



July 17, 2009

Technical Director
International Accounting Standards Board
30 Cannon Street
London, UK EC4M 6XH
Dear Sir or Madam:

Re: Invitation to Comment, Discussion Paper: Leases Preliminary Views

The Committee on Corporate Reporting of Financial Executives International Canada (FEI Canada) is pleased to submit its comments in response to the Invitation to Comment to the “Discussion Paper on Leases – Preliminary Views” as issued jointly by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB).

FEI Canada is the all-industry professional membership association for senior financial executives. With eleven chapters across Canada and more than 2,000 members, FEI Canada provides professional development, thought leadership and advocacy services to its members. The association membership, which consists of Chief Financial Officers, Audit Committee Directors and senior executives in the Finance, Controller, Treasury and Taxation functions, represents a significant number of Canada’s leading and most influential corporations.

The Committee on Corporate Reporting (CCR) is one of two national advocacy committees of FEI Canada. CCR comprises more than 30 senior financial executives representing a broad cross-section of the FEI Canada membership and of the Canadian economy who have volunteered their time, experience and knowledge to consider and recommend action on a range of issues related to accounting, corporate reporting and disclosure. In addition to advocacy, CCR is devoted to improving the awareness and educational implications of the issues it addresses, and is focused on continually improving the standards and regulations impacting corporate reporting.

Our response to the Invitation to Comment is included in the Appendix attached to this letter. Our primary concerns are:

1. The Boards propose to not change the scope of the lease standard. We agree but feel that the Board needs to clarify the difference between a contract for service and a contract for property (right to use asset). We feel that further guidance is needed for services provided under outsourcing arrangements where the outsourcer’s objective is the efficient and effective operation of a function and not “ownership” of an asset. To illustrate the need for clarification and guidance, consider the following examples:
 - a. an arrangement where a company obtains access to fibre optic lines where they are the only current user of these lines, however the service provider has the right to sell the service and use of the lines to others if the demand arises.
 - b. a company outsources its printing needs to a third party. The third party provides the labour and equipment used to meet the company’s printing needs. The equipment is fully dedicated to this company. The third party determines the equipment it needs to fulfill the terms of the agreement. In each of these examples, it is not clear whether or not the equipment would be

