September 13, 2013

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

Dear Board Members:

Consejo Mexicano de Normas de Información Financiera (CINIF), the accounting standard setting body in Mexico, welcomes the opportunity to submit its comments on the Exposure Draft ED/2013/6 on *Leases* (the 2013 ED) issued for exposure in May 2013. Set forth below you will find our comments on the topics included in the 2013 ED.

Overall comments

CINIF and its constituents believe that the IASB has responded very positively to the comments and observations it received on the first leasing project issued in 2010 (the 2010 ED). We observe that many recommendations were implemented in the revised project.

We are particularly pleased that the IASB included a substantial "Effects analysis for leases" beginning on page 92 of the Basis for Conclusions. As mentioned in our September 2012 comments on the *Invitation to Comment - IASB and IFRS Interpretations Committee Due Process Handbook* issued in May 2012, we have always believed that the due process should require pre-implementation reviews that include a thorough evaluation of the impact of all proposed new or revised standards before their issuance in those cases where the impacts could be significant. We applaud the IASB for this effort.

A brief summary of our more significant observations and comments is as follows:

- Most constituents generally believe that from the lessee's perspective, leases of intangible assets should not be excluded from the new standard.
- Many preparers expressed a strong preference for a single lease accounting model from both the lessee's and lessor's perspective. Generally the preference was for Type A lease accounting.
- Additional guidance would be greatly appreciated for application of the concepts of

"insignificant" and "more than insignificant" consumption of the underlying asset.

- Significant concern was expressed regarding the lack of symmetry between the accounting by lessees and lessors for Type B leases, under which the lessee recognizes a lease liability but the lessor does not recognize a lease receivable.

- Additional guidance would be greatly appreciated for the evaluation of the significance of economic incentives determining the lease term.

- When determining the lease term at the initiation of a lease, we recommend including the possibility of considering expected future changes in relevant factors related to the existence of significant economic incentives when there is sufficient competent evidence to support such a change.

- There is a strong preference for prospective application of the new accounting models, or at least a more simplified modified retrospective approach.

Responses to specific questions posed on the 2013 ED

Set forth below you will find our responses to the specific questions raised in the 2013 ED. These responses represent the consensus of several groups in Mexico interested in the development of International Financial Reporting Standards (IFRS). We made 11 presentations to interested groups, which included over 300 participants in total, during which we explained the 2013 ED and the changes from the 2010 ED, requesting each group's responses to the specific questions raised in the 2013 ED. Where the opinions and responses were divided, we have addressed the differing points of view in this letter.

Scope

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.

We found general support for 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.

We do not believe this project should exclude leases of intangible assets from the perspective of the lessee, since as mentioned in paragraph BC81 of the Basis for Conclusions, there is no conceptual basis for excluding leases of intangible assets. We do not agree with allowing lessees to optionally apply the proposed new standards to leases of intangible assets, but rather we believe that such application should be mandatory.

The accounting model

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 discovered that the response to this question greatly depended on the audience. The groups of highly technical practitioners (often auditors) generally agree with the proposal 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. On the other hand, most preparers of financial statements tended to believe that there should be a single model for lessees, although they were divided on which of the two models is preferable, depending on their business strategy. Nevertheless, when a single model was preferred, there was generally a preference for Type A lease accounting, in which a financing component is recognized.

There is also a general concern about how to apply the concepts of “insignificant” and “more than insignificant” consumption in practice. To the extent possible, many would like to see additional guidance from the IASB regarding how to evaluate the level of consumption of the economic benefits embedded in the underlying asset. We believe that general guidance on the evaluation of the significance of the consumption of the underlying asset could be added. One suggestion might be for the lessee or lessor to ask himself the question “If I were to sign a new lease agreement for the same asset, considering the use during the initial lease term, would I be willing to pay/collect the same amount of rent?” This question should be answered ignoring the effects of inflation. If the answer is “No”, which would be the case for most leases of assets other than property, one can assume there was more than insignificant consumption of the underlying asset. If the answer is “Yes”, which would be the case for most leases of property, one can assume there was insignificant consumption of the underlying asset.

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?

Once again we discovered that the response to this question greatly depended on the audience, as explained in our response to Question 2, with a similar response pattern. In other words, those that prefer a single lease accounting model for lessees, generally also prefer a single model for lessors.

