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

Dear Sir/Madame:

Subject: Exposure Draft Leases

Thank you for the opportunity to comment on the exposure draft related to Leases issued by the International Accounting Standards Board (IASB). The Government of Canada has approximately twenty-five Crown corporations that will be adopting International Financial Reporting Standards commencing in 2011.

We have significant concerns related to the proposed right-of-use model in the accounting for leases. The methodology proposed will result in a significant level of effort to compute and track all leases for financial reporting purposes, and we are not convinced benefits of the proposed model outweigh the costs to be incurred to track all the requisite information.

The proposed scope of the Exposure Draft excludes the service component of a contract for transactions in which the service component is distinct and able to be separated from the lease component. Consequently, although the substance of the transaction may be identical in a situation where the service component can be separated within a lease agreement, where it cannot, there will be an inconsistent accounting treatment for the transaction under the two scenarios. The assets and liabilities will differ
based on whether the organization determines if it is able to separate the service component from the lease component. We recommend that the model be reconsidered to ensure greater consistency in the accounting treatment for the service component of a lease agreement.

The Exposure Draft indicates, in paragraph 28, that the decision of whether the lessor should apply the performance obligation or derecognition approach should be based on “whether the lessor retains exposure to significant risks or benefits associated with the underlying asset.” While paragraphs B22 – B27 provide some factors to make this assessment, a significant amount of judgment is involved in making this determination, as highlighted by paragraph B26. Consequently, the decision of which method to apply may be unclear, or subject to bias. We recommend that further guidance be provided to indicate which method should be applied by a lessor.

The IASB has proposed a simplified approach whereby leases of under 12 months can be measured at the undiscounted amount of the lease payment and recognized in profit or loss over the lease term. However, we feel that applying this relief only for leases up to 12 months is not sufficient as there would be few, if any, material leases that cover only a 12-month period. We recommend that the provisions in paragraph 64 and 65 of the proposed standard be extended to the ability to elect for leases up to 60 months provided the difference between the simplified approach and the discounted approach is not significant.

The measurement model proposed will also introduce significant estimation, and therefore, potential adjustments on a regular basis to the carrying value of the liability over the life of the lease. As estimates change over time, assuming the longest possible lease term that is more likely than not to occur and using an expected outcome technique to reflect lease payments incorporating contingent rentals and expected payments will significantly reduce the reliability of the liability presented. According to the Framework for the Preparation and Presentation of Financial Statements, paragraphs 60 and 61 indicate that “an essential characteristic of a liability is that the entity has a present obligation”, “obligations may be legally enforceable as a consequence of a binding contract or statutory requirement”, and “an obligation normally arises only when the asset is delivered or the entity enters into an irrevocable agreement to acquire the asset.” Including optional lease periods in the lease term at the outset of the lease agreement is inconsistent with the description of a liability in the Framework. Likewise, the inclusion of contingent rentals using an expected outcome approach may reduce the reliability of the information presented by both the lessor and the lessee. We recommend that the standard include only committed factors in the measurement of the liability with disclosures of variables, such as extensions available and contingencies included in the
lease agreement. This provides the information to the user to assess the risks and potential changes to future cash flow streams, without introducing significant estimation volatility into the financial results of a period.

From a disclosure and presentation standpoint, the IASB should be less prescriptive in determining which balances must appear separately in the Statements of Financial Position, Comprehensive Income, and Cash Flow. It should be up to management discretion, given the significance of the lease portfolio and the needs of users to the financial statements, to assess if the requisite amounts should be separately presented in the financial statements or merely disclosed in the notes. The financial statement notes are integral to the financial statements, and the user’s needs are met by including relevant information in the notes rather than on the face of the financial statements.

Thank you again for providing the opportunity to comment on this Exposure Draft. If you have any further questions related to these comments, please do not hesitate to contact either Ms. Diane Peressini at Diane.Peressini@tbs-sct.gc.ca (613-957-9671), or me at Bill.Matthews@tbs-sct.gc.ca (613-957-9659)

Yours sincerely,

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