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17 July 2009

Sir David Tweedie, Chairman  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH

Dear Sir David,

**Re: Discussion Paper, Leases: Preliminary Views**

Deloitte & Touche Tohmatsu (“DTT”) is pleased to respond to the Discussion Paper, Leases: Preliminary Views (the “Discussion Paper” or the “DP”). We support the efforts of the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) (collectively the boards) to improve the standards on the accounting for leases. The current accounting for leases is an often-used example of accounting guidance that allows for structuring opportunities, which result in many assets and liabilities being off-balance sheet. We do not believe that economically similar arrangements should receive different accounting nor do we believe a small difference in economics should completely change the accounting results. We believe all lease transactions should be accounted for using a single model that results in the recognition by a lessee of an asset for its right to use and a liability for its obligation to pay rentals.

We have spent a considerable amount of time discussing this issue and reached out to many professionals within the DTT network to gather thoughts about how the boards should best move forward with this project. In so doing we have, through our network, also received comment from various external organisations having experience in this area which have helped us form our views. Many have expressed concern about the significant cost and effort that will be required to apply the proposed model, particularly system changes and procedures that will need to be put in place. For example, many multinational companies with thousands of leases in different jurisdictions are concerned about the cost and effort associated with the proposed requirements to assess the likelihood of renewals and contingent rent at, and subsequent to, lease inception. It is evident to us that the boards considered complexity in formulating many of their preliminary views within the DP. We are very supportive of this and believe that a high-quality accounting standard does not need to be complex. As the boards move forward with the leasing standard, the consideration of costs and benefits should remain an integral part of their standard setting processes. To this end, we strongly believe the boards should in the near term perform field testing with preparers and should reach out to various constituency groups, including users, to ensure that the benefits of the proposed model exceed its costs.

We continue to be very supportive of the convergence efforts between IFRS and U.S. GAAP around high quality standards and believe the boards should be working together on an improved high-quality lease standard. However, we are concerned that many of the preliminary views of both boards differ. We believe it is very important to have one set of high-quality global standards. Besides creating a truly level playing field for companies around the globe, having a single set of standards will eliminate the potential for accounting arbitrage between U.S. GAAP and IFRSs. Therefore, we believe that the IASB and FASB should issue identical standards on leasing and all other future convergence standards.

We do not consider lease accounting to be a high priority project at this very important time, when the boards' attention should be focussed on resolving other, urgent issues arising from the financial crisis, for example the financial instruments project. We therefore urge the boards to consider their priorities carefully.

Formulating our view on the appropriate next steps for the boards has been particularly challenging and the subject of much debate. During our discussions, it quickly became evident that there was no consensus on a single recommendation. The various thoughts we gathered can be summarised into two distinct views that are discussed in the following paragraphs. Notwithstanding the fact that we could not reach a consensus, there was strong support that the boards need to perform field testing with preparers and reach out to various constituency groups, including users, to ensure that the benefits of any proposed model exceed its costs.

Some individuals within the DTT network strongly believe that, should the boards decide that the recognition of all leases "on balance sheet" is critical in the short term, the boards should focus on lessee accounting only (as well as the limited lessor accounting issues that must be addressed as part of lessee accounting, e.g. subleases). For remaining lessor accounting issues it is likely to take considerable time to develop a conceptually consistent accounting model. Lessor accounting issues should not impede the progress on addressing the accounting for lessees nor should it impede the progress on other priorities of the boards such as the financial instruments project. As a result, these individuals are not supportive of issuing a comprehensive lease standard. Instead, they believe the boards should issue a separate standard on lessor accounting at a later date after appropriate due process.

Other individuals within the DTT network have significant concerns about the boards issuing a leasing standard in the short-term that is neither high-quality nor comprehensive. Because of these concerns, these individuals are not in favour of the boards focusing on lessee only issues and strongly believe that the boards should take the necessary time to develop a comprehensive leasing standard that addresses all issues for both lessee and lessor accounting. They consider that, in developing the leasing standard, it is critical that the boards consider the interaction of the leasing project with other on-going projects such as conceptual framework, revenue recognition, consolidation, derecognition and financial instruments. These individuals strongly believe that the boards should issue a DP on lessor accounting prior to issuing an exposure draft on lessee and lessor accounting. Taking the time to develop a comprehensive standard will help ensure that the conclusions reached are conceptually consistent between lessor and lessee

accounting and the boards' other projects and will reduce the need for the boards to issue additional implementation guidance at a later date.