However, in the case of lessors, it was noted that there is a significant lack of symmetry between the accounting by lessees and lessors for Type B leases. The lack of symmetry arises because regardless of whether the lease is classified as a Type A or a Type B lease, the lessee always recognizes a right-of-use (ROU) asset and lease liability, while the lessor recognizes a lease receivable only in the case of Type A leases. The 2010 ED proposed that a lessor recognize a lease receivable for all leases, offset by either the removal of the leased asset from its statement of financial position or a leasing liability for the obligation to allow use of the leased asset by the lessee. While most agree with the elimination of the requirement to recognize a liability for the obligation to allow use of the leased asset by the lessee, thereby avoiding inflating the statement of financial position by presenting two assets related to a single leased asset, many do not agree that a lessor should not recognize a lease receivable for Type B leases.

We believe the offsetting credit in these cases should be a reduction of the leased asset recorded by the lessor. Since the consumption of the underlying asset by the lessee is expected to be insignificant for a Type B lease, the reduction of the leased asset on the books of the lessor would be relatively insignificant. Further, over the term of the lease, the lease receivable and the asset reduction would be amortized, thereby restoring the asset to its undepreciated residual value at the end of the lease term.

We strongly recommend that the Board address the lack of symmetry and justify why for Type B leases the lessee is required to record a lease liability but the lessor is prohibited from recognizing a lease receivable.

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?

Although the majority of the participants in our presentations agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should differ depending on the nature of the underlying asset, those that believe that a single accounting model is preferable consider such distinction to be unnecessary.

Measurement

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?

In general, we found agreement with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors.

We would like to see additional guidance on what constitutes "significant" as used in paragraph 25 relating to economic incentives. We believe that different entities could have very different interpretations as to how to measure the significance of the economic incentives.

Additionally, many groups expressed significant concern regarding unilateral options for the lessee to terminate the lease agreement. In this regard, we had considerable discussion about the ability of a lessee to take into account anticipated changes in relevant factors that are expected to eliminate significant economic incentives not to terminate the lease that exist at the beginning of the lease term.

For example, assume a lessee has a 10-year Type B lease with a unilateral option to terminate such lease at any time, with a three-month notice and without any economic sanctions. Also assume that the entity makes leasehold improvements, the investment in which, based on considerable experience, it expects to recover in a maximum of two years. A literal reading of paragraph 27(a) of the 2013 ED suggests that the lessee should record a liability for the full 10 years at the beginning of the lease, and, if the investment in leasehold improvements is in fact recovered in two years, subsequently eliminate the liability for the 8 remaining years after two years have elapsed. We believe that makes little economic sense and does not provide useful or meaningful information to financial statement users. Accordingly, we suggest that paragraph 27(a) be revised to include the possibility of considering future changes in relevant factors when there is sufficient experience and appropriate documentation.

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?

We found almost unanimous support for the proposals on the measurement of variable lease payments.

Transition

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?

We found significant resistance to retrospective application of these proposals. While most recognize the benefits and theoretical soundness of a retrospective approach, the majority consider the costs of such an approach to outweigh the related benefits. At a minimum, many expressed a desire for either allowing prospective application or providing a more simplified modified retrospective approach.

Disclosure

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 found unanimous support for the proposed disclosure requirements set out in the 2013 ED.

NOTE: Questions 9, 10 and 11 only apply to responses to the FASB.

IAS 40 *Investment Property*

Question 12: 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?

We agree with the proposed amendments to IAS 40.

Other comments –

Some groups expressed concern over the determination of the appropriate discount rate to be used for recognition of the lease assets and liabilities. We understand that the 2013 ED proposes that a lessee should discount the lease liability using the rate the lessor charges the lessee (which would often be the rate implicit in the lease), if that rate can be readily determined. If the rate the lessor charges the lessee cannot be readily determined, the lessee would use its incremental borrowing rate. Our concern arises from the fact that the lessee’s incremental borrowing rate could be drastically different from the rate implicit in the lease. Accordingly, we request clarification of what is considered to be “readily determinable” to ensure that lessees do not utilize their incremental borrowing rate in all cases for purposes of convenience.

One final comment is that many are very concerned about the potential income tax consequences of the proposed new accounting models for leases. Until all of the details of the standard have been finalized, it is impossible to know what those consequences will be. Additionally, we consider it inadvisable to approach the local tax authorities until we have a final standard.

Should you require additional information on our comments listed above, please contact William A. Biese at (52) 55 5596 5633 ext. 106 or me at (52) 55 5596 5633 ext. 103 or by e-mail at wbiese@cinif.org.mx or fperezcervantes@cinif.org.mx, respectively.

Sincerely,

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Consejo Mexicano de Normas de Informacion Financiera (CINIF)

Cc: Jan Engström
Amaro Gomes