INSTITUTE OF CHARTERED ACCOUNTANTS OF JAMAICA



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

14 December 2010

Re: Invitation to Comment - Exposure Draft: Leases

Dear Sir/Madam

Through this letter, the Institute of Chartered Accountants of Jamaica (ICAJ) is responding to the invitation of the International Accounting Standards Board (IASB), to comment on the Exposure Draft (ED), Leases. The ICAJ welcomes the initiative of the IASB to address some of the existing concerns surrounding the accounting for and the financial reporting of leasing transactions and arrangements.

Overall, the ICAJ supports the right of use model being proposed for lessee accounting, as it results in the lessee recognising an asset relating to the future benefits which will flow to the entity from the leasing arrangement, and a liability, representing the entity's obligation to pay cash to the lessor as a result of the leasing arrangement. This was seen to be one the most fundamental shortcomings of International Accounting Standards (IAS) 17, Leases, certainly as it relates to lessee accounting for operating leases. The ICAJ however, has some concerns regarding the measurement of the liabilities, as the ED requires the inclusion of certain cash flows, which, under IAS 32, Financial Instruments, Presentation, would not qualify for recognition as a liability. These include for example, certain avoidable contingent rental payments and certain avoidable cash flows from renewal terms and extension options.

For lessor accounting, the ICAJ is of the view that the performance obligation model results in a duplication of the "leased asset" as it is reported both on its own as a lease receivable, as well as a part of the underlying asset. It also results in the recognition of a performance obligation liability, representing the lessor's obligation to perform, despite the fact that, by having made available the leased asset to the lessee, the lessor has satisfied its obligation to the lessee. We believe that the derecognition approach would be more appropriate, and consistent with the right of use model, but question its applicability for all types of leases. For entities involved in leasing, with large portfolios of leases, we however believe that the attendant complexities associated with the measurement of the right to receive lease payments would make compliance with the standard very difficult and costly to achieve; a cost which may outweigh the perceived benefit. We believe that one simplified model for Lessor accounting should be developed and adopted and suggest that the IASB revisits its proposals for lessor accounting.

International Accounting Standards Board United Kingdom

In inviting responses, specific questions have been asked of respondents, to which we have responded in the enclosed document. If you have any questions, or comments regarding our responses, please contact the undersigned.

Yours sincerely,

Archibald Campbell

Cull-phell

President

Question 1: Lessees

(a) Do you agree that a lessee should recognise a right of use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

Yes. The ICAJ agrees that a lessee should recognise a right of use asset and a liability to make lease payments, as this faithfully represents the effects of the lease contract.

(b) Do you agree that a lessee should recognise amortisation of the right of use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why? –

Yes. The ICAJ agrees that lessee should recognise amortisation of the right of use asset and interest on the liability to make lease payments. We note that the presentation and disclosure of the right of use asset would result in the relevant asset being disclosed within Property, Plant and Equipment (PPE), separately from similarly owned assets. We therefore believe that, in substance the IASB and the users of the financial statements will view the transaction as having resulted in the company obtaining a particular item of PPE for use in conducting its business. Consequent on this, we believe that the method for amortising the right to use asset should be the same as that for depreciating similar classes of assets.

Question 2: Lessors

- (a) Do you agree that the lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the lease term and (ii), the de-recognition approach otherwise? Why or why not? If not, what alternative model would you propose and why?
 - No. The ICAJ disagrees with the application of the performance obligation approach as it results in double counting of the leased asset, as well as the recording of a performance obligation liability, for an obligation which the lessor would have satisfied at the inception of the lease, when the asset was provided to the lessee. While we are more inclined to support the de-recognition approach, the proposals for the measurement of liabilities and assets arising from the leases may create cost and resource challenges for lessors, particularly those with large lease portfolios, costs which may far outweigh the benefits. We believe that the IASB needs to revisit its proposal for lessor accounting to arrive at a single, more simplified model.
- (b) Do you agree with the board's proposal for the recognition of assets, liabilities, income and expenses for the performance obligation and de-recognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

As above, the ICAJ is of the view that lessor accounting needs to be revisited by the IASB.