As an overall comment, we believe the boards need to explain better how the preliminary views in the DP reconcile to the definitions of assets and liabilities in their conceptual frameworks. For example, based on preliminary views, a lessee would evaluate at lease inception the probability that a contingent event would occur in the future for determining lease term and rental payments. While we understand the rationale that the right of use asset might include the effect of renewal options because the lessee can "control" the asset during the renewal periods by its ability to exercise its renewal option, it is not as understandable on the liability side because the obligating event does not occur until the lessee exercises its renewal option. The same could be said for contingent rents. Many believe that the lessee does not have an unconditional obligation to pay contingent rent until the contingency has been met. We support the boards' preliminary views that a lease should not be evaluated using a components approach but rather a holistic approach because using a components approach would increase complexity and costs to preparers. Therefore, consistent with a holistic approach, we believe renewal rights and contingent rents should be considered at lease inception for the purpose of determining the right to use asset and obligation to pay rentals. However, we believe the boards should better explain their rationale regarding the recognition of a liability in these situations and how this can be reconciled to the framework.

We understand the concerns expressed by many that a scope exception for immaterial leases is necessary in order to relieve the burden of applying a lease standard to what can amount to thousands of leases for some companies. We are not in favour of a "bright-line" exception, because of the difficulty in drawing a clear distinction between material and immaterial leases and the concern that a bright-line exception will only perpetuate the development of a rules-based approach. However, we believe it would be helpful for the boards to state specifically in the final standard that the requirements of the standard need not be applied to immaterial leases and that materiality should be evaluated individually and in the aggregate.

Consistent with our view that leases should be evaluated using a holistic approach, we support the boards' view that renewal options should be considered in determining the lease term at lease inception. However, although we agree with the proposed principle that the assessment should be based on the most likely outcome, we strongly disagree with the proposed methodology to achieve this. Instead, we support a methodology that is consistent with IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, based on the individual more-likely-than-not outcome. Using this methodology, a lessee would evaluate each potential lease term individually to determine the longest potential lease term that is more-likely-than-not to occur. We believe the same methodology should be used to determine the amount of contingent rentals that should be included as part of the right-of-use asset and obligation to pay rentals at lease inception. Notwithstanding our support for the most likely outcome in principle, we acknowledge the concerns of many about the potential complexity and the associated costs that will result and believe that the boards should in the near term perform field testing with preparers and should reach out to various constituency groups, including users, to ensure that the benefits of the proposed approach exceed its costs.

The DP requests views on a number of issues relating to lessor accounting. We declined to respond to most of these questions because of the lack of analysis by the boards on these particular issues. In line with our comments above, we believe lessor accounting in many ways is more complicated than lessee accounting and requires a well thought-out approach. We will respond at a later date when the boards have considered the various viewpoints and have formulated their preliminary views on lessor accounting.

Our detailed responses to the DP questions are included in the Appendix to this letter.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0) 207 007 0907.

Sincerely,

A handwritten signature in black ink, appearing to read "Ken Wild", written over a horizontal line.

**Ken Wild**  
**Global IFRS Leader**

## **Appendix:**

### ***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 do not object to the boards temporarily basing the scope of the proposed new lease accounting standard on existing lease standards as long as the boards eliminate the differences in scope between U.S. GAAP and IFRSs before the final Standard is issued. In addressing the scope, the IASB should consider adjusting the definition of a lease to address a difficult practice issue that is currently encountered with respect to lease accounting. Specifically, IAS 17, *Leases*, defines a lease as “an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.” Questions have arisen as to whether an agreement needs to be for a contractually agreed upon period of time to be considered a lease. For example, there are agreements that convey to a party the right to use an asset but the time period is not specified. The FASB Statement No. 13, *Leases*, definition is different in this respect because it states that a lease is “...**usually** for a stated period of time [Emphasis added].” We believe the IASB should use the Statement 13 definition that includes the word “usually” in the new leases standard.

We also believe the guidance in SIC 27, *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*, is helpful in evaluating arrangements and encourage the boards to incorporate the guidance from this interpretation into the final Standard.

