December 13\textsuperscript{th} 2010

International Accounting Standards Board
London, UK

(Through Web site at: www.ifrs.org)

Subject: Exposure draft on leases (IAS 17 Leases)

Dear Sirs:

Thank you for the opportunity to comment on the exposure draft. I note that a lot of thinking as well as efforts must have been devoted to prepare and propose this document. However, based on my reading of this exposure draft I have come to the conclusion that I oppose its main tenet requiring that all leases be recorded as assets (\textit{Right-of-Use}) for a lessee) with corresponding liabilities in the balance sheet.

I believe that the distinction between operating and financing leases needs to be maintained as is currently recommended by IAS 17, and that information relating to an entity’s significant operating leases should continue to be disclosed in notes to its financial statements. The main reason supporting my position is that operating and financing leases are not economically similar transactions, contrary to what is stated in the <Snapshot> accompanying the exposure draft. I believe that operating leases are not a source of financing of assets but rather they represent the purchase or use of a service that should be recorded as an expense over the term of the concerned lease.

The exposure draft states that the current practice, based on either IAS 17 or the current US GAAP, leads apparently to hundreds of billions of dollars of assets and liabilities not being recorded in the financial statements and that investors routinely adjust the financial statements of lessees for the effect of the operating leases. These adjustments are either arbitrary or based on estimates.
It is my view that the current proposal would not resolve the latter. Indeed, as proposed in the exposure draft, the estimation of the liabilities will often be complex and will be based on a number of assumptions, including, just to name a few, the probability of occurrence of future events, the rates of interest (for PV) and the uncertainties relating to contingent rentals. This will lead to estimated numbers of liabilities that would not likely be much better than the investors’ current estimates, but would require significant effort and costs from the entity and as well from the auditors; this will likely lead to the cost of that information that will well exceed the benefits, especially for non-public entities.

The boards have concluded that fundamental changes are required to address leasing issues and that this exposure draft addresses them. I suggest this conclusion needs reassessing. I believe the issues are really implementation issues of IAS 17 and this is what should be addressed. There are certainly cases where financing leases have been structured in such a way to look like operating leases. This is an implementation issue which needs to be looked at, as these leases should have been recorded as financing leases. Maybe what is needed in the current standards are stronger tests or better direction to determine the classification of leases, either financing or operating. For example, the current standards may need to be revised with a view to using an approach based on the premise that all leases are financing leases, unless contrary evidence is there to prove otherwise. The current exposure draft proposes the easy way out, which is to record all leases irrelevant of their nature; this is not cost effective.

I note that the accounting model requires the lessee to "... amortise the right-of-use asset over the expected lease term or the useful life of the underlying asset if shorter". This is not logical to amortise on the shorter period, as this would mean that the entity is using an asset in a given year or years at no cost (save for the interest portion of the liability) because all the cost, i.e. the amortisation of the <right-of-use>, would have been all recorded in prior years. However, for such an occurrence to occur would only be due to an incorrect original estimation of the useful life of the asset. In practice, I do not see an estimate of useful life that would be shorter than the lease period; if it was the case, then I would argue that such a lease was in fact a financing lease whereby the entity had financed an asset over a period longer than this concerned asset’s useful life.
The above paragraphs provide responses to the exposure draft's fundamentals essentially with regard to lessees. As noted earlier, I do not agree with the proposal. If, of course, you decide to go ahead with the proposal, here are some additional thoughts that you may want to consider.

With regard to the lessors, the exposure draft proposes the recording of a <right to receive lease payments> and a lease liability under the <performance obligation> approach. This approach also requires the keeping of the underlying related assets in the balance sheet; this approach is the counterpart of an operating lease from a lessee's perspective. It is my view that such recording would essentially result in two assets being recorded in the balance for the same future cash flows arising from lease payments of a given lease contract, thus overstating the assets; one would not think to record as an asset a <right to receive funds/payments> from the future delivery of goods (after the year-end) under a contract that is in force at year-end for supplying such goods in the following year.

If an entity (a lessor) wants to provide information on the value of its (operating) leases in force, it could do so in its annual report; such information, as discussed in the preceding paragraph, should not be recorded as assets in the balance sheet. I agree with the proposal referred to in question 3(b) that, at the date of inception of a lease, that 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 the statement of financial position, nor derecognise any portion of the underlying asset.

In the case of financing leases, I essentially agree with the concept for the recognition method and that the underlying asset being financed needs to be taken out of the balance sheet, and in my view, for its full book value. I anticipate problems with calculating the derecognised amount as proposed by paragraph 50. For example, how is the fair value of the asset supposed to be established? It may be easier to establish for a new asset, but what happens to older assets? Are we indirectly proposing to entities to obtain independent professional valuation of the asset? I note that the proposed mathematical calculations in that paragraph would result in the derecognized amount as being equal to the NPV of the lease payments in case where the book value of the asset is equal to its fair value; then what happens in cases where the NPV of lease
payments is lower than the book value of the asset? It seems to me that we would be left a debit balance (book value less the derecognised amount) of the asset that could possibly indicate an overstatement of that asset; on the flip side of this hypothesis, in a case where the NPV is higher than the book and fair value, then what happens to the credit balance? Does that mean that a deferred income is to be recognised over the term of the lease?

As a last point, upon reading the definition at B9, B10 where it is stated that this exposure draft does not apply to contracts classified as a purchase or sale of an underlying asset, which essentially refers to what I would call financing leases, do I have to conclude that this exposure draft is essentially concerned with operating leases? If so, then this reinforces the position I stated at the beginning of my letter and that a financing lease is different from an operating lease and thus, there should remain different accounting methods for each.

Yours very sincerely,

Serge Huot, CA