December 11, 2010

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

Dear Sirs:

Re: Comment on Exposure draft on Leasing

Thank you for your invitation to comment on the proposed leasing standards as outlined in Exposure Draft (“ED”) - Leases. Penn West is North America’s largest conventional oil and gas income trust with operations throughout Western Canada. We have a number of operating lease arrangements that would be affected by the proposals. We support the International Accounting Standards Board (“IASB”) and Financial Accounting Standards Board (“FASB”) overall goal of improving the comparability and transparency of financial reporting, however, we disagree with many of the proposals outlined in this particular ED. We believe the conclusions outlined in the ED do not increase the usefulness of the financial information and further will lead to confusion amongst users principally due to the accounting treatment proposed for arrangements that are currently reported as operating leases. We strongly believe the removal of the operating lease category and subsequent measurement of all leases as finance leases does not reflect the economic substance of the underlying contracts and hence will mislead users.

The current leasing standards are premised on a judgment of whether or not substantially all the risks and rewards of ownership are transferred to the lessee. One of our current outstanding leasing arrangements pertains to the rental of office space which is not central to our operations, but rather a cost of doing business. Under the current guidance, we have not recorded an asset or a liability on our balance sheet, however, we have disclosed the financial commitment of this arrangement in the notes to the financial statements as it meets the definition of an operating lease. Under the proposed standard, we would be required to record the office space as a right-of-use asset with a corresponding liability related to the payment obligation. In our opinion, two significant risks related to real estate ownership (for purposes of rental) are securing a tenant with the financial capacity to make the payments and the market risk associated with the residual value of the property. As a tenant in such building, we are not exposed to either of these risks; the ability to secure tenants and residual market value risk reside with the owner of the building, not the tenant. We believe the recording of an asset would be incorrect and lead to confusion for users. The rental agreement is a commercial
transaction, not a financing transaction, therefore, to record it as a financing transaction does not reflect the underlying economic reality of the arrangement.

A further complication under the current proposals is the requirement of right-of-use assets to be tested for impairment at each reporting date. From an accounting perspective, recording an impairment on an asset where the risks and rewards have not been transferred and where all of the residual value risk resides with the lessor, can only lead to a conclusion that this treatment does not accurately reflect the reality of the transaction and asset recognition is not appropriate. From a financial reporting perspective, recording impairments on right-of-use assets and possible future impairment reversals will cause increased earnings volatility. The result of this will be further confusion amongst users in determining a normalized earnings figure.

Also, in our industry, oil and gas exploration and production companies have rental agreements for the use of drilling rigs which currently meet the definition of an operating lease. Under the proposal, these contracts would result in right-of-use assets, assuming they are over one year in length. Typically, these drilling rigs are used in multiple locations, across various Cash Generating Units (“CGU’s”) during a particular year. Tracking the cost and related depreciation on these items will become extremely complicated as the rigs move multiple times between CGU’s in a given year. An additional complication is determining the appropriate method to test for impairment on these items which will be difficult and will likely involve a number of subjective decisions. A number of questions will need to be resolved such as what is the appropriate level to complete the impairment test at (i.e. separately, in aggregate, with property, plant and equipment, within a single or multiple CGU’s). Also, a company will have a number of possible options in determining the recoverable amount (i.e. based on the fair value of lease payments, future reserve potential from the use of the drilling rigs, value of the CGU or other external factors). It is questions such as these that each company will have to review and conclude on which will lead to significant increases in costs and resources and likely result in diversity in practice, ironically moving the standard away from the objective of increasing the comparability of organizations.

These are just some examples that we believe illustrates that the proposed treatment does not accurately depict the economic substance of the transaction. We agree, however, that the guidance related to the operating and finance lease classification could be improved, thereby leading to increased comparability between companies and more accurate financial reporting.

