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financial executives international

canada

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The International Accounting Standards Board
30 Cannon Street
London, United Kingdom
EC4M 6XH

Re: Exposure Draft ED/2010/09 Leases

The Committee on Corporate Reporting (CCR) of Financial Executives International Canada (FEI Canada) is writing to provide its response to the International Accounting Standards Board (IASB) Exposure Draft (ED) ED/2010/09 Leases.

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.

CCR is one of two national advocacy committees of FEI Canada, 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.

We support the boards' efforts to improve lease accounting and we applaud the boards' efforts in this regard. We support the theory that certain obligations arising from leases that are material should be capitalized, however we disagree with several major elements of the exposure draft. Although significant effort has been made to address the concerns of both lessee and lessor accounting, we believe that the proposals in this exposure draft fail to meet the boards' objectives of "meeting the needs of users … with faithful representation of leasing transactions" and "reducing undue complexity". Moreover, we believe that the proposed standards in this exposure draft will result in significant cost and complexity for many preparers and auditors, who will struggle with a series never-ending estimates and adjustments of estimates to provide information to users that is of limited value, inconsistent and therefore not comparable between entities. As those users who insist on capitalizing operating leases (such as rating agencies) have their own methodologies for doing so, we believe that the benefits to users of these proposals would be marginal at best. We do not agree that these benefits would outweigh the costs.

Dual approach

Having two distinct approaches to lessor accounting is inconsistent with the proposal to allow only one approach for lessees. We understand that the boards are against a single approach to lessor accounting and we agree with the rationale because of differences in the economics of business models for different lessors. However, this is also just as true for lessees (who may lease for reasons of operational flexibility and a lack of desire to be exposed to technical obsolescence or for financing purposes) and we question why the boards would allow only one alternative for lessees.

Some of our members have a strong preference for a multiple approach being offered to both lessors and lessees, including derecognition and performance obligation for lessors and the right-to-use and the linked approach for lessees. Differences in economics of business models are as important to lessees as to lessors.

Short-term leases

The boards should take this opportunity to truly simplify the accounting for short-term leases. The current exposure draft does not go far enough in addressing the burden to the preparer and auditor, and only addresses a small amount of the work that would be involved. While the exposure draft would permit election on a lease-by-lease basis to measure the liability at the undiscounted amount of the lease payments and the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs, the burden on companies to track short-term leases and to record them on a balance sheet would remain high.

We propose that the boards reconsider whether short-term leases should be treated (i) on a lease-by-lease basis and (ii) whether it would be truly simpler to record these lease payments by lessees under short-term leases in the income statement. Lessees should have the option to recognize short-term leases on a straight-line basis over the term, similar to accounting methods in use today. This would better match cash flows and handle the accounting and measurement in a more practical manner.

Right-of-use model

We agree that the right-of-use model is appropriate in most circumstances where lease contracts provide an alternative to asset ownership. We are supportive of the boards' efforts to recognize leases on the balance sheet, if done in a practical and disciplined manner. However, we believe that the boards should also consider whether this model is appropriate for lease arrangements where direct ownership of the underlying asset is not feasible (such as leases of a portion of a larger asset than cannot be sold on a subdivided basis), or the lessee motivation is for reasons other than for financing purposes. In Canada, examples include airport authorities which have long-term lease agreements with rentals that are wholly contingent on revenues, and other contractual arrangement such as power purchase agreements.

Definition of service contract versus lease

In the past, there was little emphasis placed on the distinction between a service contract versus a lease. As a result, we feel that the boards have overlooked the opportunity to articulate a well defined conceptual basis that will lead preparers to make appropriate and consistent judgments. One example where the interpretation is unclear is the outsourcing of data centres. In an outsourcing agreement, it may not be clear who controls the equipment (i.e. legal vs. physical) located within a client site but operated by the vendor.

