International Accounting Standards Board
30 Cannon Street, 1st Floor
London, EC4M 6XH
United Kingdom

Dear Board Members:

Re: Exposure Draft - *Leases*

The Canadian Bankers Association\(^1\) (CBA) would like to thank you for the opportunity to comment on the IASB Exposure Draft (ED) *Leases*.

The CBA appreciates the fact that the IASB and the FASB have issued a converged proposal on this topic. We strongly support the IASB in continuing to work with the FASB to issue converged standards as we strongly support the goal to achieve a single set of high quality global accounting standards. The IASB’s coordination with the FASB is of particular interest to Canadian financial institutions given our proximity to the US financial markets.

While we agree that the proposed approach addresses many of the criticisms of the existing standard for operating leases, we believe that with appropriate disclosures, users have the necessary information to properly conclude on the financial position of an entity under the current model for leases. Our overall view of the proposed approach is that the benefits to users will not outweigh the costs of implementation and application. For financial institutions, our regulators and other users rely on the statement of financial position to assess an entity’s exposure to risk. Recognizing a right-of-use asset on the statement of financial position for a lease implies that the lessee is exposed to the associated risks of ownership. This may be misleading to users in the case of operating leases when, economically, substantially all of those risks remain with the lessor.

Furthermore, we believe that elements of the proposed standard do not meet users’ needs for consistency and comparability. Determining the lease term based on *the longest term that is more likely than not to occur* and the consideration of options and contingent rentals in estimating the most likely lease payments are highly subjective exercises based on future events which may cause material differences in application of the standard. This does not meet the

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\(^1\) The Canadian Bankers Association (CBA) works on behalf of 51 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 260,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada’s economy. The CBA also promotes financial literacy to help Canadians make informed financial decisions.
IASB's objective of accounting for similar transactions consistently, as different entities can apply different judgements to arrangements which are contractually similar. Should a new standard be adopted, we support the use of the contractual lease term and contractual lease payments and the accounting for any contingent rental arrangements in accordance with IAS 37: Provisions, Contingent Liabilities and Contingent Assets. This treatment of the lease term and lease payments promotes objectivity of measurement and consistency across the IFRS framework which, when combined with relevant disclosures, would provide increased comparability across entities.

Our responses to the specific questions of the ED are included in the attached Appendix. If you have any questions, we would be pleased to discuss them.

Sincerely,

[Signature]

Attachment: Appendix
Appendix

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?

(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?

(a) We disagree. For financial institutions, our regulators and other users rely on the statement of financial position to assess an entity’s exposure to risk. Recognizing a right-of-use asset on the statement of financial position for a lease that would be classified as an operating lease under the existing standard (i.e. substantially all the risks and rewards of ownership have not been transferred) implies that the lessee is exposed to the associated risks of ownership, when economically, substantially all of those risks remain with the lessor. As such, recognizing a right-of-use asset and the associated liability to make lease payments on the statement of financial position may require our members to increase regulatory capital where no increase in economic risk has occurred. While we appreciate the shortcomings of the existing model for operating leases, we believe that with appropriate disclosures, users will be able to draw conclusions about the financial position of an entity and its exposure to any risks or interest in the leased asset. We propose maintaining the current standard for leases while expanding the disclosure requirements for operating leases to include the details of lease terms, options, and contingent rentals.

(b) Should the board adopt an approach that requires recognition of a right-of-use asset and liability to make lease payments, we agree with the proposed treatment of amortization and interest. Amortization of the right-of-use asset is consistent with the treatment for capital and other assets and recognizing interest on the liability to make lease payments reflects the implied financing aspect of the lease. However, we are concerned that charging interest costs on the liability to make lease payments as financing costs may distort the net interest margin, a key metric considered by users of our financial statements. Rental costs related to operating leases have no association with the financial instruments underlying a bank’s core operations which drive the net interest margin. As such, including financing costs related to leases in the net interest margin may distort users’ perceptions of the performance of our core operations. As noted in our response to part (a) above, we support maintaining the current standard for leases. Should the proposed lease model be adopted, we request that the board clarify in the standard or application guidance that entities may present financing costs related to leases outside of the net interest margin on the statement of comprehensive income.

Question 2: Lessors

(a) Do you agree that a 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 expected lease term, and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?