In addition to the accounting issues and complexities for users to understand, the cost to implement these proposals and meet the on-going requirements of the ED as currently written are likely to be significant for many companies, not just for those where leasing arrangements form a significant portion of a company’s business. The amount of work and costs required on the transition date to properly reflect all outstanding leases would be considerable, while the full benefit of this implementation is difficult to see since it will lead to balance sheet distortion and confusion amongst users.
We have prepared responses to the specific questions posed in the Invitation to Comment below:

**Question 1 – Do you agree that a lessee should recognize a right-of-use asset and a liability to make lease payments?**

- We strongly disagree with this concept of recognizing a right-of-use asset and liability for each operating lease. A fundamental concept of a finance lease is the transfer of substantially all the risks and the rewards of ownership of the asset. By eliminating this concept and classifying all leases as finance leases a company could be recognizing an asset whereby the lessee does not receive substantially all of the risks and rewards of ownership. For example, in the situation of office leases, many have 10-20 years terms compared to a building’s life of at least 50 years and possibly upwards of 100 years with regular maintenance. In the proposals, a lessee would record an asset even though it is clear that a 10-20 year lease, in this situation, would not transfer substantially all the risks and rewards due to the building’s long-life.

- Inclusion of a right-of-use asset and the lease liability will inflate a company’s financial position and could affect key financial ratios including, debt to equity, return on capital and possibly debt covenants. All outstanding debt agreements with covenant restrictions would be required to be reviewed and possibly modified to exclude the effect of the implementation of leasing proposals.

- After initial recognition, the subsequent measurement of the right-of-use asset and lease liability, in our opinion, does not accurately depict the economic benefit received as a result of entering the lease. The right-of-use asset is amortized on a straight-line basis over the lease term, however, the interest expense on the liability is based on the effective interest method which will lead to a higher interest expense in the earlier years of the lease. This causes the income effects between the two items to diverge, which does not reflect the economic substance of the arrangement.

- The addition of right-of-use asset and liability line items on the balance sheet and corresponding amortization and interest expense through income and the possibility of impairments also recorded through income significantly increases the complexity of the accounting for leases and could lead to confusion for users of the financial statements. In some situations these lease transactions will not be relevant to a company’s core business, thereby excluded by users, more specifically analysts, in their assessment of a company’s financial performance.
Overall, we believe the concept of an operating lease should be maintained. An alternative approach to the ED would be to review the requirements to meet the definition of an operating or finance lease as discussed in IAS 17 and increase the guidance surrounding their classification. This could reduce the amount of judgment required, if any, when determining the appropriate categorization of a lease.

Question 3 – Do you agree that a lessee or a lessor should account for short-term leases in this way?

- While it is not our desire to include short-term leases in the scope of the proposed standard, we do not understand the basis for the Boards’ decision to exclude leases of 12 months or less from the proposals. We understand that there is concern that some operating leases have been “engineered” to meet the operating lease classification, however, by excluding leases meeting this threshold, we believe this will invite “engineering” to avoid the proposed standard, thus not meeting the Boards’ objective of a unified standard for leases.

Question 5 – Do you agree with the proposed scope of the proposed IFRS?

- We agree that leases to explore for or use minerals, crude oil, natural gas and similar non-regenerative resources should be excluded in the proposals outlined in the ED. The application of these proposals on these types of assets, most notably, exploration and evaluation would be difficult.

Question 16 – Do you think full retrospective application of lease accounting requirements should be permitted?

- If the current proposals are implemented, we believe they should be applied prospectively from the transition date and only on new leases entered into after that date. The proposals in the ED are a significant change from the previous guidance and the costs associated with implementing the proposals on existing leases could be considerable. If adopted, we would recommend the proposals apply to future leasing arrangements, therefore, companies could anticipate the full impact of any new arrangements on its financial position.

Question 17 – Do you agree with the boards’ assessment that the benefits of the proposals outweigh the costs?

- We strongly disagree and believe the costs of implementing the proposals will outweigh the benefits. Each company would have to allocate a significant amount of additional resources to ensure the initial implementation, additional disclosures and on-going valuation of leases was maintained. In some situations, this additional work would be completed on leases which are non-core to the company’s overall business which would not affect the decision-making of a user.
- A software package will most likely be required for record keeping purposes and to complete the calculations in a timely manner resulting in further costs to the organization.

- We believe that the current accounting standards are not misleading to users of financial statements as disclosure of operating lease commitments is required.

We believe that the current requirements and the two categories of operating and financing leases provide users with sufficient information on a company’s leasing arrangements. The IASB could look to clarify the distinction between operating and financing leases as currently stated in IAS 17 which could increase comparability and improve disclosures. We strongly encourage the IASB and FASB to reassess the proposals currently outlined in the ED and reconsider its elimination of the operating lease category.

Yours truly,
Penn West Petroleum

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