Contingent rents

FEI Canada does not believe that rental payments that are contingent on future performance or use meet the definition of a liability. Under the right-of-use model, lease payments should only include payments that represent a probable present obligation. There is no probable present obligation arising from contingent rentals as the obligating event may occur in the future, namely when the asset is used or a performance hurdle is met. Consider, for example, contingent rent based on a percentage of sales. Contingent payments based on future use or performance hurdles are more consistent with the nature of operating costs rather than a cost of the asset itself. Further, contingent rentals will be extremely difficult to estimate with any degree of reliability given the long-term nature, complexity and variability of these arrangements. Consider again contingent rent based on a percentage of sales. The possible outcomes would include a wide range of projected sales as well as the timing and probability of each outcome. Providing lease asset and liability information to users that is based on forecasts and other estimates that cannot be reliably measured diminishes the usefulness of financial information to users and may be misleading. The lessee proposal with regards to contingent rentals should be consistent with the lessor proposal as reliability in measurement is equally as important for lessees and lessors.

Convergence

We are fully supportive of the boards' efforts to converge accounting standards between FASB and IASB. We encourage the boards to be consistently aligned in their approach and to dispense with differences upon issuance of an exposure draft. The fact that the FASB board put forward a separate discussion point for leveraged leases, but not the IASB board, only adds complexity and confusion. The fact that the boards are not aligned on a comprehensive lessor solution serves as an indicator that despite preparers' efforts, significant change to lessor accounting may remain.

Yours very truly,

Tyrone Cotie
Chair
Committee on Corporate Reporting
FEI Canada

The Accounting Model

The exposure draft proposes a new accounting model for leases in which a lessee would recognize an asset (the right of use asset) representing its right to use an underlying asset during the lease term and a liability to make lease payments (ED par 10, BC 5-12). The lessee would amortize the right-of-use asset over the expected lease term or the useful life of the underlying asset if shorter. The lessee would incur interest expense on the liability to make lease payments. The lessor would apply either a performance obligation approach or derecognition approach to account for the assets and liabilities arising from a lease depending on whether the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected term of the lease (par 28-29 and BC23-27).

Question 1: Lessees

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 amortisation of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

We believe that a right-of-use model provides useful information and for some users satisfies user needs about recognition of assets and liabilities arising from leases. However, we disagree with the boards conclusion that the linked approach is not an appropriate model because it is (a) inconsistent with the treatment of liabilities; (b) linking does not necessarily follow through the entire term of a lease; and (c) treatment in the income statement is not consistent with the boards view. We believe that by adopting a restrictive view, the boards are overlooking the fact that many entities enter into leasing arrangements for reasons other than for financing purposes. We believe that the boards should consider allowing a linked approach for contracts that are other than financing arrangements such as power purchase agreements.

We agree that where the linked approach is not used, a lessee should recognise amortisation of the right-of-use and interest on the lease liability. We agree that neither the right-of-use nor the lease liabilities are required to be measured at fair value.

Question 2: Lessors

A. Do you agree that a lessor should apply
   a. 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
   b. the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?

B. Do you agree with the boards' 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?

In general, we agree with including both the performance obligation and derecognition approaches.

We note the initial measurement of lease payments, assets, liabilities, interest income and expense by the lessor and lessee may be significantly different on account of their different expectations and information. Furthermore, the subsequent measurement proposals are complex and not aligned to the revenue exposure draft. For example, the amortisation proposals are geared to the use of the underlying asset by the lessee in contrast to the proposals in the revenue exposure draft which are geared to the discharge of the performance obligation by the seller.

Question 3: Short-term leases

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,
   a. the liability to make lease payments at the undiscounted amount of the lease payments and
   b. 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). (See also paragraphs BC41–BC46.)

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?

We are supportive of reducing the burden of accounting for short-term leases by both the lessee and lessor but believe that the boards should go further in their efforts to simplify such accounting. The boards should take this opportunity to truly simplify the accounting for short-term leases.

