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 principally agree that the lessee should recognise a right-of-use asset and a liability to make lease payments in the statement of financial position and amortisation of the right-to-use asset and interest on the liability to make lease payments in profit or loss. Amortisation of the right-to-use asset is consistent with accounting for similar assets that are owned by the lessee. Accounting for interest on the liability to make lease payments using effective interest method is similar to accounting for non-derivative financial liabilities.

However, we believe that the Boards should articulate a clear conceptual basis for the differentiation between leases and other non-lease executory contracts, such as operating contracts or employment agreements.

Further, we believe such accounting by the lessee for <u>all non-core assets</u> may clutter the presentation of information which may be of very little relevance or significance to the users of the financial statements. As mentioned in the basis for conclusions of this ED, information about assets and liabilities arising from the lease of a printer is important to assess the operations of a printing company, but would not be important in assessing the operations of a steel manufacturing company. While we consider the Boards' discussions that there is no such distinguishment of core and non-core assets in relation to purchased assets, we believe such distinguishment is necessary in case of leased assets to exclude such assets from the accounting purview as the associated costs involved in recognition of all such assets will outweigh the benefits. As accounting for leases of non-core assets may have insignificant impact on financial statements, companies may choose not to subject it to lease accounting on grounds of materiality. However, we would have preferred for such a practical expediency to be included in the standard itself.

Further, the model proposed in the ED would entail the use of significant estimates and judgments resulting in recognition of amounts in the statement of financial position for which a great deal of uncertainty exists mainly due to inclusion of extension options and contingent rentals. We do not support the proposal of recognizing an additional liability for the probability of extension of lease under renewal option. We feel this proposal undermines the *Framework* concept of present obligation.

Question 2: Lessors

- (a) Do you agree that a lessor should apply (i) 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 (ii) 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?

We disagree to the Board's proposal of 'hybrid accounting' for lessor. While the lessees are required to follow 'right-of-use' model, the lessor accounting is based on retention of exposure to risks and benefits associated with the underlying asset ('hybrid approach'). Performance obligation approach is not consistent conceptually with the proposed lessee accounting. This results in lack of symmetry in accounting. We would prefer the Board to look at lessor and lessee accounting in a similar vein. We propose that the Board may consider settling on a single approach to lessor accounting or

alternatively requiring lessees to account for 'right-of-use' assets based on exposure to risks and benefits associated with the underlying asset.

We further do not believe that a lessor should recognize lease income at lease commencement for lease contracts for which the transfer of the underlying asset would not result in the recognition of revenue under the revenue recognition principles applied to non lease contracts. The Boards have proposed under the exposure draft, *Revenue from Contracts with Customers*, that entities recognize revenue upon the transfer of control of a good or service to the customer, whereas, the ED uses concepts of exposure to risks or benefits associated with the underlying asset to determine the timing of revenue recognition. We believe that there must be better co-ordination and harmony between the two pronouncements.

Question 3: Short-term leases

The exposure draft proposes that a lessee or a lessor should apply simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term 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, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognise lease payments in profit and 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).

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?

While we appreciate the Board's efforts to simplify the accounting requirements for short-term leases, we feel that the proposals do not sufficiently simplify the requirements. While the proposal gives an option to the lessor to elect on lease-by-lease basis not to recognise assets and liabilities arising from short-term leases in the statement of financial position, it mandates the lessees to do a 'right-of-use' accounting with an exception of giving an option to elect between undiscounted and discounted lease payments. We believe that short-term leases should be excluded from lease accounting from both lessee's and lessor's perspective without giving an option to elect on lease-by-lease basis. We strongly believe that this will ensure simplicity and improved financial reporting without costs exceeding the benefits.

Further, the proposed accounting of the Board lack symmetry in accounting where a lessor may account for a short-term lease using performance obligation approach and a lessee has to account for a 'right-of-use' asset. We would like to reiterate that short-term leases should be excluded from the purview of lease accounting. The lease income or the lease expense should be recognised in the profit or loss, as and when they are earned or incurred, as the case may be.

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 for distinguishing a lease from a purchase or sale in paragraphs B9 and B10? Why or why not? If not, what alternative criteria would you propose and why?
- (c) Do you think that the guidance provided for distinguishing leases from service contracts in paragraphs B1-B4 is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

The definition in the proposal is substantially a carry forward from IAS 17 and the 'IFRIC 4 criteria' as the basis for determining the existence of a 'right to use' a specified asset. We urge the Board should take the opportunity to reconsider the guidance surrounding the definition of a lease and the distinction between lease contracts and service contracts.

