2013-270
Comment Letter No. 146

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10 September 2013

Hans Hoogervorst
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Mr. Hoogervorst:

re: Comments on Exposure Draft
"Leases"

The Corporate Accounting Committee (CAC) of the Securities Analysts Association of Japan (SAAJ) is pleased to comment on Exposure Draft "Leases" put out by the International Accounting Standards Board (IASB). The SAAJ is a not-for-profit organization providing investment education and examination programs for securities analysts. Its certified members number 25,000. The CAC is a standing committee of the SAAJ composed of 15 members, most of whom are users including equity and credit analysts, and portfolio managers, while a few others are academicians and public accountants. The CAC writes comment letters to global standard setters, including the IASB and Accounting Standards Board of Japan (ASBJ), and exchanges opinions with organizations including the ASBJ and Financial Services Agency.

Before drafting this comment letter, the SAAJ sponsored a study session on the exposure draft, inviting an ASBJ staff member as a lecturer. Some 53 of our certified members participated. A questionnaire was subsequently sent to each and 29 responded, making for a 55% response rate. This comment letter fully takes into account the views expressed in the questionnaire replies as well as discussion among CAC members. The survey results are attached as an Appendix.

General Comments (Survey Question 1)

In comments on the previous exposure draft issued in August 2010, the CAC said it "welcomes the exposure draft's proposal regarding lessee accounting and views it as an improvement". This reflects the CAC's consistent belief that putting all lease assets and liabilities on the balance sheet will better reflect corporate activities. In a survey following a study session conducted in November 2010, 79% of the respondents said recognizing all lease assets and liabilities would offer useful information for corporate analysis.

We asked the same question in the latest survey. Again, 76% answered “Yes”. When all lease assets and liabilities are on the balance sheet of a lessee, financial statement users do not need to make cumbersome adjustment to put operating leases on the balance sheet for calculating such ratios like ROA, ROI, and leverages. There is no doubt that comparability between companies that heavily use leases and those that do not will be enhanced.

The CAC firmly believes that all lease assets and liabilities should be put on a lessee’s balance sheet and highly regards the IASB’s long-standing efforts to realize this long-held dream of financial statement users.

Question 2: Lessee Accounting (Survey Question 2)

In regard to lessee accounting, the IASB has changed the single-type model proposed in the 2010 exposure draft to a two-type model where different accounting treatments are required for Type A and Type B leases. From the viewpoint that every lease contains a financing element, it could be claimed that the single-type model should be used. However, the CAC thinks the proposed change to the two-type model is more reasonable to better reflect the economic reality of diverse leases. To the question “Comparing the two models, which one do you think better, the 2010 single-type model or the revised exposure draft’s two-type model?”(Question 2), 69% of respondents supported the two-type model.

One thing that the CAC asks the IASB to reconsider is paragraph 5 of the exposure draft which specifies “A lease need not apply this [draft] Standard to intangible assets”. The CAC thinks it appropriate to require mandatory application of the standard to software leases because such leases are heavily used in certain jurisdictions, including our own.

A CAC member pointed out during discussions that increasing depreciation expenses in Type B leases is not consistent with other accounting standards. Many members agreed with this observation.

Question 4 Classification of Leases (Survey Question 3)

The CAC thinks the proposed Type A and Type B classification is better than the current finance lease and operating lease classification. Survey Question 3 asked “Assuming a two-type model is being adopted, it could be the proposed Type A-Type B model or a finance lease-operating lease model (lessees are assumed to be required to recognize lease assets and liabilities except short-term ones). Comparing the two models, which one do you think is better?” The majority (59%) of survey respondents supported the Type A-Type B model.

Although the Type A-Type B model is based on whether the underlying asset is real estate or not, it is hard to classify leases by the definition provided in paragraphs 29-30 and the illustrative examples. The CAC asks the IASB to clarify the difference between the two types by improving the definition and providing more articulate examples. Further, the CAC expects the IASB to develop nomenclature that better represents the nature of leases rather than "Type A-Type B".

