The LIAJ's Comments on the Exposure Draft: Leases

13 September 2013

The Life Insurance Association of Japan (LIAJ)

The LIAJ's Comments on the Exposure Draft: Leases

We, The Life Insurance Association of Japan (LIAJ) would like to extend our gratitude to the International Accounting Standards Board (IASB) for providing us with the opportunity to submit our comments on the Exposure Draft, *Leases*.

The LIAJ is a trade association comprised of all 43 life insurance companies operating in Japan. Its aim is to promote the sound development of the life insurance industry and maintain its reliability in Japan.

1. General opinions on the exposure draft

- We believe that due reconsideration needs to be given to the scope and disclosures of leasing transactions to which the requirements proposed in this exposure draft (ED) will be applied, taking into account the effect this ED would pose on various types of entities, mainly from the perspectives of cost-benefit and practical applicability. Our specific arguments on the ED are described below.
- 2. It is acceptable for us that recognising a leasing transaction, currently classified as an operating lease, in the lessee's statement of financial position based on the 'right-of-use model' would contribute to the enhanced transparency of financial statements. However, we believe that if an asset is a non-core asset in view of an entity's business activities, namely, the amount of assets an entity is using under leasing transaction accounts for less material portion in the amount of assets an entity is using in its operation, the requirements proposed in this ED need not be applied to the non-core asset and, hence, that such a leasing transaction underlying a non-core asset should be treated as a rental contract.
- 3. As the leasing transactions of non-core assets are generally small-sized, numerous, and short-term, we are concerned that if the requirements proposed in this ED are applied without any changes, significant cost would be imposed on preparers of financial statements for managing day to day transactions, annual accounting processing and preparing financial documents related to explanatory notes for disclosures. Moreover, given the relationship between the leasing transactions and an entity's business activities, as well as the less materiality of the amount of those transactions, the benefits for the users from the results of the requirements might be very limited.
- 4. The requirement to determine lease term proposed in this ED shows an improvement over the requirements proposed in the initial exposure draft: Lease, issued in 2010. However, it should be noted that in practice when entities make decisions to replace lease contracts, they do not always consider all the 'relevant factors' (contract-based, asset-based, market-based and entity-based factors, in paragraph B5) as proposed in this ED. Therefore, when assessing whether they have a significant economic incentive to exercise the replacement option in advance, requiring entities to consider all the 'relevant factors' would not align with their actual decision-making process, and might fail to reflect appropriate lease term. In addition, we are concerned that entities might find it difficult in practice to consider all the 'relevant factors' as a whole, and preparers are likely to incur undue cost because of the need to collect relevant data.

Accordingly, with regard to determination of the lease term, we believe that the IASB should require entities to consider periods covered by an option to extend the lease, only 'when at the

inception of the lease it is reasonably certain that the lessee will exercise the option', described in the existing IAS 17: Lease, nor to require subsequent review of the lease term.

Furthermore, we disagree with this part of the definition of a short-term lease,; 'a maximum possible term under the contract, including any options to extend' in Appendix A in this ED. Based on this definition, almost all lease contracts would not be classified as the short-term lease, and entities would not be able to apply the simplified requirements even if the lease term is substantially 12 months or less. This would likely not achieve the objective of the exceptions, as stated in BC296 in this ED, to 'offer more relief to lessees' by applying simplified accounting to short-term leases. Therefore, with regard to the determination of the lease term of short-term lease, we believe that the IASB should require entities to consider periods covered by an option to extend the lease, only 'when at the inception of the lease it is reasonably certain that the lessee will exercise the option', similar to our proposed way of determining the other lease term.

- 5. The ED sets out a wide range of detailed disclosure requirements for both lessees and lessors. We do not agree with these requirements, because significant practical burden might be imposed on preparers if they are required to provide all such disclosures. In particular, regardless of whether its underlying asset is equipment or property, a Type B lease has the following characteristics described as; (a) the lease term is for an insignificant part of the total economic life of the underlying asset, or; (b) the present value of the lease payments is insignificant relative to the fair value of the underlying asset at the commencement date. Therefore, we don't believe that the IASB should require the preparers to disclose a wide range of information above all about a Type B lease, which would likely not provide useful information for users.
- 6. For those entities already applying IFRS, this ED sets out transition relief with regard to leases previously classified as finance leases. We believe that for the purpose of providing fair and equal requirement, first-time adopters of IFRS should also be allowed to use similar relief if they have already applied lease accounting similar to the existing IAS 17.
- 7. We are of the view that both lessees and lessors will need to upgrade and expand their operating systems in order to manage leasing transactions, which are currently classified mainly as operating leases. It is likely that at least three years or more lead time will be required to enable an orderly transition to the new IFRS.