APPENDIX – Response to *Preliminary Views on Leases*

- captured as a lease under the current proposal or whether it falls under scope of a service agreement.
2. We strongly disagree with including payments for contingent rentals within the rental payment obligation where these amounts are based on either usage (or volume) or performance. Further, we believe that contingent amounts based on usage or performance are not true liabilities at inception of an agreement. These become liabilities only upon occurrence of the event itself - usage or performance. Contingent rentals should depend on the nature of the contingency. If the contingent rental is dependent on a price index, then it would be included in the calculation of minimum lease payments, but if the contingent rent is dependent on usage or volume, then the obligation would be excluded from the contingent rent. There is a fair amount of subjectivity used in estimating contingent rentals as contingent rentals contemplate an uncertainty about future changes in the factors on which lease payments are based. While IASB recommends probability weighting, we feel that it is more realistic to uphold the FASB “most likely” approach. We do not believe that contingent payments based on future use or performance meet the definition of a liability because there is no present obligation as an obligating event will occur in the future, namely the asset is used or a performance hurdle is met. We feel that contingent payments based on future use or performance hurdles is more consistent with the nature of an operating costs rather than a cost of the asset itself. We feel that capitalizing contingent rents will significantly increase complexity. The steps involved in recalculating changes in estimates and deferred tax accounting for leases will be complex and burdensome.
 3. We feel that it is important to distinguish between an in-substance purchase and other leases on the balance sheet as these are distinct activities. One is a financing activity and the other is an operating activity. We feel that this distinction is important in light of the preliminary view of the Boards on financial statement presentation. While we understand that the scope of the lease standard is not supposed to include items that are not currently considered to be leases, we feel that the broader term of “right to use” may capture items not currently categorized as leases (either operating or financing). Consequently, the board should provide more guidance around operating nature versus financing nature. To illustrate our point, consider a power plant where if it is directly owned, then the entity would record depreciation along with the corresponding operating costs required to run it. However, if a similar plant is considered to be leased, then the entire lease payments (which would include the underlying operating costs) would be recorded on the balance sheet and result in depreciation and interest expense. We feel that the accounting treatment should be reflective of the situation – regardless of whether the company entered into a lease or retained ownership and therefore there should be no significant difference on the profit & loss statement or balance sheet. As it stands under the proposed accounting for leases, the asset under lease would be significantly higher because it would include the operating costs. The linked approach to the subsequent measurement of lease arrangements is more reflective of the economic reality for operating leases as compared to in-substance purchases. The right of use asset and the obligation are inextricably linked, and the accounting should reflect this linkage. This prevents inappropriate skewing of the income stream from the arrangement.
 4. We believe that the Boards should consider the impact of their preliminary views on lessor accounting. We believe that the lease accounting model and concepts should be consistent between lessor and lessee to meet the Boards’ objective of decreasing complexity in the leasing standard. We recommend, therefore, that the Boards delay issuing the final standard until the accounting standards for lessors are more clearly defined.
 5. We would encourage the Boards to determine whether mortgage based amortization of a lessor receivable meets the proposed revenue recognition principles contained in the recently released Discussion Paper - Preliminary Views on Revenue Recognition in Contracts.
 6. The proposed model may change how companies write leases in the future and may change lease versus buy decisions. We query whether the benefit of the revisions to the accounting for leases will be at too great a cost to the leasing industry as a whole.

APPENDIX – Response to *Preliminary Views on Leases*

We hope that our comments will be useful to the IASB and FASB in their deliberations. If you have any questions or would like to discuss any of these matters, please do not hesitate to contact us.

Yours very truly,



Victor Wells
Chair
Committee on Corporate Reporting
FEI Canada

Copy: Mr. Peter Martin, Accounting Standards Board (Canada)

APPENDIX – Response to *Preliminary Views on Leases*

The Committee on Corporate Reporting responses to the questions raised in the Discussion Paper are set out below.

Scope

Question 1

The Boards tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards. Do you agree with this proposed approach?

If you disagree with the proposed approach, please describe how you would define the scope of the proposed new standard?

We agree with the approach but think that clarifications are required within the existing scope guidance of IFRIC 4 *Determining Whether an Arrangement Contains a Lease*. Additional clarification is needed when determining whether a service is being received versus obtaining a right to use an asset.

In the current scoping of the standard, contracts other than financing arrangements are pulled into the scope of lease accounting. Contracts are entered into, not only as alternate financing arrangements, but also to manage operational risk by outsourcing to organizations specializing in those areas. Often the outsourcer's objective under outsourcing arrangements is the efficient and effective operation of a function and not "ownership" of an asset.

Question 2

Should the proposed new standard exclude non-core asset leases or short-term leases? Please explain why.

Please explain how you would define those leases to be excluded from the scope of the proposed new standard.

We agree with the tentative conclusion of the Boards that leases of non-core assets and short-term leases should not be scoped out of the new standard.

Approach to Lessee Accounting

Question 3

Do you agree with the Boards' analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract? If you disagree, please explain why.

We agree that this analysis has some merit for simple lease contracts. However, for more complex arrangements where payments are based on performance hurdles or usage, we would not agree. In these instances we do not believe that there is an obligation for future performance or usage amounts since the event that gives rise to the obligation has not yet taken place.

APPENDIX – Response to *Preliminary Views on Leases*

Question 4

The Boards tentatively decided to adopt an approach to lessee accounting that would require the lessee to recognize:

- (a) an asset representing its right to use the leased item for the lease term**
- (b) a liability for its obligations to pay rentals.**

Do you support the approach?

