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14 July 2009

Dear Mr Ong

Response to IASB Discussion Paper on *Preliminary Views on Leases*

We refer to your letter of 27 May 2009 to invite comments on the Discussion Paper on *Preliminary Views on Leases* issued by International Accounting Standards Board (IASB) in March 2009.

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

- The costs of recognising the "right-of-use" assets for operating leases (as defined under the existing IAS 17) will out-weight the benefit.
- The proposed remeasurement of lease obligations at each reporting date is inconsistent with the treatment of most financial liabilities, for instance, secured loans.
- Lessor accounting is not addressed at the same time as the lessee. This will result in inconsistent accounting treatments in the financial statements of companies which act as both lessors and lessees.

The following sets out our views in order of the questions raised in the Discussion Paper:

1. We do not agree. We think that the scope of the existing lease accounting standards should be critically reassessed, in particular the application of IFRIC-Int 4 *Determining whether an Arrangement contains a Lease*. The current IFRIC-Int 4 has resulted in certain arrangements, like power purchase arrangements with only one off-taker, being inappropriately classified as leases. The typical problems when applying lease accounting to power purchase arrangements include:

    - To apply lease accounting, it requires the analysis of the power purchase payments into different elements (minimum lease payments, service-related payments, fuel cost recovery, etc), the estimation of residual value of the subject power station and the determination of an appropriate interest rate. As all these may not be apparent from the power purchase agreements, the process is often subjective and involves significant level of judgement.
    - IFRIC-Int 4 did not satisfactorily address the accounting implications of subsequent additions, replacement or disposal of components of a "leased" power station. Should they be accounted for as new leases in case of additions? Should they be accounted for as adjustment to the lease receivables in case of disposals? As these will occur from time to time over the power purchase period, the resulting lease accounting implications could be very complicated.

    We therefore suggest to excluding power purchase and similar arrangements from the scope of the proposing new standard on leases.

2. We suggest to retain the existing operating/finance lease approach (as set out under point 4 below). We therefore have no comment on this question.

3. We do not agree.

   We do not agree that "right-of-use" should be recognised separately from the underlying assets. The concept of "right-of-use" asset is too abstract and academic. If we recognise the "right-of-use" separately from leased assets, should we also recognise the "right-of-use" separately from own assets as well? It is also inconsistent with the principle of not recognising executory contracts as financial instruments under IAS 39.

   We think that an operating lease contract (as defined in the existing IAS 17) 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 inception of the lease. In fact, in a simple lease, if the lessee chooses to early terminate the lease, it is under no obligation to pay for the remaining lease term (unless the contract specified otherwise).

   We believe in a lease arrangement, the central issue is whether it is an in-substance purchase of the subject asset. If the answer is yes, it is a finance lease with the recognition of the leased asset and the corresponding liability; otherwise, it is an operating lease and should be accounted for like an executory contract.

4. We do not support the proposed approach. As we expressed in point 3 above, we do not agree with the IASB's analysis.

   We consider the proposed approach has the following pitfalls:

   - The proposed approach failed to account for the economic reality of a hire purchase. In a hire purchase arrangement, the ultimate purpose is to acquire the subject asset by the lessee (buyer). Although the legal title does not pass until the final payment, the lessee (buyer) actually takes full control of the asset throughout and after the lease term. Merely recognising the "right-of-use" under the proposed approach does not reflect the economic reality of the arrangement.
   - Implementing the proposed approach to leases which are currently classified as operating lease (for example, retail shops under short-term leases of 2 to 3 years) will result in the recognition and the derecognition of the "right-of-use" assets and the corresponding lease obligations within a relative short period of time. The associated costs will out-weight its benefits.

   On the other hand, we think that the current operating/finance lease approach under IAS 17 works well and has the following merits:

   - It is well-understood and familiar by the preparers and the users.
   - It is simple to apply for operating lease and reflects the executory contract nature of operating lease.
   - The current operating lease commitment disclosure is sufficient for readers to understand a company's obligations under operating leases.
   - It reflects the economic reality of finance leases which are in substance purchase of assets.

   We also suggest expanding the disclosure on assets under operating leases (for both lessors and lessees) so that readers can evaluate the effect of operating leases on a company's operating capacity.

   We therefore support to maintain the existing operating/finance lease approach under IAS 17.

5. No comment.

6. No comment.

7. No comment.

8. No comment.

9. No, it should not. Such option will undermine the comparability between financial statements. Moreover, it is also inconsistent with the subsequent measurement approach of most financial liabilities (like a secured loan, which is similar to a finance lease).

10. No, in any case it should not. It is inconsistent with the subsequent measurement of most financial liabilities (like a secured loan, which is similar to a finance lease).

11. No comment.

12. No comment.

13. We support the proposed approach.

14. We do not agree. We think that requiring reassessment of the lease term at each reporting date is too costly and to account for any resulting changes could be complicated. The costs involved will out-weight the potential benefits. It is also inconsistent with the subsequent measurement approach of most financial liabilities (like a secured loan, which is similar to a finance lease).

    Alternatively we suggest making reassessment only when there are significant changes in the terms of the lease. This will make the reassessments less frequent.

    No. Requiring reassessment may not provide more relevant information as it will open up opportunities for manipulation and undermine the objectivity and reliability of financial statements.

15. No comment.

16. We do not agree. We think there are too many uncertainties in estimating contingent rent which may undermine the objectivity and reliability of financial statements. Moreover, we consider that the obligation to pay contingent rent arises when the contingent event has occurred but not upon inception of the lease.

    Alternatively, we suggest to retain the current approach under IAS 17 i.e. recognise contingent rent as an expense as incurred. This approach requires less estimation and will enhance the objectivity and reliability of financial statements.

17. We do not agree with either approach as we explained in point 16 above.

18. No comment.

19. We do not agree as we explained in point 16 above.

20. We do not agree with either approach as we explained in point 16 above.

21. No comment.

22. No comment.

23. No comment as we do not agree the recognition of right-of-use asset as we explained in point 3 above.

24. No comment.

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25. No comment.

26. We do not support either approach as we do not support the "right-of-use" approach as we explained in point 3 above.

27. No comment.

28. No comment.

29. No comment.

We welcome the opportunity to comment on the Discussion Paper and are happy to discuss this letter further with you.

Yours sincerely

Robert Kwok
Manager – Group Accounting & Compliance