The boards should also take an opportunity to reconsider the current guidance in IFRIC Interpretation 4, *Determining whether an Arrangement contains a Lease* and EITF Issue No. 01-8, *Determining Whether an Arrangement Contains a Lease*. Although we believe the principles underlying these interpretations are still appropriate, we observe that it is often difficult under these interpretations to differentiate between a lease and service contract. For example, a hotel management company may enter into a contract with an owner of a hotel to manage the day-to-day operations of the hotel. Often the contracts are structured such that it is not clearly evident whether the contract should be considered a lease of the hotel or a service contract. Another example is a royalty arrangement that provides a third party with the exclusive right to use a trade name in return for a royalty fee. It is often not clear under IFRIC 4 whether the right to use the trade name should be considered a lease. Additionally, the application of these interpretations is often very difficult because they focus on “outputs” to assess the “right to use” specific assets. This has been further complicated because many of the arrangements considered when these interpretations were initially issued have evolved since that time. For example, in evaluating whether a power purchase or sale arrangement contains a lease, one must currently understand the “outputs” of the facility. When the interpretations were initially

issued, the “output” from a power plant was generally limited to electricity or possibly steam or other by-products. Within the last few years, the structure of many power purchase and sale contracts has changed to include many intangible elements (such as capacity credits and renewable energy credits) which have raised questions as to whether these items represent an output of a power plant for the purposes of applying lease accounting. While these deliverables are not tangible, they are intangible attributes associated with the power plant that are often retained by the owner or marketed or used by a party other than the purchaser of the electricity.

***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 do not believe that non-core asset or short-term leases should be excluded from the scope of the proposed new Standard. There is no conceptual basis for excluding these types of leases, and trying to draw a distinction between core and non-core assets or short-term and long-term will be very difficult and will only perpetuate the development of a rules-based approach. We understand the concerns expressed by many that a scope exception for immaterial leases is necessary in order to relieve the burden of applying the standard to what can amount to thousands of leases for some companies. Although we are not in favour of a “bright-line” exception, we believe it would be helpful for the boards to state specifically in the final Standard that the requirements of the Standard need not be applied to immaterial leases and that materiality should be evaluated individually and in the aggregate.

***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 in principle with the boards’ analysis that the rights and obligations of a simple lease contract meet the definition of an asset and liability, respectively. The boards refer simply to the lessor’s obligation to deliver an asset with delivery being the point at which control passes. Lessors may also have an obligation to continue to provide access beyond this date. Consider an example of a high-rise office building where a lessor and lessee enter into a lease for a single floor. The obligation of the lessor to deliver the floor to the lessee is separate from the lessor’s ongoing obligation to provide continuing access for example via lifts. The boards should clarify that the obligation to provide continuing access does not affect the date that control passes.

The boards should also consider providing guidance on “in-substance delivery” of the leased property. This is particularly relevant when a contract represents a lease under IFRIC 4 or EITF 01-8 and the leased asset is never delivered. Although the asset (for example, a power plant) is never actually delivered to the lessee, the terms of the

purchase contract result in the owner (lessor) transferring the right to use the asset to the purchaser (lessee).

In addition, the boards should consider that there may be differences in the term “legally enforceable” between countries when the right of use is established.

**Question 4**

*The boards tentatively decided to adopt an approach to lessee accounting that would require the lessee to recognise:*

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

*Appendix C describes some possible accounting approaches that were rejected by the boards.*

*Do you support the proposed approach?*

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

We support the proposed approach as we believe it will simplify the accounting for lease transactions, better reflect the substance of such transactions and increase comparability for financial statement users.

**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 recognises:*

- (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?*

While we acknowledge the arguments against the proposed approach, on balance we believe it is the most practical approach given the problems identified with the components approach in paragraph 3.32 of the Discussion Paper.

**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 do not fully 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. In particular, we disagree with the DP view that it is a simpler approach. Rather, we believe that lessees should use the implicit rate inherent in the lease if it is known. We believe this is the best approach because the implicit rate is the rate of return on the actual transaction and is therefore more relevant and reliable than the incremental borrowing rate which is based on a hypothetical transaction. We understand that often the lessee will not be able to obtain the information that is necessary to calculate the implicit rate. In those situations, use of the lessee's incremental borrowing rate would be appropriate. We believe the boards should provide specific guidance on how such a rate should be determined, given the many variables that can go into the calculation of the incremental borrowing rate.