(b) Do you agree with the boards’ proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

We disagree. As discussed from the lessee’s perspective, our preference is to continue to apply the current standard for leases, as we believe that with appropriate disclosures, users are able to draw conclusions about the financial position of an entity and its exposure to any risks or interest in the leased asset. Should the board adopt the proposed standard, we believe lessors should apply the derecognition approach in all cases. During the term of the lease, the lessee’s right to use the leased asset is an economic resource that is controlled by the lessee. Therefore, the portion of the underlying asset that relates to the lessee’s right to use the asset is no longer an economic resource that is controlled by the
lessee and does not meet the definition of an asset to the lessor. We believe the derecognition approach is conceptually sound and provides the required reciprocity in leasing transactions. Applying the derecognition approach in all cases will also eliminate the need to assess whether the lessor retains exposure to significant risks or benefits associated with the underlying asset, which is a subjective exercise that may limit comparability across entities.

**Question 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 lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at 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 lease payments plus initial direct costs. Such lessees would recognise lease payments in profit or 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 the statement of financial position, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit or loss over the lease term (paragraph 65). (See also paragraphs BC41–BC46.)

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

Overall, our preference is to exclude short term leases from the scope of the proposed new standard, as the costs associated with recognizing and measuring the rights and obligations related to short term lease contracts outweigh the benefits. If short-term leases are to be included in the scope of this standard, we do not support the use of a simplified approach. While we agree that the simplified approach is easier to apply, the lessee and lessor will record higher balances related to these leases since they are determined on an undiscounted basis, thus ‘inflating’ the financial statements. Accordingly, this approach may impact entities’ loan covenant ratios, resulting in unintended negative business consequences to entities.

We also believe that lessees and lessors should not be allowed to elect to use the simplified approach on a lease-by-lease basis. Electing the application on a lease-by-lease basis will decrease comparability of financial statements among entities. Elections will result in entities potentially applying different accounting models to their own portfolio of leases that are of similar short duration. This makes it difficult to interpret financial information when an entity applies different accounting models to its portfolio of short term leases. In our view, the approach to short-term leases, whether it’s a simplified approach, full application of the proposed standard, or exclusion from the proposed standard, should be prescribed by the standard and not elective to ensure consistency across entities.

**Definition of a lease**

The exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1–B4 and BC29–BC32). The exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59–BC62) and on distinguishing a lease from a service contract (paragraphs B1–B4 and BC29–BC32).

**Question 4**

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

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

(a) We agree. The definition of a lease is consistent in principle with previous IFRS guidance which regards a lease as a contract that conveys the right to use a specified asset for a period of time in exchange for consideration. We agree conceptually with this definition.

(b) We agree. The transfer of control is a key element in a sale. The sale treatment criteria of automatic title transfer or bargain purchase option at the end of the lease are consistent with this principle.

(c) We believe that the guidance in paragraphs B1-B4 for distinguishing leases from service contracts is generally sufficient. However, the board should provide examples to clarify the application guidance in B3 that “a contract that permits or requires the supplier to substitute other assets only when the specified asset is not operating properly may be a lease”. As it reads presently, users may be unsure whether or not a contract is a lease if it includes such a provision.

Scope

Question 5: Scope exclusions
The exposure draft proposes that a lessee or a 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 and similar non-regenerative resources (paragraphs 5 and BC33–BC46).

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?

We agree with the proposed scope for the reasons outlined in the basis of conclusions but would also exclude short term leases as discussed in our response to Question 3.

Question 6: Contracts that contain service components and lease components
The exposure draft 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 (paragraphs 6, B5–B8 and BC47–BC54). If the service component in a contract that contains service components and lease components is not distinct:

(a) The FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.

(b) The IASB proposes that:
   (i) A lessee should apply the lease accounting requirements to the combined contract.
   (ii) A lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.
   (iii) A lessor that applies the derecognition 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 contracts that contain both service and lease components and why?

We agree with the FASB’s approach that would have the lessee and lessor apply the lease accounting requirements to the combined contract, as this is consistent with our view of lease arrangements with service components as single assets. Additionally, separating service and lease components that are not
distinct may be impractical and result in highly judgemental measurement, decreasing the usefulness of this information for users.

**Question 7: Purchase options**
The exposure draft proposes that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraphs 8, BC63 and BC64).

Do you agree that a lessee or a lessor 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?

We agree. A lessee should account for purchase options only when they are exercised as this is when the contract ceases to be a lease and becomes a sale and the risk and rewards of the asset have been transferred from the lessor to the lessee. This is the point at which we believe, as discussed in Question 1, the asset is recognised. Accounting for a purchase option in advance of exercise introduces management judgement which may be subjective and inconsistent across entities, causing issues with comparability of financial statements under the proposed accounting. In our view, information on purchase options should be disclosed in the notes to financial statements.