If you support an alternative approach, please describe the approach and explain why you support it.

We support this approach.

Question 5

The Boards tentatively decided not to adopt a components approach to lease contracts. Instead, the Boards tentatively decided to adopt an approach whereby the lessee recognizes:

- (a) a single right-of-use asset that includes rights acquired under options**
- (b) a single obligation to pay rentals that includes obligations arising under contingent rental arrangements and residual value guarantees.**

Do you support this proposed approach? If not, why?

We feel that it should be optional to select a conceptual components approach (derivatives that have a value) but acknowledge that this may give rise to measurement issues if the components approach is not adopted. While it may be difficult to measure components, difficulties may also arise if options are not reviewed separately. In that regard, we support the view of some members of the Board who feel that contingent rentals that are dependent on usage or volume should be excluded from the obligation calculation as the events related to the creation of an obligation have yet to occur and there is uncertainty whether an obligation does, in fact, exist.

Initial Measurement

Question 6

Do you agree with the Boards' tentative decision to measure the lessee's obligation to pay rentals at the present value of the lease payments discounted using the lessee's incremental borrowing rate?

If you disagree, please explain why and describe how you would initially measure the lessee's obligation to pay rentals.

We agree with measuring the obligation using the lessee's incremental borrowing rate.

APPENDIX – Response to *Preliminary Views on Leases*

Question 7

Do you agree with the Boards' tentative decision to initially measure the lessee's right-of-use asset at cost?

If you disagree, please explain why and describe how you would initially measure the lessee's right of use asset.

We agree with initially measuring the right-of-use asset at cost and that the cost of the asset would be determined by the present value of rental payments.

Subsequent Measurement

Question 8

The Boards tentatively decided to adopt an amortized cost-based approach to subsequent measurement of both the obligation to pay rentals and the right-of-use asset. Do you agree with this proposed approach?

If you disagree with the Boards' proposed approach, please describe the approach to subsequent measurement you would favour and why.

We disagree with the Boards' proposed approach and prefer the linked approach to subsequent measurement as outlined in the Discussion Paper. The primary reason for our preferred approach is that it is more representative of economic reality. Recognizing interest expense on the obligation as required by the non-linked amortized cost-based approach can create significant differences in the amount of the expense recognized in year one versus, say, year twenty. In addition, there are circumstances where the amount payable for rent is the most meaningful number to reflect in the income statement. Not all lessees lease by choice; buying may not be an option at their disposal. These lessees do not make the leasing decision based on a lease versus buy analysis. Accordingly, their decisions to lease should not be construed as financing decisions. The reasons for dismissing the linked approach given in section 5.12 of the Discussion Paper are weak when one considers the requirements of all users of financial statements:

- (a) "Non-derivative financial liabilities (other than those measured at fair value) give rise to interest expense. The obligation to pay rentals in a lease contract clearly contains an interest component." This is not always the case. Lessees do not always have the option of purchasing the asset they are leasing. Accordingly, it is unwise to assume that leasing is a financing option and that leases are always considered with respect to the interest costs that they bear.
- (b) "This approach requires the lessee to differentiate between finance and operating leases. This would add complexity..." This is not a valid reason for dismissing the linked approach. This statement inappropriately dismisses what lessees and lessors already do today – differentiate between finance and operating leases. Further we feel that without this option, lessor accounting would be more complex and disjointed.
- (c) "The right of use asset could be impaired but the lessee would still be required to make the same rental payments". This situation is already addressed when an entity makes a decision to discontinue operations. "Conversely, *increases* in the value of the right-of-use asset do not necessarily result in a change in the rental payments". In our response to Question 10, we indicate that we do not support subsequent re-measuring due to changes in the incremental borrowing rate. Except for the impacts of re-measuring due to decreases in the incremental borrowing rate, it is hard to imagine when an increase in value would occur under the amortized cost approach.

