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September 11, 2013

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNIITED KINGDOM

Via “Open to Comment” page, www.iasb.org

RE: Exposure Draft 2013-6, Leases

Dear Sir or Madam:

The Committee on Corporate Reporting of Financial Executives International Canada (FEI Canada) is responding to the International Accounting Standards Board’s and the Financial Accounting Standards Board’s Exposure Draft 2013-6, Leases (the ED). We appreciate the opportunity to provide comments.

FEI Canada is the all-industry professional membership association for senior financial executives. With eleven chapters across Canada and 1,800 members, FEI Canada provides professional development, thought leadership and advocacy services to its members. The association membership, which consists of Chief Financial Officers, Audit Committee Directors and senior executives in the Finance, Controller, Treasury and Taxation functions, represents a significant number of Canada’s leading and most influential corporations.

The Committee on Corporate Reporting (CCR) is one of FEI Canada’s advocacy groups. CCR is devoted to improving the awareness of issues and educating FEI Canada members on the implications of the issues it addresses, and is focused on continually improving the standards and regulations impacting corporate reporting.

The ED has addressed many of the concerns highlighted in our response to the initial Exposure Draft (2010) including contingent payments and short term leases. However we feel it is important to outline some fundamental concerns that we have with the new ED. We acknowledge that revised guidance is required to address situations where financing of the acquisition of an asset or right to use an asset can be presented as off balance sheet financing when in fact the substance of the transaction is better represented as a debt and corresponding asset on an issuer’s balance sheet. We agree that the right-of-use model is appropriate in circumstances where lease contracts provide an alternative to asset ownership. We are supportive of the Boards’ efforts to recognize leases on the balance sheet, if done in a practical and disciplined manner. However, we believe that the Boards should also consider whether this model is appropriate for lease arrangements where direct ownership of the underlying asset is not feasible (such as leases of a portion of a larger asset that cannot be sold on a subdivided basis), or the lessee motivation is other than for financing purposes.

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We support the objective of providing useful information to users of financial statements about the amount, timing and uncertainty of cash flows arising from a lease. However, we do not believe that requiring an entity to account for arrangements as assets that do not have the risks and rewards associated with ownership achieves this result. Presenting assets on the balance sheet that are not owned or being financed to be owned, gives the false impression that an entity holds title as users of financial statements generally equate an asset presented on an issuer's financial statements as an ownership interest. As the IFRS conceptual framework is still under review, we recommend the Boards not proceed with this ED until the framework is completed and clarity is incorporated around the definition of an asset.

We have highlighted other concerns in the attached appendix including addressing the distinction between a service contract and a lease. We feel that the Boards have overlooked the opportunity to articulate a well-defined conceptual basis that will lead preparers to make appropriate and consistent judgments. One example where the interpretation is unclear is the outsourcing of data centres. In an outsourcing agreement, it may not be clear who controls the equipment (i.e. legal vs. physical) located within a client site but operated by the vendor.

We believe that the ED does not provide clarity in defining "significant", "insignificant", "substantially all" and "major part" and in the absence of specific thresholds this encourages inconsistent interpretation and accounting application which can lead to increased regulatory risk in reporting.

We feel that implementation of the proposed standards will have a significant impact and issuers will incur significant costs and we recommend field testing to assess the cost versus the benefit to users of financial information. Based on our assessment of the proposal we believe the cost will significantly outweigh the benefit.

Thank you for allowing us the opportunity to respond to this proposal.

Yours very truly,

Gordon Heard
Chair – Committee on Corporate Reporting
FEI Canada

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Appendix A

QUESTION 1

Do you agree with the definition of a lease and the proposed requirements in paragraphs 6–19 for how an entity would determine whether a contract contains a lease? Why or why not?

If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease, is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

We believe that the definition of a lease is a contract that conveys the right to use an asset for a period of time in exchange for consideration, which is consistent with the current standard, *IAS 17 – Leases(IFRS)* and 840 *Leases (USGAAP)*.

Under the proposed ED, factors determining "control" would result in all lease arrangements, including those operating in nature, being assessed as financing activities. Contracts that do not represent financing to acquire an asset should continue to be accounted for as operating leases and excluded from the statement of financial position.

As outlined in the IFRS Conceptual Framework, paragraph 4.4 "An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity." An example of an operating lease that does not meet the definition of an asset is a building lease. The lease of a building does not convey the right to control through directing the use as a lessee does not have permission to restructure the area leased without consent of the lessor. As well, any repairs and maintenance are provided by the lessor. In both instances the lessee does not have the ability to direct the use of the building without the lessor's consent, therefore lacks control over the space. The use of the building has no direct impact on the company's core operations. The economic benefit is the appreciation of the building and rental income, not the business conducted within it. The space itself can be indifferent to the actual business being conducted. A lessee will only be able to receive future economic benefit from assets it owns and controls, not through the use of a rented building as consumption should not equate to control. Without control and future economic benefits assumed by the lessee, the building being rented does not meet the definition of an asset within the conceptual framework, and therefore should be treated as an operating lease consistent with the current lease standards (IAS 17 and 840 USGAAP).