We believe that the guidance given in paragraphs B1-B4 is not sufficient for distinguishing leases from service contracts. The guidance resembles the current IFRIC4 provisions and there are a lot of challenges faced in application of these provisions. We urge the Board to take this opportunity to address these issues in the application guidance which include the following:

- The meaning of the word 'more than an insignificant amount' of output or other utility.
- The meaning of the word 'ability or right to operate' and 'ability or right to control physical access' can be explained in a detailed manner
- The meaning of the word 'fixed per unit of output' and 'market price per unit of output'

IFRIC 4 explicitly acknowledges that current lease standards do not address whether an undivided interest or pro rata portion of an asset could be subject of a lease, for example, parts of a telecom tower. We believe that the Boards must take this opportunity to address these issues and provide proper guidance.

Further, the proposal states that an entity should determine whether a contract is, or contains, a lease, at inception of the contract but does not address reassessment. Without a reassessment, the accounting treatment may no longer be a faithful representation or reflect the underlying economics of the transaction. However, reassessment should be done only when certain conditions exist as specified in the current standard.

The proposal excludes leases that contain a bargain purchase option or provide for the automatic transfer of title to the underlying asset to the transferee. These contracts are considered as purchase or sale of underlying asset and are excluded from lease accounting. This proposal is totally different from the current underlying premise of classifying such contracts as finance lease. This proposal will also result in unnecessary distinction among lease contracts. The risks of the lessee during the lease period are different from the risks of the lessor. While the lessor can part with the assets had they not been leased, the lessee cannot typically resell the assets during the period where the title is still with the lessor. However, if the Board considers such accounting to be more robust way of accounting for leases, we suggest the Board to bring about more clarity in accounting for such sale or purchase transaction.

Question 5: Scope and 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 agree with the proposed scope excluding biological assets, assets of mineral, oils and non-regenerative resources and intangible assets from the application of proposed standard.

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?

The ED requires that only the lessors applying derecognition approach to separate such components and for lessees and lessors applying performance obligation approach the whole contract shall be accounted for as lease. We believe that all services should be excluded from the amounts recognised for leases and accounted for separately by both lessees and lessors in accordance with other relevant accounting standards failing which the basic premise of the lease standard envisaging payment for right to use an asset is not met.

The presence of an immaterial lease component in an arrangement could require an entire contract to be accounted for as lease, which is misleading. Additionally, the accounting could cause the lessee's right-of-use to be valued at an amount that is higher than the underlying asset. We struggle to appreciate the rationale for how a right to use an asset could ever be greater than the asset itself. We therefore believe, that the separation of the lease and service component should be required and not elective.

Question 7: Purchase options

The exposure draft proposes that a contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus a contract is accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraph 8 and BC63 and BC64).

Do you agree that a lessee or a lessor should account for purchase options when they are exercised? Why or why not? If not, when do you think that a lessee or a lessor should account for a purchase option and why?

We agree with the proposal that a lessor and lessee should account for purchase options as a sale or purchase respectively when such option is exercised. In line with our argument on excluding certain contingent rentals, we agree with the Boards' views that the exercise price of the option is not a lease payment and should not be included in the measurement of assets and liabilities arising from a lease.

Measurement

Question 8: Lease term

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).

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 disagree to the proposal of defining lease term as 'longest possible term that is more likely than not to occur' meaning to include extension options based on probability. To be in accordance with the conceptual framework, the liability recognized by the lessee should include the lessee's unconditional obligation to make lease payments. As such, all non-cancellable and unavoidable payments owed by the lessee should be included in the recognized obligation. We believe the Board will address this issue in the final standard.

Further, leaving a scope for determining the 'longest possible term that is more likely than not to occur' may result in both lessees and lessors considering different contract terms and accounting them differently.

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 contract should be included in the measurement of lease assets and lease liabilities 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?

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?

While we agree that contingent rentals (some but not all) should be included in the measurement of assets and liabilities arising from a lease, we believe only contingent payments that are not within the control of the lessee should be included in the calculation of lease payments using a best estimate approach. We acknowledge that the inclusion of contingent payments outside the control of the lessee will add complexity and cost to the preparers but ignoring the same may also be incorrect. However, contingent payments which are within the control of the lessee should not be included in the lease payments.

For example, consider contingent rent based on a percentage of sales. Determining numerable outcomes, along with their timing and probability will entail complex calculations, and require companies to forecast activities beyond their normal planning or budgeting cycle. Further, despite the onerous and cumbersome calculations, a liability would be recognized for an obligation that may not occur.

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 obligation or receivable 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?