APPENDIX – Response to *Preliminary Views on Leases*

While we agree with the option to use mortgage based amortization of the obligation, this is inconsistent with the requirement to depreciate the right-of-use asset. As evidenced by the Boards' endorsement of the 'catch up' approach whereby the right-of-use asset is adjusted for any subsequent remeasurement of the liability, the obligation to pay rentals and the right-of-use asset are inextricably linked. It does not make conceptual sense to treat these amounts differently within the income statement when they are so closely related. On the balance sheet, mortgage based amortization implies that each agreement within the scope of the lease standard is a financing agreement, similar to debt that can be prepaid.

We would suggest using the linked approach in accounting for all lease transactions other than those that are in-substance purchases (equal to a capital lease as perceived in current prevailing practice). This better reflects the economic realities of most lease transactions. In addition, it also measures the obligation to make future rental payments which assists the users of financial statements in determining the level of future commitments.

Question 9

Should a new lease accounting standard permit a lessee to elect to measure its obligation to pay rentals at fair value? Please explain your reasons.

We would not support measuring obligations to pay rentals at fair value. Fair value may not be significantly different than amortized cost and would not add significant additional decision-useful information. In addition, permitting the use of fair value could result in inconsistencies among all preparers in how fair value is determined for these agreements. This would increase the complexity of statements which would increase the burden on users and preparers without much additional marginal benefit.

Question 10

Should the lessee be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate? Please explain your reasons.

If the Boards decide to require the obligation to pay rentals to be revised for changes in the incremental borrowing rate, should revision be made at each reporting date or only when there is a change in the estimated cash flows? Please explain your reasons.

We agree with the FASB position and would not support requiring the lessee to revise its obligations to pay rentals due to a change in incremental borrowing rate for the following reasons:

- Changing the discount rate for the current rate is effectively fair valuing the obligation for current market conditions as discussed in Question 9.
- Borrowing rates do not have any direct economic implications on most lease arrangements. For decisions to lease that are based on lease versus buy analyses, the decision is based on the cost of capital at the time the decision is made to lease. These decisions cannot be revisited and reversed subsequently. We feel that it does not make sense to include these changes in the remeasurement of the liability.
- Like term loans, the rate is set using the current market conditions and risks associated with the cash flows, for the term of the arrangement at the time the leasing decision is made.
- Annually changing the liability for changes in cash flows as well as changes in the incremental rate would increase complexity for preparers and make the results more difficult for users to understand.
- On the lessor side, the rate implicit in the lease will not change over time so it would not make sense to revise cash flows due to changes in market rates from the lessee side.

Since we do not believe that the rate should be revised, we would not support either option of requiring revision at the reporting date or when there is a change in estimated cash flows. If subsequent remeasurement for changes in incremental borrowing rates was deemed necessary by the Boards, it would be more straightforward to perform the assessment at each reporting date. Cash flows under some lease

APPENDIX – Response to *Preliminary Views on Leases*

agreements could be constantly changing based on variable usage payments so it would not make sense to repeatedly revise the rate. In addition, the cash flows have no relation to the incremental borrowing rate of the Company so revising the rate based on changes in cash flows does not make conceptual sense.

Question 11

In developing their preliminary views the Boards decided to specify the required accounting for the obligation to pay rentals. An alternative approach would have been for the Boards to require lessees to account for the obligation to pay rentals in accordance with existing guidance for financial liabilities.

Do you agree with the proposed approach? If you disagree, please explain why.

We agree with the proposed approach only for purposes of subsequently measuring the obligation and do not think it would be appropriate to account for lease obligations under existing guidance for financial liabilities. Lease obligations are inherently different from other financial liabilities and these differences should be reflected in the accounting.

Question 12

Some Board members think that for some leases the decrease in value of the right-of-use asset should be described as rental expense rather than amortization or depreciation in the income statement.

Would you support this approach? If so, for which leases? Please explain your reasons.

We would not support this approach unless the amount is equal to the amount payable as rent. We feel that the linked approach to subsequent measurement more closely approximates the common understanding of “rent expense”.