If the boards agree that the implicit rate should be used, where known, but insist that reassessment is required, additional guidance will be needed to determine how reassessment of an implicit rate would be performed (note in Question 10 our disagreement with the reassessment proposal).

In addition, the boards should make the definition of "incremental borrowing rate" consistent between IFRS and U.S. GAAP. The definition under Statement 13 does not include the requirement to look to the rate of interest the lessee would have to pay on a similar lease. Specifically, the definition under Statement 13 is "...the rate that, at the inception of the lease, the lessee would have incurred to borrow over a similar term the funds necessary to purchase the leased asset" while the definition under IAS 17 is "...the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset."



***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 the tentative decision to measure the lessee's right of use asset initially at cost because this is consistent with guidance for the initial measurement for most non-financial assets such as property, plant, and equipment and intangible assets.

***Question 8***

*The boards tentatively decided to adopt an amortised 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 favor and why.*

The obligation to pay rentals creates, in our view, a new category of liabilities, for which we agree with an amortised cost-based approach to subsequent measurement of the obligation to pay rentals. However, we believe that subsequent measurement for the right-of-use asset should be consistent with the relevant accounting guidance that would be applied to the underlying leased asset if the asset was owned rather than leased. For example, a lessee would apply IAS 16, IAS 38, or IAS 40, respectively, if the underlying leased asset is an item of property, plant, or equipment, an intangible asset, or an investment property.

***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 do not believe that the fair value option should be allowed for the obligation to pay rentals. In our view the obligation to pay rentals is different from other types of financial liabilities because it is inextricably linked to the right-of use asset and therefore the leasing standard should specify the measurement requirements. Also, we believe providing a fair value option will increase complexity and reduce comparability.

**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.*

No.

We do not believe a lessee should revise its obligation to pay rentals for changes in the incremental borrowing rate (or implicit rate if the boards agree with our proposal in Q6) because it is inconsistent with existing requirements for subsequent measurement in IFRS or U.S. GAAP for many liabilities under the amortised cost approach. Additionally, the costs and complexity for preparers will likely outweigh the potential benefits. Although we strongly encourage the boards not to require the obligation to pay rentals to be revised for changes in the incremental borrowing rate (or implicit rate), if the boards should decide to require such a revision, we believe it should be made only when there is a change in the estimated cash flows.

**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 taken by the boards?*

*If you disagree, please explain why.*

We support the proposed approach because existing IFRSs and U.S. GAAP are inconsistent, and the alternative approach would result in less comparability. In particular, we do not believe the fair value option in other Standards should be available for such lease obligations (please also see our comments to Q9).

**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 amortisation or depreciation in the income statement.*

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

We believe the decrease in the value of the right-of-use asset for all leases should be presented as amortisation or depreciation expense in line with the accounting requirements under IAS 16, IAS 38 and IAS 40, as appropriate.

**Question 13**

*The boards tentatively decided that the lessee should recognise an obligation to pay rentals for a specified lease term ( i.e., 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 what alternative approach you would support and why.*

Consistent with our view that leases should be evaluated using a holistic approach, we support the boards' view that renewal options should be considered in determining the lease term at lease inception. However, although we agree with the proposed principle that the assessment should be based on the most likely outcome, we strongly disagree with the proposed methodology to achieve this. Instead, we believe a methodology consistent with current IAS 37 based on the individual more-likely-than-not assessment should be used in determining the lease term.

The proposed methodology based on the “most likely lease term” may result in a lease term that is not indicative of the expected lease term due to the inclusion of multiple fixed-price renewal options in the lease. For example, consider a lease that has a 10-year base lease term with one 5-year renewal option. There is a 45% chance that the lessee will not renew and a 55% chance that the lessee will opt to renew for 5 years. The most likely lease term under the proposed model would be 15 years. However, the lessee could structure the lease so that the term is 10 years with two renewal options (at the end of 10 years with a 4-year renewal and at the end of 14 years with a one-year renewal). By structuring the lease in such a way, the proposed “most likely lease term” methodology would require the lessee to assign probabilities to the base lease term and the two renewal options. Assume that the lessee estimates that there is a 45% chance that the lease term is 10 years, a 25% chance that the term is 14 years, and a 30% chance that the term is 15 years. Under the proposed “most likely lease term” methodology, the lease term would be 10 years when in actuality there is a 55% probability the lease term will be at least 14 years. We disagree with this result of the proposed methodology.