**Question 8: Lease term**
Do you agree that a lessee or a 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 lessee or a lessor should determine the lease term and why?

We disagree. Requiring entities to estimate the probability of various lease terms scenarios involves significant management judgement and causes significant variability in application from entity to entity. The information would likely be subjective as entities are unlikely to be able to predict whether renewal options will be exercised 10 or 15 years into the future, resulting in no incremental benefits to users and inconsistency across entities. Our preference is to use the contractual term of the lease as defined in the lease agreement as this involves the use of only objective information and will ensure consistent application across entities. Should the board require the consideration of options to extend/terminate the lease term, we believe the treatment should be based on an entity's past behaviour regarding such options. The board should require entities to disclose options to extend or terminate the lease term in the notes to financial statements to provide users with relevant information about the leases.

**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 technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?

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

We disagree with the board's proposal that contingent rental payments, term option penalties and residual value guarantees should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique. The expected outcome technique requires significant management judgement which will limit comparability across entities. In addition, the annual reassessment requirement proposed in this ED will result in volatility to entities' net assets and earnings that is driven by subjective considerations and may obscure results from our core business activities, which do not include leasing. We believe that contingent rental payments, residual value guarantees and expected payments under term
option penalties should not be included in the measurement of assets and liabilities arising from a lease until cash outflows related to the payment become probable and reliably measurable as required under IAS 37. This will prevent overstatement of assets and liabilities by excluding from consideration contingencies where the likelihood of occurrence is low or not determinable. It also provides consistency within the IFRS framework in regards to the recognition and measurement of contingent liabilities. The board should require entities to provide disclosures on contingent rental arrangements, term option penalties, and residual value guarantees that do not meet the recognition criteria under IAS 37 to provide users with the same level of useful information about the potential variability of lease payments.

From the lessor’s perspective, we agree that contingent rentals, expected payments under term option penalties and residual value guarantees should only be included in the measurement of the right to receive lease payments if they can be measured reliably.

**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 reassessment and why?

We agree. Requiring lessees and lessors to remeasure 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 as contingent payments become probable as discussed in Question 9, will provide users with more relevant information that is reflective of the likely economic outcome of the arrangement. We also agree that this reassessment should only be performed when there is an indication that there is a significant change in the lease payments or term. Reassessments performed in the absence of such indicators are unlikely to result in a more accurate measurement of the assets and liabilities under the lease, and thus, the benefit to users would not outweigh the costs of performing the reassessment.

**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?

We agree with the criteria for classification as a sale and leaseback transaction. It establishes a framework for sale treatment that is consistent with the rest of the proposed standard and results in accounting treatment of the arrangement that is consistent with the economic substance of the transactions.

**Question 12: Statement of financial position**

(a) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment or investment property as appropriate, but separately from assets that the lessee does not lease (paragraphs 25 and BC143–BC145)? 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?

(b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

(c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think
that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

(a) We disagree. We believe presenting right-of-use assets and obligations to pay rentals separately from owned assets and other financial liabilities in the statement of financial position will not provide useful information to users when an entity’s leasing activities are not significant to the entity. The board should permit entities to provide such information in the notes to the financial statements if leasing activities are not considered to be significant to an entity’s operations.

(b) We disagree. We acknowledge that there are interdependencies in the underlying assets, rights to receive lease payments, and lease liabilities recognised by the lessor under the performance obligation model; however, presenting the details on the statement of financial position will not provide useful information to users when an entity’s leasing activities are not significant to the entity. The board should permit entities to provide such information in the notes if leasing is not significant to an entity’s operations.

(c) We disagree. We believe presenting rights to receive lease payments separately from other financial assets and residual assets separately within property, plant and equipment will not provide useful information to users when an entity’s leasing activities are not significant to the entity. The board should permit entities to provide such information in the notes if leasing is not significant to an entity’s operations.

(d) We disagree. We believe distinguishing between assets and liabilities that arise under a sublease in the statement of financial position will not provide useful information to users when an entity’s leasing activities are not significant to the entity. The board should permit entities to provide such information in the notes if leasing is not significant to an entity’s operations.

**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 (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

We disagree. Notwithstanding our response to Question #1 (b) where we state that charging interest costs to financing costs will distort net interest margin, if interest costs must be charged to financial assets, we believe that presenting lease income and lease expenses separately from other income and expense in profit or loss will not provide additional useful information to users when an entity’s leasing activities are not significant to its operations. The board should permit entities to provide such information in the notes to the financial statements if leasing activities are not considered to be significant to the entity’s operations.