For any short-term lease, the principal effort is with respect to obtaining information for a large volume of leases. While the exposure draft would permit election on a lease-by-lease basis to measure the liability at the undiscounted amount of the lease payments and the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs, the burden on companies to track short-term leases and to record them on a balance sheet would remain high. Eliminating the requirement to discount cash flows is helpful in a small way, but there is still a great deal of work that remains for both the preparer and the auditor.

We recommend two areas for simplification: (i) the boards should reconsider whether short-term leases should be treated on a lease-by-lease basis versus permitting election to treat short-term leases as a basket, and (ii) record lease payments by lessees under short-term leases in the income statement. Lessees should have the option to recognize short-term leases on a straight-line basis over the term, similar to accounting methods in use today for operating leases. This would better match cash flows and handle the accounting and measurement in a more practical manner. Further, this method is already in use and well understood by preparers, auditors and users of the financial statements.

It is our belief that the cost and effort to comply with the full requirements of the proposed Exposure Draft for short-term leases outweighs the benefit of providing additional information to the users of financial statements. We believe that most financial statement preparers will elect to follow simplified requirements due to the reduced burden of reporting. The accounting treatment for short-term leases would remain consistent and comparable across most preparers.

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?*
B. *Do you agree with the criteria in paragraphs 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?*
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 generally agree that a lease is defined appropriately. However, we believe that the boards need to provide further guidance in identifying the difference between a lease and a non-executory contract. The fact that capitalized leases on the balance sheet will no longer be an indication as to who bears the risks and rewards of ownership are a hindrance to users of the financial statements. We feel that the boards' objective of meeting user needs will not be met on this point.

To assist entities to determine whether an arrangement is within the scope of the proposals (i.e. is a lease contract or a service contract) the exposure draft carries forward the guidance in IFRIC 4 *Determining whether an Arrangement contains a Lease*. Under the current standards where companies could easily expense items, concern over appropriate guidance as laid out in paragraphs B1-B4 was not important.

Going forward, the distinction or bright line between a service contract and a lease will become increasingly important and consequently we believe that there is a need to further clarify the differences. The following examples illustrate circumstances where the interpretation could be mixed: Consider the traditional aspect where a business would lease the hardware in their data center and contract with the solution provider for support. At the end of the term, solution providers would give the customer the option of either upgrading equipment or purchasing the hardware and extending the warranties. The segregation between the leased hardware and the service is fairly clear. Under a managed service environment, models such as "hardware as a service" or HaaS, entities no longer have to take delivery of the equipment but does contract for functionality and service. Another area where service contract vs lease may raise concerns is for pipeline capacity.

Scope

Question 5: Scope exclusions

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 (paragraphs 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 support the scope limitations in the Exposure Draft which exclude leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources.

In particular, we agree with the recommendation that leases of intangible assets be excluded from the scope of the proposed IFRS until the matter of accounting for intangible assets is addressed in a broader context. However, in view of the materiality of the asset class and the fact that the boards have found no conceptual reason to exclude intangible assets from the standard, we would support giving some priority to the intangible asset project in order to remove uncertainty and confusion.

We encourage FASB to align their work with IASB existing standards and to move forward on such issues as measurement of investment properties at fair value.

Question 6: Contracts that contain service components and lease components
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 lease components (paragraphs 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 component in accordance with the lease requirements, and the service component 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?

Where the service component in a contract that contains both service and lease components is not distinct, consistent accounting treatment should be applied to the entire contract. This proposal is consistent with the exposure draft “Revenue from Contracts with Customers”. The exposure draft “Revenue from Contracts with Customers” states that the components of a contract should be bundled until a distinct group of goods and services can be identified and then accounted for as a single performance obligation. We suggest clarifying that no single indicator determines whether a performance obligation is distinct and that the indicators should be considered in their entirety. If this bundled performance obligation meets the criteria of a lease it should be accounted for as such.

Requiring a different approach for lessors applying a derecognition approach adds complexity and provides little value to users.

We note that there is no guidance for lease inducements.