2. Responses to the questions

Question 1: identifying a lease

This revised Exposure Draft defines a lease as "a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration". An entity would determine whether a contract contains a lease by assessing whether:

- (a) fulfilment 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.

A contract conveys the right to control the use of an asset if the customer has the ability to

direct the use and receive the benefits from use of the identified asset.

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.

[No comment]

Question 2: lessee accounting

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 disagree with the application of the requirement proposed in this ED to lease transactions of non-core assets in view of an entity's business activities.]

8. We agree with the proposed requirement that apply different accounting approach for leases with different characteristics. However, we believe that if an asset is a non-core asset in view of an entity's business activities, namely, the amount of assets an entity is using under leasing transaction accounts for less material portion in the amount of assets an entity is using in its operation, the requirements proposed in this ED need not be applied to the non-core asset and, hence, that such a leasing transaction underlying a non-core asset should be treated as a rental contract.

Question 3: lessor accounting

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?

[No comment]

Question 4: classification of leases

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?

[No comment]

Question 5: lease term

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 believe that the requirements to determine lease term under the existing IAS 17 need not be amended]

9. The requirement to determine lease term proposed in this ED shows an improvement over the requirements proposed in the initial exposure draft: Lease, issued in 2010. However, it should be noted that in practice when entities make decisions to replace lease contracts, they do not always consider all the 'relevant factors' (contract-based, asset-based, market-based and entity-based factors, in paragraph B5) proposed in this ED. Therefore, when assessing whether entities have a significant economic incentive to exercise the replacement option in advance, requiring entities to consider all the proposed 'relevant factors' would not align with their actual decision-making process, and might fail to reflect appropriate lease term. In addition, we are concerned that entities might find it difficult in practice to consider all the proposed 'relevant factors' as a whole, and preparers are likely to incur undue cost because of the need to collect relevant data.

Accordingly, with regard to determination of the lease term, we believe that the IASB should require entities to consider periods covered by an option to extend the lease, only 'when at the inception of the lease it is reasonably certain that the lessee will exercise the option', described in the existing IAS 17: Lease, nor to require subsequent review of the lease term.

10. Furthermore, we disagree with this part of the definition of a short-term lease,; 'a maximum possible term under the contract, including any options to extend' in Appendix in this ED. Based on this definition, almost all lease contracts would not be classified as the short-term lease, and entities would not be able to apply the simplified requirements even if the lease term is substantially 12 months or less. This would not likely achieve the objective of the exceptions, as stated in BC296 in this ED, to 'offer more relief to lessees' by applying simplified accounting for short-term leases. Therefore, with regard to determination of the lease term of a short-term lease, we believe that the IASB should require entities to consider periods covered by an option to extend the lease, only 'when at the inception of the lease it is reasonably certain that the lessee will exercise the option', similar to our proposed way of determining the other lease term.

Question 6: variable lease payments

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?

[No comment]

Question 7: transition

Paragraphs C2–C22 state that a lessee and a lessor would recognise 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?

[First-time adopters of IFRS should also be allowed to use similar transition relief.]

- 11. For those entities already applying IFRS, this ED sets out transition relief with regard to leases previously classified as finance leases. We believe that for the purpose of providing fair and equal requirement, first-time adopters of IFRS should also be allowed to use similar relief if they have already applied lease accounting similar to the existing IAS 17.
- 12. We are of the view that both lessees and lessors will need to upgrade and expand their operating systems in order to manage leasing transactions, which are currently classified mainly as operating leases. It is likely that at least three years or more lead time will be required to enable an orderly transition to the new IFRS.

Question 8: disclosure

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 don't believe that the IASB should require the preparers to disclose a wide range of detailed information above all about a Type B lease]

13. The ED sets out a wide range of detailed disclosure requirements for both lessees and lessors. We do not agree with these requirements, because significant practical burden might be imposed on preparers if they are required to provide all such disclosures. In particular, regardless of whether its underlying asset is equipment or property, a Type B lease has the following characteristics described as; (a) the lease term is for an insignificant part of the total economic life of the underlying asset, or; (b) the present value of the lease payments is insignificant relative to the fair value of the underlying asset at the commencement date. Therefore, we don't believe that the IASB should require the preparers to disclose a wide range of detailed information above all about a Type B lease, which would likely not provide useful information for users.

Question 12 (IASB-only): Consequential amendments to IAS 40

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?

[No comment]