For leases that are in substance purchases, we would support disclosing the decrease in value of the right-of-use asset as amortization or depreciation expense in the income statement as is done today in accounting for capital leases. This would be consistent with the nature of the asset as it was initially recognized and with the Boards’ objective of recognizing the asset. Calling this charge “rental expense” would also frustrate the calculation and use of EBITDA by many financial statement users. Disclosure in the notes to the financial statements should reconcile this amortization or depreciation amount to the amount of rent payable for the leased asset.

Leases with Options

Question 13

The Boards tentatively decided that the lessee should recognize an obligation to pay rentals for a specified lease term. Ie – in a 10-year lease with an option to extend for five years, the lessee must decide whether its liability is an obligation to pay 10 or 15 years of rentals. The Boards tentatively decided that the lease term should be the most likely lease term.

Do you support the proposed approach? If you disagree with the proposed approach, please describe which alternative approach you would support and why.

We would support this approach of determining the appropriate lease term for lessees.

APPENDIX – Response to *Preliminary Views on Leases*

Question 14

The Boards tentatively decided to require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances. Changes in the obligation to pay rentals arising from a reassessment of the lease term should be recognized as an adjustment to the carrying amount of the right-of-use asset.

Do you support the proposed approach? If you disagree with the proposed approach, please describe which alternative approach you would support and why.

Would requiring reassessment of the lease term provide users of financial statements with more relevant information? Please explain why.

We agree with the approach with the Boards' requirement to reassess the lease term at the reporting date on the basis of any new facts or circumstances.

Question 15

The Boards tentatively concluded that purchase options should be accounted for in the same way as options to extend or terminate the lease.

Do you support the proposed approach? If you disagree with the proposed approach, please describe which alternative approach you would support and why.

We support this approach of accounting for lessee purchase options.

Contingent Rentals

Question 16

The Boards propose that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements.

Do you support the proposed approach? If you disagree with the proposed approach, please describe which alternative approach you would support and why.

We strongly disagree with including payments for contingent rentals within the rental payment obligation where these amounts are based on either usage (or volume) or performance. Further, we believe that contingent amounts based on usage or performance are not true liabilities at inception of an agreement. They become liabilities only upon occurrence of the event itself - usage or performance.

By definition, liabilities arise from past transactions or events. In contrast, a decision by management to purchase goods or services in the future does not give rise to a present obligation. The decision to incur expenditures in order to generate revenues does not meet the definition of a liability until the goods are ordered or the services are received. The concept of estimating how much a leased asset is to be used in the future and immediately recognizing this as an obligation is in direct contrast with the accounting framework. A liability does not arise until the leased asset is used or event is performed.

Contingent amounts based on usage or performance of the right to use asset, do not give rise to a liability until usage or performance is complete, and should be recorded as an operating cost at that time. We understand that the Boards may wish to reduce the possibility of making all arrangements contingent on use or performance; however, we feel that this is unlikely to arise because these arrangements would be risky for the lessor unless some minimum usage was required within the agreement. If minimum production or sales amounts are stated in the agreement, only then is there an obligation for payments up to that set minimum amount. We would therefore recommend that only minimums should be recognized.

APPENDIX – Response to *Preliminary Views on Leases*

Question 17

The IASB tentatively decided that the measurement of the lessee’s obligation to pay rentals should include a probability-weighted estimate of contingent rentals payable. The FASB tentatively decided that a lessee should measure contingent rentals on the basis of the most likely rental payment. A lessee would determine the most likely amount by considering the range of possible outcomes. However, the measure would not necessarily equal the probability-weighted sum of the possible outcomes.

Which of these approaches to measuring the lessee’s obligation to pay rentals do you support? Please explain your reasons.

As noted above in our response to Question 16, we do not agree that contingent rents based on performance or usage should be included. However, if the Boards decide that it is appropriate to include contingent rentals within the calculation of the obligation, then it should be measured at the most likely amount.