Question 7: Purchase options
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?

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 term that is more likely than not to occur, taking into account the effect of any options to extend or terminate the lease (paragraphs 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).*

A lease contract should be considered as terminated when an option to purchase the underlying asset is exercised and that a contract should be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised. We believe that the alternative to this position (treating the purchase option as a term of the lease that should be accounted for as if it were an option to extend the lease term) will unduly complicate accounting without commensurate benefits.

Question 8: Lease term

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 do not 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. This terminology is extremely confusing and the illustrative example in paragraph B17 of the ED adds to this confusion making it potentially misleading.

We propose that the lease term should be *the most likely lease term based* on *management's best estimate*. This would appropriately include the effect of any option to extend or terminate a lease to the extent that it is reasonably likely to be extended with consideration for contractual, non-contractual and business factors including management intention and past practice. The most likely term would be to reflect the best estimates of the economics of the transaction (refer to our comments for Question 10).

Question 9: Lease payments

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?

Contingent rentals

We strongly disagree with including contingent rentals in the measurement of assets and liabilities arising from a lease where they are based on usage or performance. Contingent amounts, based on usage or performance, are not probable obligations on execution of an agreement but only become a probable obligation as usage or performance occurs. Liabilities arise from past transactions or events. Further, a decision to incur future expenditures in order to generate revenues does not meet the definition of a liability until the goods are ordered and received or the services are rendered. For example, execution of a supply agreement does not in itself create an obligation until goods are ordered and received under that agreement.

The boards have expressed concern that *not including* contingent rentals in the measurement of assets and probable liabilities arising from a lease would create structuring opportunities. Their concern is that companies could structure arrangements to include primarily contingent payments and accordingly significant lease assets and liabilities would remain “off balance sheet”. This is unlikely to occur - making lease arrangements more contingent on use is unlikely in practice because such arrangements would impose undue risk on the lessor unless some minimum usage was required in the agreement. Furthermore, we would suggest that including contingent rentals in the measurement of assets and liabilities arising from a lease would create biases in estimating at inception given proposed measurement requirements (i.e. an income boost or reduction could be achieved simply by reassessing initial estimates with a resultant “significant” change (refer to our response in Question 10).

The significant judgment and cost to preparers to estimate contingent amounts at inception, and periodically thereafter, would not provide more reliable or useful information to users than simply recording amounts as incurred. For example, usage of an asset over a 25 year life would be very difficult to predict with a high level of reliability. Performance levels would be even more difficult to predict. These estimates become an even greater concern as the term of the lease becomes longer since a single change in a variable can lead to significant changes from one period to the next. Considering multiple changes to multiple variables will compound this issue. We note that the boards have proposed that <u>lessors</u> should only include contingent rentals if they can be reliably measured.

As suggested by some board members, a proposed solution to this problem would be to only recognize contingent amounts based on their *nature*. We agree with this proposal. Contingent rentals based on both usage and performance does not give rise to a liability and should therefore be recorded as an operating cost when incurred. However, if *minimum production or sales amounts* are stated in the lease agreement, then there will be a probable obligation for lease payments of at least the amount based on that set minimum production or sales. We further propose that to continue to disclose arrangements with significant contingent amounts provides sufficiently reliable and useful information without the ability to create undue management bias. It is important to note that the small group of users who could potentially benefit from the current proposals already obtains needed information from current required disclosures.

Since FEI Canada includes representatives from many industries, we have several examples where a "one size fits all" approach will not be appropriate in all applications. Contingent rentals are prevalent across a variety of industries and the nature of contingent rentals varies significantly in practice. Some high level examples include:

- Canadian airport authority leases with terms in excess of 60 years where ground rent is calculated and payable solely as a percentage of revenues on a graduated scale basis.

- Long term power purchase agreements based on asset availability and consumer demand.

- Real estate rentals based on levels of sales and economic conditions.

- Photocopy equipment leases that are based on usage.