In regards to the exclusion of service contracts, we are requesting further clarity within the ED. An example can be found in the oil and gas industry where issuers contract drilling service companies to provide a rig and an operational crew in order to perform drilling operations. These service contracts do not allow for the transfer of the asset at the end of the lease, the assets are returned in a similar condition to when they were first contracted and replacement of the asset is a viable option given the rigs are rarely customized for specific drilling purposes. It is unclear whether the term of the contract is

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for an insignificant portion of the economic life of the asset, and the ED lacks clarity as to whether the present value of the lease payments would equate to substantially all of the fair value of the rig because of a lack of extensive guidance. While the contractor can direct the service company as to where the rig is to be positioned, it can be argued that there is no control by the oil and gas company over the operation of the rig itself. It is clear this is not a financing lease and that the contractor has no control over the asset being used. Under the current standard this would be classified as an operating lease, which is reasonable because it does not place these arrangements on the statement of financial position.

With all leasing agreements being accounted for on the statement of financial position, regardless of the financing aspects associated with the arrangement, there is an indication of "ownership" of assets when in substance the lessee does not assume the same risks and rewards of ownership or control. The "right to use" and directing the use of an asset is understood by the relevant users as a loan of an asset from one party to another, not the purchase, unless financing to purchase has been established through the contractual terms. The objective of the ED is to "establish the principles that lessees and lessors shall apply to report useful information to users of financial statements about the amount, timing and uncertainty of cash flows arising from a lease". We are concerned that the inclusion of all leases on the balance sheet of an issuer and finance and amortization expense in earnings will introduce confusion surrounding asset ownership and the operating cash flows of the issuers underlying core business. The capitalization of these contracts based on the right to use through the ability to direct the use fundamentally changes the definition and general understanding of an asset. A relevant user associates specific rewards and key obligations, such as insurable risk, taxation liability and legal liability, with the term "asset", which would not exist with a non-financed lease agreement. For example, a banking institution assessing available collateral of an entity does not consider leasehold improvements as a viable asset because they do not believe that the improvement has "the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents" (as outlined in section 4.8 of the IFRS Conceptual Framework). We believe it is essential for the accounting standards/codifications to be congruent in the meaning of assets, liabilities, revenues and expenses. Implementation of a new standard that contradicts the conceptual understanding of the elements of the financial statements provides for greater inconsistencies and confusion. With the current conceptual framework under review for improvement, the Boards may wish to consider deferring implementation of the proposed lease ED until a finalized framework is established in order to affirm that the lease standard to be developed appropriately complements the concepts behind the elements of the financial statements.

Furthermore, capitalizing these arrangements changes the outcome of key financial ratios users employ to assess the financial position of an entity as identified in Appendix A: *Effect of the proposals on key financial ratios of a lessee with operating leases.* We believe that the standard will lead issuers to employ more non-GAAP measures in order to present to users their financial position and returns generated by their core business.

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QUESTION 2

Do you agree that the recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

We believe that the presentation of expenses and cash flows should differ for financing leases and non-financing leases. From the perspective of a lessee, arrangements, which are for the majority of the economic life of an asset, represent a significant portion of the fair value of an asset, and are in substance the acquisition of an asset (including the transfer of title in many circumstances), should be accounted for as assets and corresponding liabilities on the statement of financial position, consistent with the Type A lease accounting treatment within the ED. These factors are associated with ownership and control of an asset if not at inception, at a future date and should therefore be recognized as such. Any arrangement that does not achieve the above criteria, from the lessee's standpoint, should not be presented on the statement of financial position; we therefore disagree with the EDs proposed Type B lease accounting treatment, with respect to the lessee. Type B leases should be accounted for in the same manner as current operating leases are accounted for under IAS 17 and USGAAP 840 .

Relevant users place emphasis on key performance metrics to analyze the true financial position of an entity based on the information presented in the financial statements. Capitalizing all lease arrangements causes a counterfactual representation of an entity's financial position. For example, metrics such as return on capital (ROC) become inaccurate when the asset base applied in the ROC calculation is inflated by the inclusion of operating lease and service provider arrangements, thereby lowering the total returns presented on the face of the issuer's financial statements. Users with specific interest in the oil and gas industry are concerned with the operating netbacks. Reclassifying operating lease payments from operating expenses to finance and amortization expense will lead the reader to conclude that operating costs have improved when it is simply an accounting change. As a result an entity will be required to apply non-GAAP measures so that users can assess its true financial position. This results in a lack of comparability between peers within an industry as methods of contract restructuring and other similar means to obtain the desired outcome may occur, which increases the complexity of determining the actual financial position, such as the actual costs of operating.

In addition, the increase in long-term liabilities as a result of accounting changes may lead lenders to conclude that a company has become overleveraged even though nothing has changed with respect to the issuers financial commitments. This may require issuers to either renegotiate loan terms or apply non-GAAP measures to present debt covenant calculations consistent with those applied at the time that loans were granted.