The exposure draft seems to assume that most real estate leases will be classified as Type B. In countries like ours where the economic life of buildings is relatively short and land prices very high, many real estate leases can be classified as Type A when the present value of the lease payments accounts for only an insignificant portion of fair value but the lease term is slightly longer than "the major part" threshold of the remaining economic life of the underlying asset, thus hindering international comparability of financial statements. The CAC respectfully asks the IASB to change the requirement to be classified as a Type A lease in paragraph 30 from "one of the following two criteria" to "both of the following two criteria".

Question 1 Identifying a lease (Survey Question 4)

The CAC thinks it will be practically difficult to identify a lease according to the stipulations in paragraphs 6 to 19. In the survey, less than half of the respondents (44.8%) thought that the stipulations would be sufficient while almost the same number of respondents said "Cannot judge at this moment".

The CAC is concerned that "the right to use an asset (the underlying asset)" in paragraph 6 may induce widely different interpretations when applied under regionally different legal requirements. Some members opined that the concepts of "an identified asset" and "the right to control the use of the identified asset", which are the basis of identification, are vague and difficult to implement. Others mentioned that the cases explained in Examples 1 to 4 are too specific and lack the universality needed in practical application.

Further, the exposure draft does not provide Examples for the shipping industry. Some members are greatly concerned that the stipulations in paragraphs 6 to 19 are not sufficient to judge whether a time charter contract for a vessel, widely used by shipping companies, is a lease or not. Application of the exposure draft may induce significantly different accounting treatments amongst shipping companies around the world, hindering comparability of such companies.

The CAC requests the IASB to further clarify the identification of leases by refining the language in paragraphs 6 to 19 and by adding easy-to-understand Examples.

Question 3 Lessor Accounting (Survey Question 5)

For lessor accounting, the exposure draft proposes a model similar to the derecognition model proposed in the 2010 exposure draft (for Type A leases) and a model similar to the current operating lease (for Type B leases). In responses to Survey Question 5 regarding this proposal, the majority of respondents (59%) thought it appropriate. Overall, the CAC thinks the proposal reasonably reflects the economic reality of lessors. Some raised concern that Type A accounting is different from current accounting standards and that practical application may be difficult, suggesting there is a room for further improvement.

Question 5 Lease Term (Survey Question 6)

The exposure draft's proposal of lease term, with "a significant economic incentive" requirement of optional extension, is a notable improvement over the 2010 exposure draft which contains the controversial "more likely than not to occur" requirement. In answering Survey Question 6, 72% of respondents supported the lease term proposal.

In order to help judge the existence of a significant economic incentive in terms of contract-based, asset-based, market-based, and entity-based factors, and to prevent arbitrary application of the significance threshold, the CAC proposes the expansion and enrichment of Application Guidance (B5).

Question 8 Disclosure (Survey Question 7)

The CAC highly regards both lessee disclosure (paragraphs 58 to 67) and lessor disclosure (paragraph 98 to 109) requirements as an improvement to provide useful information to financial statement users. 59% of survey respondents shared this view (Survey Question 7).

Specifically, a lessee's maturity analysis of lease liability (paragraph 67) will be useful for liquidity risk analysis and a lessor's maturity analysis of the lease receivable (paragraph 106) will be useful to forecast future cash flow. Further, reconciliation of right-of-use assets (paragraph 61) and lease liabilities (paragraph 64) will provide a breakdown of changes in the right-of-use assets and lease liabilities which is valuable information to evaluate the relevant balance sheet items.

The proposed disclosure requirements may include items which are costly and burdensome for companies to prepare. The CAC thinks that when the principle of materiality is applied properly, certain disclosure items with insignificant amounts will be omitted, reducing the possible burden on preparers.

Finally, the CAC reiterates its assertion that putting all lease assets and liabilities on the balance sheet will better represent the economic reality of companies. The CAC hopes the exposure draft will be refined taking into account the suggestions mentioned above and that the day will soon come when we can see all lease assets and liabilities on the balance sheet.

If you have any questions or need further elaboration, please do not hesitate to contact Sei-Ichi Kaneko, Executive Vice President, SAAJ (s-kaneko@saa.or.jp).