Ouestion 3: Short-term leases

The Exposure Draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is twelve months or less:

- (a) At the date of inception of a lease, a lease that has a short-term lease may elect, on a lease-by-lease basis, to measure, both a initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right of use asset at the undiscounted amount of the lease payments plus initial direct costs. Such lessees would recognise lease payments in profit and loss over the lease term
- (b) At the date of inception of a lease, a lessor that has a short term lease may elect, on a lease by lease basis, not to recognise assets and liabilities arising from a short term lease, in profit or loss, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRS' and would recognise lease payments in profit or loss over the lease term,

Question 3: Short-term leases (Continued)

Do you agree that a lessee or lessor should account for short term leases in this way or not? Why or why not? If not, what alternative model would you propose and why? —

In general, the ICAJ supports the proposed simplified requirements for short term leases. We however believe that this should be achieved through an accounting policy election, and applied consistently to all such leases, and not on a lease by lease basis.

Question 4 – Definition of a lease

(a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?

Overall, the ICAJ agrees that a lease is appropriately defined.

(b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?

The ICAJ disagrees with the distinction between a lease and a sale, as the classification of a contract with a bargain purchase option as a sale may conflict with the proposed revenue standard, where such a transaction contract may not qualify as a sale. It is our recommendation that the standard makes reference to the proposed revenue standard in defining a sale, to remove the possibility of any potential conflict.

Additionally, the guidance contained in the ED regarding the accounting treatment in the event of a sale is not sufficient. Such a transaction would, in substance, be a vendor financed sale. The ICAJ believes that provision of guidance either explicitly, or by way of reference to the relevant standards under which the transaction would be accounted for, would be useful.

(c) Do you think the guidance in paragraphs B1-B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what alternative guidance do you think is necessary and why?

Yes. The ICAJ believes that the guidance distinguishing leases from service contracts is sufficient.

Question 5 – Scope exclusions

This exposure draft proposes that a lessee or lessor should apply the proposed IFRS to all leases, including leases of right of use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas or similar non-regenerative resources.

Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and why?

Yes. The ICAJ is in agreement with the proposed scope of the proposed IFRS. We would however like the IASB to provide further clarity on its reason for the scope exclusion of investment property carried at fair value. Whilst the ICAJ has no objection to the separate accounting for investment property carried at fair value, the ICAJ believes that further guidance is necessary in the accounting requirements for leases in relation to investment property.

Question 6 – Contracts that contain service components and lease components

The ED proposes that lessees and lessors should apply the proposals in Revenue from Contracts with Customers to a distinct service component of a contract that contains service components and lease components. If the service component in a contract that contains service components and the lease components is not distinct, the IASB proposes:

- (a) A lessee should apply lease accounting requirements to the combined contract
- (b) A lessor that uses the performance obligation approach should apply the lease accounting requirements to the combined contract
- (c) The lessor that applies the de-recognition approach should account for the lease component in accordance with the lease requirements and the service component in accordance with the proposals in Revenue from Contracts with Customers.

Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for a contract that contain both service and lease components and why?

Yes. The ICAJ agrees with the proposed accounting treatment.

Question 7 – Purchase Options

The exposure draft proposes that a lease contract should be considered as terminated when an option to purchase the asset is exercised. Thus a contract is accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised.

Do you agree that a lessor or lessee should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?

The ICAJ disagrees. We believe that purchase options should be accounted for, not only when exercised, but when there is a very high probability, given all the facts and circumstances, that the option will be exercised. If this suggestion is accepted, the IASB should provide clear guidance that will assist preparers of financial statements to determine a threshold for "very high probability" and also ensure no conflict with the proposed revenue standard.

Question 8 – Lease Term

Do you agree that a lessee or lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account, the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessor or lessee should determine the lease term and why?

The ICAJ disagrees. We are of the view that the current method of determining the lease term may result in the inclusion of cash outflows which the lessee can avoid (by choosing not to exercise the extension option). The inclusion of the cash flows from these periods would conflict with IAS 32's guidance for the definition of a liability. We believe that extension and termination options should be taken into account, only when, given all the facts and circumstances, it is very highly probable, or, there is virtual certainty that the option will be exercised.

Question 9 – Lease Payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease, using an expected outcome? Why or why not? If not, how do you propose that a lessee or lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why? —

The ICAJ agrees that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease, should be included in the measurement of assets and liabilities arising from a lease. We do believe however that all avoidable cash flows should be excluded from the contingent rentals and expected payments, as their inclusion would also violate the principles of IAS 32 regarding the definition of a liability. Avoidable cash flows in a contingent rental arrangement include, for example, rents that are based on various usage levels. We encourage the IASB to revisit this and to narrow the scope of such contingent rents and expected payments that are now proposed to be included in the determination of these liabilities.