We support a methodology based on the individual more-likely-than-not outcome and believe that this methodology would address the issues raised above. Using this methodology, a lessee would evaluate each potential lease term individually to determine the longest potential lease term that is more-likely-than-not to occur. In applying this “more-likely-than-not” methodology to the example above, there is a 100% chance that the lease term will be 10 years, a 55% chance that the lease term will be 14 years and a 30% chance that the lease term will be 15 years. Consequently, our proposed approach would result in a lease term of 14 years, being the longest potential lease term that is more-likely-than-not to occur.

As discussed in our cover letter, although we do agree in principle that a lessee should consider renewal options in determining the lease term at lease inception, we acknowledge the concerns of many about the potential complexity and the associated costs that will result from applying this proposed approach. We strongly believe the boards should in the near term perform field testing with preparers to assess whether the proposed approach is operational and should reach out to various constituency groups, including users, to ensure that the benefits of the proposed approach exceed its costs.

The boards should also consider if the methodology adopted in the final Standard should be different in situations in which the renewal option is in the control of the lessor rather than the lessee.

**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 recognised 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 what 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.*

No. We strongly disagree with the proposed continuous reassessment of the lease term as we do not believe that a continuous reassessment is necessary nor do we believe it is practicable for many companies. We strongly believe that reassessment of the lease term should be required only when an indicator shows clearly that there has been a significant change to the original lease term and that change will have a material impact on the financial statements. We believe this approach would still provide users with relevant information but it would be considerably less difficult and costly to implement in practice than the boards' proposed approach because lessees would not have to document at the end of each reporting period that they reassessed each of their leases (absent a clear indicator that there has been a significant change). This is especially true for lessees that have a significant number of leases to evaluate. We strongly recommend that the boards' consider which indicators represent triggers for reassessment of the lease term and provide guidance in their final standards.

We support the approach of changes in the obligation being recognised as an adjustment to the carrying amount of the right-of-use asset.

**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 agree with the proposed approach?*

*If you disagree with the proposed approach, please describe what alternative approach you would support and why.*

We agree that purchase options should be accounted for in the same way as options to extend or terminate the lease, because providing a purchase option is essentially the same as providing renewals that extend over the entire economic life of the lease.

**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, what alternative approach would you recommend and why?*

We believe the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements because this approach is consistent with our view that leases should be evaluated using a holistic approach. We believe recognising the individual components of a lease separately would increase complexity as well as costs and would reduce comparability for financial statement users.

**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, this 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.*

In principle, we believe that the measurement of the lessee's obligation to pay rentals should generally be consistent with the approach for determining the lease term. In our response to question 13, we strongly disagree with the boards' proposed methodology. Instead, we strongly support a methodology consistent with IAS 37 that reflects the individual outcome that is more-likely-than-not to occur.

Therefore, for an individual lease, the obligation to pay rentals should reflect the single more-likely-than-not rental payment. Similarly, where multiple leases have rental obligations that are contingent on a single factor (e.g. total sales of the entity), the obligation should reflect the single more-likely-than-not rental payment. However, where there is a large population of leases with contingent rents based on a single factor and similar probabilities of independent outcomes (e.g. multiple photocopiers with rentals based on use), we would support the IASB's proposed approach for measuring the lessee's obligations to pay rentals under those leases based on a probability weighted average because this approach is consistent with the "expected value" approach to large populations of items in IAS 37.

Notwithstanding our support in principle for a methodology to measuring the lessee's obligation to pay rentals that is consistent with the methodology to determine the lease term, we strongly believe the boards should in the near term perform field testing with preparers to assess whether the proposed approach is operational and should reach out to

various constituency groups, including users, to ensure that the benefits of the proposed approach exceed its costs.

***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 support the proposed approach because it would be very difficult to estimate future changes in indexes or rates over a long period of time.

