits should be made in evaluating whether the derecognition or performance obligation approach applies for the lessor. We believe that such date of assessment should be the date of initial application. In addition, it should be clarified that the measurement of the remaining lease terms should be done in accordance with paragraphs 13 – 15 of the Leases ED.

Benefits and costs

Question 17

Paragraph BC200-BC205 set out the board's assessment of the costs and benefits of the proposed requirements. Do you agree with the board's assessment that the benefits of the proposals would outweigh the costs? Why or why not?

As expressed above, we have significant concerns regarding the costs and resources that will be required for the initial and ongoing implementation of the proposed changes to lease accounting. In summary our concerns are as follows:

1. The requirements to record assets and liabilities for all assets will result in the need to accumulate and measure information for individually immaterial leases.
2. The requirement to estimate contingent amounts and use probability weighted outcomes in the estimation process will result in significant effort initially and ongoing as such subjective estimates will naturally change.
3. Significant system changes and enhancements will certainly be needed to accumulate and manage the information necessary to measure lease assets and liabilities as well as provide the required disclosures.
4. Significant investment in education and training of staff will be required given the analysis and estimation processes that will be required for each individual lease.
5. Debt covenants and other agreements may need to be renegotiated to reflect the increased leverage that will accompany the balance sheet recognition of leases.
6. The practice for estimation required under the proposed standard would vary from entity to entity and would impair the comparability of financial results among these entities.

Other comments

Question 18

Do you have any other comments on the proposals?

In addition to our response to Question 2 and 12(c), where the derecognition approach is used for lessors, please clarify when and how to derecognise the residual asset (and re-recognise the underlying asset) when the lease is expired and the lessee does not exercise the purchase option.