Across these industries, representatives concur that contingent rentals are extremely difficult to estimate with any degree of reliability given the long-term nature, complexity and variability of these arrangements. Providing leased asset and liability information to users that is based on estimates that cannot be reliably measured, or subsequently verified, diminishes the usefulness of that financial information and may be misleading.

While we strongly disagree with the inclusion of contingent rentals in the measurement of assets and liabilities arising from a lease where they are based on usage or performance, should the boards choose to include contingent rentals, the *most likely approach* provides a more appropriate basis for measurement. The most likely payment based on *management's best estimate* would be more supportable and would provide more reliable and useful information to users on a go forward basis under current reassessment proposals if a *significant* change is determined.

Term option penalties and residual value guarantees

While we strongly disagree with including non-committed contingent rental payments in the measurement of assets and liabilities arising from a lease, we agree with the inclusion of term option penalties and residual value guarantees using the most likely approach.

If management determines that the most likely lease term would result in a term option penalty being incurred, then a term option penalty would appropriately be included in the calculation. We see residual value guarantees as different in nature from non-committed contingent rental payments, since these guarantees are an actual lessee commitment. Measurement that is based on the most likely outcome derived from *management's best estimate* would be more supportable and would provide more reliable and useful information to users under current reassessment proposals should a *significant* change be determined.

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?

We believe that these components are distinct from the contractually unavoidable rental payments and should be subject to separate recognition and measurement criteria.

All of the challenges noted above with respect to inclusion of contingent amounts for lessees are equally relevant and of concern to lessors. Lessee and lessor proposals with regards to contingent rentals should be consistent. Reliability in measurement is equally important for lessees and lessors.

Consistent with our lessee views, amounts that are contingent on the use or performance of the leased asset should not be included in the measurement of the right to receive lease payments for lessors. However, if there is a minimum usage or performance amount specified in the lease contract, lease payment amounts based on this minimum usage or performance should be included. We agree that expected payments under term option penalties and residual value guarantees should only be included in the measurement of the right to receive lease payments if they can be reliably measured.

Question 10: Reassessment *Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease 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? Why or why not? If not, what other basis would you propose for reassessment and why?*

The term "*significance"* is highly subjective and there will be considerable variability in practice based on the proposed requirements with respect to the *significance* of a change in the liability to make lease payments or in the right to receive lease payments. This will have a considerable impact on comparability of financial information and usefulness to users and the boards should provide further guidance in this regard.

We agree that lessees and lessors should remeasure assets and liabilities arising under a lease 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.*

We strongly disagree with including *contingent rental payments* based on usage and performance in the calculation of assets and liabilities arising under a lease unless there is a minimum usage or performance level set out in the lease contract. As noted in our response to Question 9, contingent amounts are difficult to estimate with any degree of reliability. Given the numerous variables in estimating contingent rentals, even the slightest change can have a significant and potentially misleading impact. Accordingly, remeasurement of contingent rentals could not be performed without significantly impacting the reliability and usefulness of information to users.

We support re-measurement when changes in facts or circumstances indicate that there is a *significant* change in the liability to make lease payments arising from changes in other contingent payments, specifically term option penalties and residual value guarantees. As noted in our response to Question 9, if management determines that the most likely lease term would result in a term option penalty being incurred, then a term option penalty would appropriately be included in the initial lease asset and liability calculation and remeasured accordingly. Further, in our view, residual value guarantees are different from non-committed contingent rental payments, since these guarantees are an actual lessee commitment, which would appropriately be included in the initial lease asset and liability calculation and remeasured accordingly.

Question 12: Statement of financial position

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?

We disagree and believe that lessees should present separately from property, plant and equipment, if material, on the face of the balance sheet the right to use assets and liabilities. We also believe that it would be appropriate to disclose this separately in the notes to the financial statements.

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 (paragraphs 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?