**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 (paragraphs 27, 45, 63, BC147, BC153 and BC159)? 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?

For lessees and lessors, this information should be provided in the statement of cash flows only if leasing activities are considered to be significant to an entity’s operations. Otherwise, we believe that this information should be provided in the notes to the financial statements.
Disclosure

Question 15
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 (paragraphs 70–86 and BC168–BC183)? Why or why not? If not, how would you amend the objectives and why?

(a) We agree. Disclosing this information will provide users with a clear understanding of an entity’s leasing transactions.
(b) We agree. Disclosing information about the features and terms of the leases will provide relevant information for users to assess the uncertainty related to the future cash flows resulting from leasing transactions. As proposed in our response to Question #1, we suggest to the board to maintain the current standard for leases and to expand the disclosure requirements for operating leases to include details of lease terms, options and contingent rentals.

Transition

Question 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 (paragraphs 88–96 and BC186–BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?
(b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?
(c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

(a) We agree that if entities are required to implement this proposal, the simplified retrospective approach should be used for transition; however, we do not agree with the proposal to require all outstanding leases to be recognized and measured on the date of initial application, as this could include leases that expired before the adoption date but existed in the earlier periods. While we appreciate the importance of comparability of information over the periods, we believe recasting information for leases that have expired is a time consuming and costly exercise that would not provide commensurate value to users. We believe entities should only be required to disclose information on expired leases (e.g. lease terms, amount, and timing of expiry) in the notes for users to assess the impact of leases not captured in restatements.
(b) No, full retrospective application of lease accounting requirements should not be permitted. Allowing different entities to apply different accounting treatments to similar leases will limit comparability of financial statements.
(c) In determining a transition date, we ask the board to consider the amount of lead time that entities will need to apply the new model and other new standards. We appreciate that the board recognized the implementation challenges and separately issued a document on October 19, 2010 seeking views on the effective dates for accounting standards. We support the board’s approach to assist entities in implementing these changes and look forward to the opportunity to provide our views on that document.

Benefits and costs

Question 17
Paragraphs BC200–BC205 set out the boards’ assessment of the costs and benefits of the proposed requirements. Do you agree with the boards’ assessment that the benefits of the proposals would outweigh the costs? Why or why not?
We appreciate that the proposed standard addresses many of the criticisms of the previous standard for operating leases; however, we are concerned that the benefits will not outweigh the costs of implementation and ongoing application. The proposed model captures all leases, including those that are of short term nature. To apply the proposed standard, entities will need to implement significant system changes in order to capture the data required to estimate the right-of-use assets and lease obligations. For entities with a significant number of leases, performing such estimates will be a challenging task.

Furthermore, we disagree with the board’s statement in BC203(c) that a new lease model would not change the way a business operates. From the lessor’s perspective, we believe that the proposed standard may encourage lessors to structure more fixed term contracts to avoid the challenges associated with predicting the behaviour of lessees in regards to lease options and contingent rents.

As discussed in our response to Question 1, we believe that with additional disclosure on the features and terms of lease contracts, the current standard for leases can provide sufficient and relevant information to enable users to assess the financial position of entities under their leasing arrangements. Should the board elect to proceed with a new standard for leases, we ask the board to exclude short term leases with a duration of twelve months or less from the proposed model to ease the burden of implementation and ongoing application to entities.

Other comments

Question 18
Do you have any other comments on the proposals?

The board should address other issues that are of relevance to leases such as leasing incentives offered by the lessor to the lessee under the lease agreement in the proposed model, as these leasing incentives generally impact the lease payments and cash flows of the lessee/lessor.

We also believe that the board’s requirement to apply the new model to all outstanding leases at the initial application date would result in the use of hindsight by entities to determine the assets and liabilities related to lease contracts for the comparative periods. Since calculation of these assets and liabilities involves significant judgement, the use of hindsight would likely impact the objectivity and usefulness of such information.

In addition, we note the ED does not discuss whether the determination of the appropriate approach to lessor accounting (i.e., performance obligation approach or the derecognition approach) can be made by the acquirer on the date of acquisition in a business combination. The ED states that a lessor shall not change the lessor accounting approach after the date of inception of the lease. We believe that an acquirer should have the ability to review the lease in the context of the acquirer’s facts and circumstances and have the opportunity to change the lessor accounting model given the significant change in circumstances in the event of a business combination.