Sincerely yours,

Keiko Kitamura

Keiko Kitamura
Chair
Corporate Accounting Committee

APPENDIX

Results of SAAJ Survey on "Leases"

Background and methodology

The Securities Analysts Association of Japan (SAAJ) sponsored a study session on IASB's exposure draft "Leases", inviting a lecturer from the Accounting Standards Board of Japan (ASBJ). Some 53 of our certified members participated in the session held on 2 August. A questionnaire was subsequently sent to each participant and 29 responded, making for a 55% response rate. The respondents were also invited to make comments. The survey, although small in size, focused on a cohort with the same background (certified members of the SAAJ) and same knowledge level (participation in the study session). This focus and very high response rate gives credibility to the reliability of the survey.

Survey questions and answers

Q1: The current standard for leases (IAS 17) requires lessees to recognize assets and liabilities arising from finance leases but does not require the same for operating leases. The exposure draft requires recognizing assets and liabilities arising from all leases (except short-term ones). Do you think this will be an improvement to the current standard?

A1

(a) Yes.	75.9%
(b) No.	13.8%
(c) Cannot judge at this moment.	10.3%
Total	100.0%

Q2: The 2010 exposure draft proposed a single-type model where the lessee is required to recognize a right-of-use asset and lease liability. The current exposure draft proposes a two-type model where Type A is similar to the one proposed in the 2010 exposure draft and

Type B requires recognizing a fixed amount lease expense on a straight line basis.

Comparing the two models, which one do you think is better, the 2010 single-type model or the revised exposure draft's two-type model?

A2

(a) Single type.	13.8%
(b) Two type.	69.0%
(c) Cannot judge at this moment.	17.2%
Total	100.0%

Q3: Based on the amount of consumption of the underlying asset principle, the revised exposure draft proposes dividing leases into two types, Type A (mostly plant and equipment) and Type B (mostly real estate), and to apply different accounting treatments. Assuming a two-type model is being adopted, it could be the proposed Type A–Type B model or a finance lease–operating lease model (lessees are assumed to be required to recognize lease assets and liabilities except short-term ones).

Comparing the two models, which one do you think is better?

A3

(a) Type A–Type B model.	58.6%
(b) Finance lease–operating lease model.	13.8 %
(c) Cannot judge at this moment.	27.6%
Total	100.0%

Q4: Based upon the right-of-use model, the revised exposure draft proposes identifying a lease based upon the following two criteria:

(a) fulfillment of the contract depends on the use of an identified asset; and

(b) the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

Do you think the above definition of a lease and the proposed requirements in paragraphs 6-19 of the revised exposure draft are sufficient to determine whether a contract contains a lease or not?

A4

(a) Yes.	44.8%
(b) No.	13.8%
(c) Cannot judge at this moment.	41.4%
Total	100.0%

Q5: For lessor accounting, the revised exposure draft proposes a model similar to the derecognition approach in the 2010 exposure draft (for Type A leases) and a model similar to the current operating lease (for Type B leases). Do you think this proposal is appropriate?

A5

(a) Yes.	58.6%
(b) No.	17.2%
(c) Cannot judge at this moment.	24.1%
Total	100.0%

Q6: The revised exposure draft proposes determining a lease term as the non-cancellable period, together with both of the following:

(a) periods covered by an option to extend the lease if the lessee has a significant economic incentive to exercise that option; and

(b) periods covered by an option to terminate the lease if the lessee has a significant economic incentive not to exercise that option.

Do you think this lease term definition appropriate?

A6

(a) Yes.	72.4%
(b) No.	17.2%
(c) Cannot judge at this moment.	10.3%
Total	100.0%

Q7: The exposure draft proposes detailed presentation and disclosure requirements for lessees and lessors, separately for Type A leases and Type B leases. Do you think this will provide useful information?

A7

(a) Yes.	58.6%
(b) No.	13.8%
(c) Cannot judge at this moment.	27.6%
Total	100.0%

*****In Questions 5 and 6, (a)~(c) do not add up to 100.0 because of rounding.