December 15, 2010

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Gentlemen:

Re: Leases Exposure Draft ED2010/09

We are pleased to provide the comments of Grant Thornton LLP, a Canadian member firm of Grant Thornton International, on the Leases Exposure Draft (ED) issued by the International Accounting Standards Board and Financial Accounting Standards Board (the Boards). Grant Thornton International is providing, under separate cover, a detailed response to the Exposure Draft. We fully support the Grant Thornton International response but are writing separately to emphasise certain matters that are of particular concern in a Canadian context. Firstly, we wish to acknowledge the efforts of the Boards to date with respect to seeking a solution to the recognized challenges inherent with the existing lease accounting model. At the same time we have a number of concerns with certain of the provisions outlined in the Exposure Draft as well as its proposed implementation timeframe. We offer the following comments:

In its Introduction and Invitation to Comment, the Board speaks to criticism of the existing lease accounting model “for failing to meet the needs of users of financial statements because they do not provide a faithful representation of leasing transactions”. The document cites omission of relevant facts about rights and obligations and considers leases in the context of assets and obligations under the Board’s conceptual framework. Further, the Board identifies a “lack of comparability and undue complexity (in the existing model) because of the sharp bright-line distinction between operating and financing (capital) leases” resulting in the need for users to make adjustments to the statement of financial position to obtain a faithful representation of an entity’s financial position. While we too acknowledge flaws in the existing lease accounting model, we have serious concerns that many of the ED’s proposals are themselves unduly complex, potentially leading to a range of interpretation and resulting lack of comparability among preparers and questionable utility to users.
Accounting by Lessees
We believe that a right-of-use model of accounting for leases by a lessee is conceptually sound. In application the model must also reflect the substance of the relationship in order to result in meaningful enhancement of information to users. As proposed, we believe the model may lead to inconsistent application by preparers and be of marginal incremental benefit to users. We have concerns in the following areas:

- The inclusion of option periods in determining the right of use asset and liability and the introduction of “probabilities” in determining lease term is we believe flawed. Firstly we are not convinced that an option to renew represents an obligation to the lessee. Secondly, the application of “judgment” by the preparer in assessing the probability of renewal is likely to result in a range of interpretation by preparers potentially to meet specific reporting objectives.

- The use of the effective interest rate method in determination of the rent expense results in a front end load to leasing costs. We believe this does not reflect the substance of many leasing/rental arrangements and the economic contribution of the leased asset to the entity’s activities.

- The consideration of contingent rentals in determination of leased assets and obligations is also of concern to us. In determining the inclusion of contingent rentals there needs to be consideration of whether an “obligation” exists in situations where the lessee may be able to influence the contingency.

- The guidance in paragraphs 21 through 24 with respect to revaluation of right-of-use assets is in need of further review. We believe the existing materials in IAS 36 and IAS 16 do not take into consideration the unique circumstances which we believe are inherent in the right-of-use model as compared to a traditional ownership model and, as written, are an over-simplification of the practical challenges of the proposed model. We believe a revisit of certain other of the provisions of the ED as noted earlier in our letter could lead to a simplification and reduced work effort in the periodic reassessment of relationships with regards to impairment.

Accounting by Lessors
A number of the points of concern raised under the lessee provisions carry over to the lessor accounting as well, namely lease term options, contingent rentals and revaluation. In addition, however, we have further concerns with the lessor provisions including:

- First among our concerns is the introduction of the derecognition model. In keeping with the model proposed for lessees we would have expected a simplification, such that if the relationship is in substance a lease, it should be accounted for as a mirror image of the right-of-use by a lessee. We believe instead the introduction of the de-recognition model, almost in the nature of a partial sale, results in accounting of questionable utility to a user group. The decision point at inception of the arrangement to determine whether it is a sale versus a lease should be consistent with revenue recognition standards, and if applied correctly, should eliminate the need for a derecognition model.
• We note among the options available on application is one available to users with IAS 40 Investment Property. Specifically, entities with investment property carried at fair value are permitted to account for their leases on a straight-line basis. The application of the proposed lease accounting model to lessors of investment property would, in the absence of an exemption, result in substantial work effort. By introducing this option, entities choosing not to adopt the fair value option, now will be at a significant cost and work effort disadvantage versus those choosing to value investment property through earnings. We believe users may, due to the complexity of applying the leasing model to their leases in their role as lessor, be economically forced to change to the fair value model. We believe that accounting should not lead business decisions and for this reason this provision should be reconsidered.

Summary comments
In addition to the specific matters commented on above, we have concerns with the proposed implementation timetable feeling that work remains to be done including perhaps the need for further re-exposure prior to implementation. We believe this new guidance will be a massive undertaking for many entities given the prevalence of leasing as a form of capital to many entities. Acknowledging that while the existing leasing model is not ideal, changes the magnitude of which are proposed in the ED should result in a model providing consistent and useful information to users. We believe further work needs to be done to achieve these objectives.

We are hopeful that these comments will be of assistance to the Board as it further deliberates on this important matter.

Yours sincerely,
Grant Thornton LLP

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