We agree that there should be reassessment of estimates of both lease terms and contingent payments. We agree with the Board's assessment in the basis of conclusion that users of financial statements receive more relevant information when entities reassess the lease term at each reporting date because such reassessment reflect current market conditions.

Sale and lease back

The exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents the sale of the underlying asset, the leaseback would also meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66–67, B31 and BC160–BC167).

Question 11

Do you agree with the criteria for classification as a sale and leaseback transaction? Why or not? If not, what alternative criteria would you propose and why?

We agree with the criteria for classification as a sale and leaseback transaction.

Presentation

The exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25–27, 42–45, 60–63 and BC142–BC159).

Question 12: Statement of financial position

- (a) Do you agree that a lessee should present its liability to make lease payments separately from other financial liabilities and present right-of-use assets as if they were tangible assets within property, plant and equipment, or investment property as appropriate, but separately from other assets that the lessee does not lease (paragraphs 25 and BC143–BC145)? Why or why not? What alternative presentation do you propose and why?
- (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, totalling 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?
- (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?
- (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?

We agree that an entity should present the obligation to make lease payments separately from other financial liabilities and the right-of-use assets separately from the owned property, plant and equipment.

In cases of lessor applying performance obligation approach, we agree that the entity should present underlying assets, rights to receive lease payments and lease liabilities, totaling to a net lease asset or lease liability in the statement of financial position. However, we seek clarification from the Board on presentation of such net lease asset or liability in the statement of financial position. Also, within a group when entities have such lease transactions then at a group level the underlying asset may not be visible as property, plant and equipment in the consolidated statement of financial position, but will be reflected as 'net lease asset or liability. Alternatively the Board may review the disclosure of underlying asset within 'property, plant and equipment' and disclosing the total of 'right to receive lease payments' and 'lease liabilities' as 'net lease asset or liability' in the statement of financial position.

In case of lessor applying derecognition approach, we agree that the entity should present the rights to receive lease payments separately from other financial assets and should present the residual asset separately within property, plant and equipment.

In case of sub-leases, we agree to the Board's proposal of disclosure requirements.

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 there is sufficient guidance provided in IAS 1 for IFRS preparers. The disclosure of lease income and expense in profit or loss separately should be based on materiality. For entities having very negligible lease transactions, reporting a separate line item for lease income and lease

expense to its size may not be required. An option should be given to the entities for disclosing the same in profit or loss separately or in the notes.

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?

Similar to our response in question 13, we believe that there is sufficient guidance in IAS 1 in conjunction with IAS 7 'Statement of cash flows' for IFRS preparers. We believe that an entity should decide whether separate presentation is necessary in the primary statements or whether it is adequate to provide the information in notes based on materiality. Accordingly an option may be given to the entity.

Question 15 - Disclosures

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 lease contracts; and
- (b) describes how lease contracts may affect the amount, timing, and uncertainty of the entity's future cash flows?

Why or why not? If not, how would you amend the objectives and why?

We agree with the Board's disclosure objectives in relation to leases to enhance the information provided to users.

Question 16 - Transition

- (a) The exposure draft proposes that lessees and lessors should recognise 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?
- (b) Do you think that full retrospective application of lease accounting should be permitted? Why or why not?
- (c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

We consider that a mandatory retrospective application would be very onerous for companies to follow and therefore believe that the simplified retrospective approach should ease the application of this standard.

Question 17 - Benefits and costs

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 outweigh the cost? Why or why not?

As discussed earlier in response to some of the questions above, we believe that the costs involved in accounting will far outweigh the benefits to be received.

Question 18 - Other comments

Do you have any other comments on the proposals?

a) Cancellable contracts

The existing IAS 17 defines non-cancellable leases. It makes sense, from a lessee's perspective to do a right-of-use asset accounting and from a lessor's perspective to do a derecognition approach only in case of such non-cancellable contracts. We suggest the Board to include the definition of non-cancellable leases and thereby excluding application of this standard to cancellable contracts. Lease income or expense relating to cancellable contracts may be accounted for as and when they are earned or incurred.

b) Revaluation of tangible assets / Fair Valuation of investment properties

The proposal excludes leases that contain a bargain purchase option or provide for the automatic transfer of title to the underlying asset to the transferee. These contracts are considered as purchase or sale of underlying asset and are excluded from lease accounting. This implies that only contracts where the underlying asset is assumed to revert back to the lessor are accounted as per the proposed ED. During such term of contract, the lessee normally cannot part with such leased assets. In such cases, it may be inappropriate to apply a revaluation model in case of lease of tangible assets and fair value model in case of investment properties as this will result in recognition of these assets at values that cannot not be realised by the lessee.