

Jenny Ng

From: Winnie Chan
Sent: Monday, July 22, 2013 10:11 AM
To: Jenny Ng
Subject: FW: HKICPA Invitation to Comment on IASB ED on Leasing

From: Steve Ong [mailto:SteveOng@HKEX.COM.HK]
Sent: Friday, July 19, 2013 7:01 PM
To: Simon Riley
Cc: David Graham; Grace Hui; LIAA; Winnie Chan; Ambrose Wong; Committee-FRSC
Subject: HKICPA Invitation to Comment on IASB ED on Leasing

Dear Simon,

HKICPA Invitation to Comment on IASB ED on Leasing (HKICPA deadline 15 August 2013)

Thank you for the HKICPA letter dated 8 July 2103 on the subject matter addressed to our Mr. David Graham, Chief Regulatory Officer and Head of Listing, which has been passed to me for my attention as the HKEx representative member on the HKICPA Financial Reporting Standards Committee.

It is encouraging to note that this is a joint project between the IASB and FASB which will result in a single global standard, if finalized, to improve the quality and comparability of financial reporting by providing greater transparency about leverage in relation to the assets and entity uses in its operations, and the risks to which it is exposed from entering into lease transactions.

I have the following comments for your further consideration:

- 1) It is my understanding that, like the previous ED issued in 2010, the balance sheet distinction between operating and financial leases has been eliminated. A new asset (the right to use) and liability (the obligation to pay rentals) are recognized for all leases except short term leases. Short term leases are leases with a maximum term, including renewal options, of 12 months or less, where both lessees and lessors can elect, by class of underlying asset, to account for such leases in a similar way to current operating lease accounting.

In this regard, I would like to take this opportunity to remind the HKICPA that the latest IASB/FASB revised proposals do not seem to have addressed the many concerns that were previously raised by the key HK stakeholders to the HKICPA, details of which were set out in the HKICPA submission to the IASB dated 15 December 2010. The submission can be accessed at:
http://www.hkicpa.org.hk/file/media/section6_standards/standards/FinancialReporting/submission-pdf/2010/sub-ed-leases.pdf

I would therefore recommend that the HKICPA holds roundtable discussions with the key HK stakeholders to further gauge their views, as on a previous occasion.

- 2) I also noted that there is a further significant change since the first ED issued in 2010, which is the proposal for two different models for expense recognition (dual model), as follows:

- (a) When the lessee acquires or consumes more than an insignificant portion of the underlying asset (called Type A in the ED), expense is front-loaded, which is similar to the extant IAS 17 finance lease accounting.
- (b) For leases other than Type A which is called Type B leases in the ED, expense is recognized on a straight line basis.

The ED proposes two presumptions depending on the nature of the underlying asset where (i) property leases are type B, unless the lease term is for the major part of the remaining economic life, or the present value of the payments accounts for substantially all of its fair value; and (ii) Leases of assets other than property, for example equipment, are type A, unless the term represents an insignificant proportion of the underlying asset's economic life, or the present value of the fixed payments is insignificant relative to its fair value.

In this regard, the dual model for leases would appear to be inconsistent with the Board's initial objective of introducing a single lease accounting model. I understand that this is a major compromise by the Boards, designed to make the proposals more acceptable when applied to leases of property. However, this could create operational complexity and structuring opportunities as raised by the 2 IASB Board members in the ED, both of whom dissented from the proposals – Prabhakar Kalavacheria and Wei—Guo Zhang. They have also questioned (which I had the same issues) how a company would assess what are "insignificant", "substantially all" and "major part" without inconsistent arbitrary interpretations.

- 3) It is generally my view that implementing these proposals would not be easy for companies and could be very costly and challenging as all existing leases and potential lease contracts have to be re-analyzed. Furthermore, the ED includes a proposal to reassess key judgments of the lease term at the end of each reporting period. This is a significant change from IAS/HKAS 17. Companies would need to reassess key judgments and consider the need to re-measure leases balance each time they report.

Given the above, I would encourage the HKICPA to hold roundtables with key stakeholders, given that Hong Kong's concerns in 2010 were not addressed, to gauge the best way to take forward this important project, which have major implications to preparers of financial statements in terms of costs, complexity, compliance with debt covenants and others.

Thanks.

Kind regards,
Steve

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Vice President, Head of Accounting Affairs (Listing Department)
HKEx

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