***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 a continuous remeasurement of the lessee's obligation to pay rentals for all changes in estimated contingent rental payments as we do not believe that such a continuous remeasurement is necessary nor do we believe it is practicable for many companies. We strongly believe that remeasurement of the lessee's obligation to pay rentals for changes in estimated contingent rental payments should be required only when an indicator shows clearly that there has been a significant change to the original assumptions used and that change will have a material impact on the financial statements. In other words, we do not believe that companies should be required to monitor and re-estimate their original assessments to identify whether there have been any changes to estimated contingent rental payments; instead a remeasurement of the obligation should only be required where an observable event indicates that there has been a significant change.

Consistent with our response to question 14, we believe this approach would provide users with relevant information but it would be considerably less difficult and costly to implement in practice than the boards' proposed approach because lessees would not have to document at the end of each reporting period that they reassessed each of their leases (absent a clear indicator that there has been a significant change). This is especially true for lessees that have a significant number of leases to evaluate. We strongly recommend that the boards' consider which indicators represent triggers for remeasurement of the lessee's obligation to pay rentals and provide guidance in their final standards.

**Question 20**

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

- (a) recognise any change in the liability in profit or loss*
- (b) recognise 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.*

We support the approach of recognising any change in the liability as an adjustment to the carrying amount of the right-of-use asset. We believe changes in the obligation to pay rentals in effect reflect a revised estimate of the value of the underlying leased asset and are therefore better reflected as an adjustment to the asset. Also, this approach is consistent with how adjustments are proposed to be recognised for changes in the lease term and therefore translates into an overall simpler, coherent accounting Standard. However, as discussed in our cover letter, we believe that the boards should perform field tests with preparers to assess whether the proposed model is operational and should reach out to various constituency groups including users to ensure that the benefits of the proposed model exceeds its costs.

**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?*

As discussed in our cover letter, we support the boards' preliminary views that a lease should not be evaluated using a components approach but rather a holistic approach because a components approach would increase complexity and costs to preparers and reduce comparability and because the lease is negotiated as a single contract. Consistent with this holistic approach, we agree in principle with the proposed approach that residual value guarantees should not be separated from the lease contract and accounted for as derivatives. Notwithstanding our support for this view, we acknowledge that separating the residual value guarantee from the lease contract may have more conceptual merit because the change in residual value is not necessarily directly related to the use of the leased asset. Although we agree in principle that the recognition and measurement for residual value guarantees is the same as those for contingent rentals, we strongly disagree with the boards' proposed methodology. As discussed in our response to question 17, we strongly support a methodology consistent with IAS 37 that reflects the individual outcome that is more-likely-than-not to occur.



**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?*

While the obligation to pay rentals is different from other types of financial liabilities because it is inextricably linked to the right-of-use asset, we believe an entity should not be required but rather permitted to present the obligation separately if it elects to do so.

**Question 23**

*This chapter 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?*

We support the boards' approach of presenting the right-of-use asset in the statement of financial position on the basis of the nature of the leased item. We also support an option for separate presentation of owned and leased assets either on the face of the statement of financial position or in the notes to the financial statements. This would provide users with the information they need to differentiate leased assets from owned assets yet still providing flexibility in how lessees present the information.

**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 following issues should also be considered:

- 1) Reconsideration of EITF 01-8 and IFRIC 4 (see response to Question 1).
- 2) Lease modifications.
- 3) Build to suit transactions (EITF 97-10)
- 4) Sale-leaseback transactions.
- 5) Rental payments versus asset retirement obligations.
- 6) Allocation of leases involving land and buildings in the statement of financial position.
- 7) Initial direct costs.

**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.*

We believe that a lessor's right to receive rentals under a lease meets the definition of an asset as described in the IASB's *Framework for the Preparation and Presentation of Financial Statements* and the FASB's Concept Statement No. 6, *Elements of Financial Statements*.

**Question 26**

*This chapter 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 are not able to respond to this question due to the lack of analysis by the boards on lessor issues. We will respond at a later date when the boards have considered the various viewpoints and have formulated their views on lessor accounting.

**Question 27**

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

We are not able to respond to this question due to the lack of analysis by the boards on lessor issues. We will respond at a later date when the boards have considered the various viewpoints and have formulated their views on lessor 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 are not able to respond to this question due to the lack of analysis by the boards on lessor issues. We will respond at a later date when the boards have considered the various viewpoints and have formulated their views on lessor 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 are not able to respond to this question due to the lack of analysis by the boards on lessor issues. We will respond at a later date when the boards have considered the various viewpoints and have formulated their views on lessor accounting.