We do not perceive contingent lease obligations as being different from other obligations in terms of measurement (such as taxes, provisions). We feel that it is important that FASB and IASB come to a common understanding on that overall topic so that such measurements are relatively consistent. That being said, our members are divided on this subject. Regardless of method chosen, our members all agree that consistency within IFRSs for the treatment of other unknown liabilities is important.

In practice, we feel that the amount calculated by using the most likely payment versus the probability-weighted payment should not differ materially and the calculation of the most likely amount would be less onerous on preparers. When determining the most likely amount, preparers would inherently need to consider the range of possible outcomes and their likelihood.

We would strongly encourage the Boards to agree on the appropriate method to avoid complexity for preparers and users that need to interpret and/or prepare both US GAAP and IFRS financial statements.

Question 18

The FASB tentatively decided that if lease rentals are contingent on changes in an index or rate, such as the consumer price index or the prime interest rate, the lessee should measure the obligation to pay rentals using the index or rate existing at the inception of the lease.

Do you support the proposed approach? Please explain your reasons.

We would support the FASB proposed approach because of its simplicity and the fact that, in most established economies operating in normal circumstances, inflation and interest rates are relatively consistent. Changes in these indices represent current and future market conditions which should be reflected in the changes in cash flows and other assumptions reassessed at each reporting date. In unusual times, where the interest rate and inflation are not within typical benchmarks, the increased / decreased expense would be reflected in the remeasurement of the current obligation.

Question 19

The Boards tentatively decided to require remeasurement of the lessee’s obligation to pay rentals for changes in estimated contingent rental payments.

Do you support the proposed approach? If not, please explain why.

We strongly disagree with including contingent rental payments based on usage and performance within the calculation of the obligation, unless there is a minimum usage or performance level set in the lease contract (refer to our response to Question 16). Where these contingent payments are required to be

APPENDIX – Response to *Preliminary Views on Leases*

included in the measurement of the obligation, we support the Boards' tentative approach because these contingent amounts are difficult to estimate with any degree of reliability and consistency. Usage of an asset over a five to twenty-five year life would be difficult to predict with a high level of accuracy. Performance levels would be even more difficult to predict. We consider it necessary to revise these estimates on a continuous basis so that the liability would reflect the best information available at the time.

We support revising the lessee's obligation to pay rentals and not changes in rates since, in most cases, the variability of contingent payment estimates would be much greater than the variability in rates. In addition, changes in contingent rental payments would normally have a much larger impact on the total lease payment than changes in CPI or rates.

Question 20

The Boards discussed two possible approaches to recognizing all changes in the lessee's obligation to pay rentals arising from changes in estimated contingent rental payments:

- (a) recognize any change in the liability in profit or loss**
- (b) recognize any change in the liability as an adjustment to the carrying amount of the right-of-use asset.**

Which of these two approaches do you support? Please explain your reasons. If you support neither approach, please describe any alternative approach you would prefer and why.

Again, we strongly disagree with including non-committed contingent rental payments based on usage and performance within the calculation of the obligation. However, if required, we would recommend recognizing changes in the lessee's obligation as an adjustment to the carrying amount of the asset, since the change will be primarily due to changes in the original estimate. We agree with the IASB's view that the liability and the asset are linked and therefore changes should also reflect this linkage. We also believe that this rationale supports the use of the linked approach to subsequent accounting for lease transactions, other than in-substance purchases.

Residual Value Guarantees

Question 21

The Boards tentatively decided that the recognition and measurement requirements for contingent rentals and residual value guarantees should be the same. In particular, the Boards tentatively decided not to require residual value guarantees to be separated from the lease contract and accounted for as derivatives. Do you agree with the proposed approach? If not, what alternative approach would you recommend and why?

We agree with the accounting proposed for residual value guarantees. We see these as different from non-committed contingent rental payments, since these guarantees are an actual lessee commitment. While we strongly disagree with including non-committed contingent rental payments within the obligation, we agree that residual value guarantees should be included.