We believe that the boards should clarify the manner in which the net asset and liability are presented in the current or non-current section of a classified statement of financial position. An entity should be able to elect separate presentation in the primary statements or determine whether it is adequate to provide information in the notes based upon materiality.

C. Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

We believe that the boards should clarify the manner in which the net asset and liability are presented in the current or non-current section of a classified statement of financial position. An entity should be able to elect separate presentation in the primary statements or determine whether it is adequate to provide information in the notes based upon materiality.

D. Do you agree that lessors 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?

For subleases, the exposure draft proposes netting the sublease with the head lease right to use asset for the intermediary lessor, but the effect is to disclose the lease on a gross basis on the books. We note that most subleases are likely to be reflected under the performance obligation approach. As stated, we believe that the entity should determine whether separate presentation is necessary in the primary statements or whether it is adequate to provide the information in the notes based upon materiality.

Question 13: Statement of comprehensive income
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?

We believe that additional information would be best disclosed in the notes to the financial statements. Separation on the income statement may focus attention on leasing activities instead of on normal operating activities. As stated, we believe that the entity should determine whether separate presentation is necessary in the primary statements or whether it is adequate to provide the information in the notes based upon materiality.

Question 14: Statement of cash flows
Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 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?

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We believe that additional information would be best disclosed in the notes to the financial statements. Separation on the income statement may focus attention on leasing activities instead of on normal operating activities. As stated, we believe that the entity should determine whether separate presentation is necessary in the primary statements or whether it is adequate to provide the information in the notes based upon materiality.

We do not believe that lease cash flows should necessarily be classified entirely as financing. In practice, entities enter into leases for many reasons, not always to do with financing. The model proposed by the boards approaches leases as purchases of assets financed by a specific debt, which is not always the case. We recommend that the boards look at specific situations where an entity may enter into a lease for reasons other than for financing, such as in Canada the airport contingent leases with the Crown and power purchase agreements.

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

We concur that lessees and lessors should disclose quantitative and qualitative information if material in the notes. We do not believe that sensitivity analysis is useful to users of the financial statements in this instance.

Transition
Question 16

A. *The exposure draft proposes that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186– BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?*

We agree with the simplified retrospective approach.

B. *Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?*

While the work involved to do full retrospective application of lease accounting requirements would be onerous, we do believe that it should be permitted for those entities that are willing to undertake the additional effort and cost as it would yield a more faithful representation of the economics.

C. *Are there any additional transitional issues the boards need to consider? If yes, which ones and why?*

The final standard needs to address additional transitional issues such as sale and leaseback transactions and in-substance purchases and sales.

Benefits and costs

Question 17 *Paragraphs BC200–BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?*

We note that the Board has considered the costs and benefits of the proposals in paragraphs BC200 to BC205 of the exposure draft. Under the current form of this exposure draft, we do not agree that the benefits would outweigh the costs and believe that considerable uncertainties remain regarding the benefits of the proposals to users.

We are concerned that the burden for financial statement preparers to apply all aspects proposed to be significant. For example, one area is the treatment of short-term leases on a lease-by-lease basis as proposed by the boards is impractical to apply in the real world. We also question whether preparers have adequate tools, resources, internal controls and processes, and information and accounting systems to complete not only the tasks required in order to meet the needs of the exposure draft in its current form but also to track deferred and permanent tax treatments.

Other comments

Question 18

Do you have any other comments on the proposals.

Operations and Finance resources will be required to support implementation and ongoing support especially for companies with large lease portfolios.
Systems will have to be built/bought/modified to handle the multiple calculations and assessments and then be able to deal with the amortization and interest and asset and liability calculations and financial reporting interfaces.
There does not appear to be any language on how to deal with lease inducements?

For entities that do not go to the capital markets to borrow money, it is difficult to determine the incremental borrowing rate to use to do the PV calculations?
Under Par 17 the relief provided is really not helpful as all the leases need to be reviewed before determining if any significant changes have occurred.
Ascertaining the executory costs for the PV calculations may be difficult for some lessees that have structured net leases.