We also disagree with the use of an expected outcome model. We believe that the use of an expected outcome model introduces levels of complexity and subjectivity that may not be justified by the perceived benefits. We believe that a more simplified approach to the determination of the cash flows, contemplating the discussions in the aforementioned paragraph, should be adopted.

Do you agree that lessors should only include contingent rentals and expected payments under term option penalties ad residual value guarantees in the measurement of the right to receive lease payments if they can be measured reliably? Why or why not?

As discussed above, we believe that the IASB should revisit its proposal regarding lessor accounting.

Question 10 – Reassessment

Do you agree that lessees and lessors should re-measure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for re-assessment and why?

Question 10 (Continued)

Yes. The ICAJ agrees that the lessees and lessors should re-measure asset and liabilities consequent on a change in facts and circumstances. This re-measurement may prove very costly and time consuming under the existing proposals for the ED. This re-measurement should be more easily and effectively attained should the suggestions in the response to question 9 be accepted.

Question 11 –

Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?

Conceptually, the ICAJ has no issues with the proposed treatment of sale and leaseback transactions. As discussed in our response to question 4, we have concerns regarding the definition of a sale in the proposed standard, and the potential conflict with the proposed standard on revenue.

Question 12 – Statement of financial position

a) Do you agree that a lessee should present liabilities to make lease payments separate from other financial liabilities and should present right-of-use assets as if they were tangible assets within PPE or investment property as appropriate, but separately from assets that the company does not lease? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?

Yes. The ICAJ is in agreement.

b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, right to receive lease payments and liabilities gross in the statement of financial position, totalling a net lease or lease liability? Why or why not? If not, do you think that a lessor should disclose information in the notes instead? What alternative presentation do you propose and why?

As discussed, we believe that the IASB should reconsider lessor accounting.

c) Do you agree that a lessor applying the de-recognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within PPE? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes?

As discussed, we believe that the IASB should reconsider lessor accounting.

Question 13 – Statement of comprehensive income

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss? Why or why not? If not, do you think that the lessee should disclose that information in the notes instead? Why or why not?

The ICAJ agrees that lease income and expense should be disclosed separately in profit or loss. We do believe, however, that consideration should also be given to the materiality of the income and expense amounts when determining whether or not to make the presentation.

Question 14 - Statement of Cash Flows

Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

Yes. The ICAJ agrees that the cash flows should be shown separately, but characterised in accordance with the pronouncements of IAS 7- Cash Flows.

Question 15 – Disclosure

Do you agree that lessees and lessors should disclose quantitative and qualitative information that:

- a) Identifies and explains the amounts recognised in the financial statements arising from leases; and
- b) Describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows.

Why or why not? If not, how would you amend the objectives and why?

Yes. The ICAJ agrees with these disclosure requirements.

Ouestion 16

a) The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application, using a simplified retrospective approach. Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?

Question 16

Yes. We are in agreement with the simplified retrospective approach. As below, we do also believe that an option for full retrospective application should be permitted.

b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?

Yes. Preparers of the financial statements should be given the option to do a full retrospective application. For comparability, users who opt to do full retrospective application should disclose in the financial statements, the differences arising between full retrospective and the simplified retrospective approaches.

c) Are there any additional transitional issues that the board needs to consider? If yes, which ones and why? –

No.

Question 17 – Benefits and costs

Paragraphs BC200-BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree that the boards' assessment that the benefits of the proposal would outweigh the costs? Why or why not?

For lessee accounting, the ICAJ is of the view that the benefits outweigh the costs, as the proposed standard seeks to result in the presentation of more relevant and reliable information in respect of lease contracts. We are mindful however, of the far reaching implications of the proposed standard for organisations that have lease contracts. Extensive modifications will have to be done to information systems and data gathering and analysis routines. Key users of the financial statements and stakeholders will now have to be sensitised to the impact this will have on earnings, the entities' assets and liabilities, and how this can impact their key financial ratios, attainment of debt covenants, capital adequacy requirements etc.

For lessor accounting, we believe that the costs associated with the proposed models far outweigh the benefits, and that the IASB should revisit the proposed model, to facilitate determination of a single simplified model.

Question 18

Do you have any other comments on the proposal?

No.