1850-100 Comment Letter No. 729

Institute of Chartered Accountants of British Columbia 505 Burrard Street, Suite 500 Box 22 Vancouver, BC V7X 1M4 Tel: 604 681.3264 Fax: 604 681.1523 Toll Free in BC: 1 800 663.2677 www.ica.bc.ca



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International Accounting Standards Board 30 Cannon Street London EC4M 6XH United Kingdom Electronic submission via website at www.iasb.org

Dear Sir or Madam:

Re: <u>Exposure Draft – Leases</u>

The Exposure Draft Forum of the Institute of Chartered Accountants of British Columbia in Canada has reviewed the above exposure draft and is pleased to provide the following comments to the International Accounting Standards Board for its consideration.

The Forum is comprised of volunteer members from public practice, industry, and other sectors who meet periodically to discuss and comment on draft guidance. The views expressed in this letter are solely those of members of the Forum and do not represent the views of the Institute, its Council, or its staff.

General Comments

Members of the forum do not support the proposed standard on leases and do not believe the new IFRS meets the objective of providing useful information to financial statement readers. Moreover, they find the proposed accounting model for lessees inconsistent with that for lessors – the former applies a new "right of use" concept while the latter retains the traditional "risks and benefits" approach.

Useful information

Forum members are concerned that putting all leasing arrangements on the balance sheet could mislead readers as to the nature of operations for an entity by giving a disproportionate weight to leased assets. For example, a company that leases land to operate parking lots will have many land assets on their balance sheet, thus making them look more like property developers than parking space renters at first glance.

It's the experience of forum members that creditors are interested in cash flow to service debt and security on assets. Forum members believe these proposals do not provide any information of benefit to creditors – they cannot attach a lien on a "right of use", which is an intangible asset. As such, they question whether information under the proposed standard would be any more useful than that provided under the existing standard.

Members of the forum believe an average reader might find the proposed model for lessor accounting very confusing – they will likely have trouble with two assets created from one transaction and the same asset recorded as such on two different balance sheets.



Consistent accounting treatment

Forum members are troubled by the proposal to recognise all leases as assets under the "right of use" concept as it seems to contradict the traditional definition that involves controlling the benefits from an asset. This concept is particularly difficult to grasp for leased assets with terms in excess of twelve months but less than substantially all of the economic life of the asset.

Using an example of a five-year lease on a building with a thirty-year life, a lessee might simply pay rent and not permitted to make any decision regarding the building without the legal owner's permission – the lessee cannot make modifications to the building, let alone sell it. Furthermore, the lessee may not sub-lease without the owner's approval, so it is difficult to accept the argument that the lessee "controls the resource" as stated in the Basis of Conclusion for the "right of use" model on this type of lease. The "right of use" is strictly limited and falls far short of "ownership" that applies to other assets on the balance sheet.

Members of the forum are concerned that in trying to solve the problem of some lessees manipulating "bright line" rules to avoid recording financing leases, the ability of all lessees to meaningfully record and report operating leases is diminished. It's the experience of forum members that true operating leases exist and they should not be shown on an entity's balance sheet as an asset. They suggest that the proposed one year limit for short-term leases is too short and requires too many legitimate operating leases to be capitalised.

While members of the forum agree that there might have been some abuse with the recording of leases, they do not believe the problem to have affected significant economic decisions. Moreover, the one-year cut-off for short term leases is artificial and does not address those lessors and lessees intent on creating off-balance sheet assets – they will just prepare 364-day lease agreements. Accordingly, forum members recommend the Board consider removing any "bright-line" rules that might continue to encourage structuring of lease arrangements to meet the rules. They believe the correct emphasis remains accounting that reflects economic substance over compliance with a particular form.

Inconsistency between proposed standards

There appears to be a fundamental inconsistency between this proposed standard for leases and that for contract revenue. While the revenue standard deliberately scoped out leases, there does not appear to be a fundamental difference that distinguishes leases from other types of revenue. Indeed, leases certainly involve contracts and should the Board wishes to implement two separate standards, they should be consistent with each other but, as proposed, they are not.

In broad terms, the revenue standard seeks to make revenue recognition "discrete", in the sense that the entity at a point in time has either fulfilled the terms of a contract or not. For the sale of goods, this is often easy to apply. For services rendered over a period of time, it's difficult to implement this "discrete" method, thus the "completed contracts" approach is often used instead. Regardless of the merits of the "discrete" approach to revenue accounting, the current proposal for leases goes in the opposite direction, which is to make continuous what used to be discrete. Whereas the existing



leasing standard uses the operating/finance lease dichotomy to reflect the economic substance of leases, this exposure draft proposes to treat all leases in the same manner on a continuum.

Forum members encourage the Board to consider further the inconsistency between the revenue and leasing standards. It is possible that there are fundamental reasons why the standards should be different; in which case, members of the Forum suggest the Board articulate those reasons for further public consultation before moving forward with either standard.

Conclusion

Since the Board and FASB seem to be looking to address the problem of poor quality information by some lessees, then any solution should be focused on that problem area. Instead, the proposals over-complicate the lease transaction and do not provide any truly useful information to the user. Forum members urge the Board to reconsider these proposed changes and, perhaps, put the lease project on hold until the work on the framework has been completed.

We appreciate the opportunity to provide input to the International Accounting Standards Board and hope you find our comments useful.

Yours truly, Exposure Draft Forum

[Via email]

Stella Leung, CA Professional Standards Advisor Staff Liaison to Exposure Draft Forum Advisory Services Department sleung@ica.bc.ca

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