APPENDIX – Response to *Preliminary Views on Leases*

Presentation

Question 22

Should the lessee's obligation to pay rentals be presented separately in the statement of financial position? Please explain your reasons. What additional information would separate presentation provide?

We believe that a lease obligation is inherently different than a debt instrument, and therefore, should be presented separately on the statement of financial position. With reference to the Discussion Paper released on Financial Statement Presentation, we do not think that lease obligations should be recognized within financing activities unless they are in-substance purchases or the scope of the lease standard is adjusted appropriately. Leases, other than in-substance purchases, should be classified as an operating activity for both lessor and lessee.

Question 23

This paper describes three approaches to presentation of the right-of-use asset in the statement of financial position. How should the right-of-use asset be presented in the statement of financial position? Please explain your reasons.

What additional disclosures (if any) do you think are necessary under each of the approaches?

The three approaches discussed by the paper include presentation based on the nature of the underlying asset, presentation as an intangible asset or presentation based on classification between in-substance purchases and intangible assets. We believe that there should be a distinction between an in-substance purchase and other leases. We do not agree that leases should be presented as intangible assets.

Leases that are in-substance purchases would meet one of the following criteria:

- Contract transfers ownership of the asset at the end of the lease term.
- Contract contains a bargain purchase option during or at the end of the lease term.
- The lease term is equal to the entire useful life of the asset.

All other leases would comprise the 'other leases' category. Leases that are in-substance purchases are a financing activity whereas other leases are an operating activity.

Other leases should be presented based on the nature of the underlying asset and included within the same line item as other similar owned assets on the balance sheet. We do think that it is important for financial statement users to distinguish between what assets are leased and what assets are owned. We would propose requiring this disclosure within the notes to the financial statements, as opposed to on the statements themselves. This approach would give users the most decision-useful information by providing both the nature of the asset, and indicating whether or not it is owned or leased.

Other Lessee Issues

Question 24

Are there any lessee issues not described in this discussion paper that should be addressed in this project? Please describe those issues.

The proposed lease standard will only apply to material items. However, the discussion paper does not address high-volume, low value leases. For example, the lease of one computer may not be material, but the lease of 10,000 computers may be material in the aggregate.

Discussions with our membership who are joint ventures have also highlighted that the Boards have not addressed how a lease should be accounted for if an entity is both the lessee and partial lessor to a

APPENDIX – Response to *Preliminary Views on Leases*

contract. For instance, if the entity is the lessee to a contract with a joint venture that it accounts for under the equity method, does the entity have to unwind the investment in the equity account in order to eliminate the intercompany portion of the lease on consolidation? If not, how should the duplicate asset value be accounted for and disclosed? Does the existence of a “right to use” asset deem the entity to have control over the joint venture?

Other issues not addressed in the Discussion Paper are:

- Timing of initial recognition
- Sale and leaseback transactions
- Treatment of initial direct costs
- Leases that include service arrangements
- Difference between right to use asset versus service arrangement
- Leases with indefinite useful life (easements, land use rights, patents, trademarks)
- Royalties and licenses
- Disclosure

Lessor Accounting

Question 25

Do you think that a lessor’s right to receive rentals under a lease meets the definition of an asset? Please explain your reasons.

Yes, these amounts are receivable from the lessee and should be recognized as an asset.

Question 26

This paper describes two possible approaches to lessor accounting under a right-of-use model: (a) derecognition of the leased item by the lessor or (b) recognition of a performance obligation by the lessor.

Which of these two approaches do you support? Please explain your reasons.