Furthermore, the lack of clarity between "significant", "insignificant", "substantially all" and "major part" encourages inconsistent application of the accounting guidance amongst peers within an industry. The availability to apply significant judgment gives cause for regulatory risk. There is also a risk of

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entities changing the structure of contracts to be either Type A leases to capture a better operating cash flow, or short-term leases to abate accounting for an operating agreement as assets, which may expose an entity to new commercial risk.

We recommend the Boards maintain the current accounting treatment of leasing arrangements as described in IAS 17 *Leases* for IFRS and the 840 *Leases* USGAAP standard.

QUESTION 3

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

We agree that there should be different accounting approach to different leases, depending on whether the lessee is expected to consume a significant portion of the economic benefits embedded in the underlying asset.

However, the lack of clarity between “significant”, “insignificant”, “substantially all” and “major part” encourages inconsistent application of the accounting guidance amongst peers within an industry. The availability to apply significant judgment may increase regulatory risk.

Furthermore there is a lack of clarity in determining the control of the asset through “directing the use” from the lessor’s perspective when joint control exists over significant decisions, including; the design of the asset, directing the daily operations, access to the asset and other key factors.

A lease agreement for an oil and gas pipeline may allow both the customer and pipeline owner to have direct or joint input on all or some of the decisions needing to be made. The concern is determining which decisions are the most significant in assessing which party has control over directing the use of the asset. If a customer has control over the design of the pipeline and can have input in certain aspects of the operations, but does not have input regarding shutdowns and maintenance and other daily operational activities, it is unclear which of these decisions have the higher weighting.

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QUESTION 4

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 28–34, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

We agree that the classification of leases should be based on the expected consumption of the economic benefits embedded in the underlying asset. However, we are concerned with the lack of clarity regarding property with respect to Type B classification.

Under US GAAP, lessor's, treatment of leases of integral equipment is similar to real estate property which is accounted for as an operating lease. For instance, oil and gas pipeline lease agreements are generally considered operating leases because there is no transfer of ownership at the end of the lease term.

Property, within the proposed ED, is classified as Type B leases when the lease term is not for a "major part" of the remaining economic life of the asset or the PV of lease payments is not for "substantially all" of the fair value. The removal of ownership as a component of lease classification along with the lack of bright lines in deciphering "major part" and "substantially all", may result in integral equipment being classified as Type A leases, which forces the lessor to derecognize the asset and accelerate the related expense. The lease term for a pipeline may be for a major part, given a lack of clear thresholds, of the remaining economic life of the asset, therefore resulting in the reclassification as a Type B lease to a Type A lease. Type A treatment requiring derecognition of the asset is inconsistent with the substance of the transaction as title and ownership of the pipeline resides with the lessor. As previously commented, this is also inconsistent with the definition of an asset within the IFRS conceptual framework.

We recommend that the Boards provide more extensive guidance or consider the inclusion of ownership as a component of lease classification, which is consistent with current reporting requirements.

QUESTION 5

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

We agree with the proposals of the lease term.

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QUESTION 6

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

We agree with the measurement of variable lease payments or a reassessment if there is a change in an index rate as this should truly reflect the payment to the lessor.

QUESTION 7

Paragraphs C2–C22 state that a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why? Are there any additional transition issues the Boards should consider? If yes, what are they and why?

The implementation of the proposed ED will result in significant costs to issuers. As well, adoption of the standard will result in a considerable amount of work due to the need to reassess each contract. Software to aid in the assessment process will not be constructed until a standard is finalized. It is recommended that the Boards provides a minimum of three years from the date the standard is finalized before required application in order to accommodate the time needed to develop appropriate software and business processes. We encourage the Boards to perform thorough field testing to assess the true benefits of the proposed recognition and disclosure. Based on our assessment of the proposed changes, we believe that the costs to achieve compliance with this ED outweigh the potential benefits to relevant users.

We would also like to recommend that the Boards remove the option for early adoption. Given the substantial change in accounting treatment, permission to early adopt will result in a lack of comparability amongst peers, which will cause more confusion for the users in interpreting the statements.

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QUESTION 8

Paragraphs 58–67 and 98–109 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments; reconciliations of amounts recognised in the statement of financial position; and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

We disagree that all leasing arrangements should be accounted for on the balance sheet, consistent with our responses in questions 1 and 2. However, if changes to the leasing standard were to be implemented we agree with the disclosure requirements for a lessee and a lessor.

QUESTION 12

The IASB is proposing amendments to other IFRSs as a result of the proposals in this revised Exposure Draft, including amendments to IAS 40 Investment Property. The amendments to IAS 40 propose that a right-of-use asset arising from a lease of property would be within the scope of IAS 40 if the leased property meets the definition of investment property. This would represent a change from the current scope of IAS 40, which permits, but does not require, property held under an operating lease to be accounted for as investment property using the fair value model in IAS 40 if it meets the definition of investment property. Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

We agree with the inclusion of amendments to IAS 40 to include a right-of-use asset arising from the lease of property to be within its scope so long as the arrangement meets the definition of investment property.