We would support derecognition of the leased item by the lessor because we feel that this presents the most useful information to financial statement users. There are many problems with showing the full value of the asset on the lessor books and a corresponding obligation representing future economic outflows from the use of the asset:

- A lessor showing an obligation to a lessee is counterintuitive and will create confusion for financial statement users. Most users will not understand what the obligation represents.
- Users will have a difficult time determining which obligations represent a lessor obligation and which represent a lessee obligation for instances where the Company is involved in leasing assets as well as obtaining assets under lease.
 - The same problem will exist for the additional asset recognized by the lessor.
- It is questionable whether the obligation represents a true liability since no cash outflows will result. This is inconsistent from other liabilities recorded, where the vast majority result in cash outflows.
- The lessor is recognizing the full value of the asset on its books but does not have the ability to use the asset for its full life.
- The lessor is recognizing depreciation expense on an asset that it is not using.

Derecognition of the leased item and recognition of a residual asset is easier to understand for financial statement users and is more consistent with the conceptual framework. The benefits are:

APPENDIX – Response to *Preliminary Views on Leases*

- Residual assets are classified separately from other assets. Users will be able to understand which assets are under lease and which assets are currently in use.
- It is consistent with the conceptual framework. The lessor is only recognizing benefits that it expects to receive. The receivable representing future cash inflows from the agreement, and the residual asset representing future benefits from the remaining life.
- Users can determine when the company is leasing an asset versus when the company has obtained an asset under lease.

We strongly support the derecognition concept in favour of recognizing a performance obligation by the lessor.

Question 27

Should the Boards explore when it would be appropriate for a lessor to recognize income at the inception of the lease? Please explain your reasons.

We do not have any comments on this issue however are concerned that the Boards are treating lessor accounting separately from lessee accounting.

Question 28

Should accounting for investment properties be included within the scope of any proposed new standard on lessor accounting? Please explain your reasons.

We do not have any comments on this issue however are concerned that the Boards are treating lessor accounting separately from lessee accounting.

Question 29

Are there any lessor accounting issues not described in this discussion paper that the Boards should consider? Please describe those issues.

We strongly recommend that the Boards' reconsider their decision to evaluate lessor accounting separate from lessee accounting. We understand that there are other projects that will provide foundation and insight to any lessor accounting solution but we firmly believe that lessee accounting must take into consideration the most appropriate lessor approach. The concept of leasing involves two parties and evaluating the accounting for one side of the transaction cannot provide the complete picture necessary.

For example, using mortgage based amortization for the lessor receivable increases the amount of revenue recognized in the first year at the expense of the later years of the agreement. The Boards need to evaluate whether or not this income statement impact is in accordance with the new discussion paper on revenue recognition since revenue will be recognize irrespective of when performance obligations are met. Mortgage based amortization would not be consistent with revenue recognition based on performance obligations. Further, we feel that it is not appropriate to measure the lessee obligation using mortgage based amortization. It is our view that the accounting by lessee and lessor should mirror each other.

We also question how the concept of determining the most likely lease term would be applied to a lessor, who is not the holder of the option to extend. In our opinion, it would be difficult and unreliable for a lessor to determine a most likely scenario for the other party. In this case, from the lessor perspective, we would not support this view unless the term extension was structured to be advantageous to the lessee. If the goal of the Boards is to determine a method of accounting for options within the lease that works for both the lessor and lessee, this may not be the appropriate model.

Taking this one step further, we strongly believe that the method of accounting for purchase options discussed in this Discussion Paper would be unrealistic to apply to a lessor. Unlike term extending

APPENDIX – Response to *Preliminary Views on Leases*

options, there is usually a period of time in which a purchase option can be exercised that can be for an extended duration. Determining the timing as to when this purchase option may be exercised would be difficult for the lessor and would likely be inaccurate.

We would not support this approach to purchase option accounting for lessors since it would most likely result in inaccurate recognition of the receivable. We do not believe that lessor accounting should reflect any purchase options of the lessee unless, upon subsequent re-evaluation, it becomes clear that a bargain purchase will take place at a specific point in time. We question how the lessee would be able to reliably determine when to purchase the asset at the inception of the agreement but believe that they still have the ability to determine the most likely scenario.