UBS AG appreciates the opportunity to provide comments on the International Accounting Standards Board's (IASB) and the Financial Accounting Standards Board's (FASB) (together, the "Boards") exposure draft ED/2010/9, Leases (the ED). We support the efforts of the IASB and FASB to further improve Lease Accounting and commend the Boards' efforts to achieve a substantial level of convergence on this important topic.

We acknowledge that the current model under IAS 17, Leases, (and related US GAAP) may omit relevant information about rights and obligations associated with leases due to its bright-line classification requirements. We generally agree that the basic right of use ("ROU") principle articulated in the ED is a conceptually sound solution for "core-assets" Lessees. However, we are very concerned that the proposed measurement and presentation methodologies will lack decision utility for users and will result in unnecessary operational complexity. Further, we do not believe that the proposed Lessor model is an improvement over IAS 17.

The summary below highlights our specific concerns and recommendations for the Boards:

**Lessees:**

We do not agree that there is sufficient conceptual basis for incorporating cancellable or avoidable lease extension option periods in the determination of a Lessee's liability. The "more likely than not" threshold proposed for establishing the term over which lease payments are incorporated into the ROU will introduce substantial measurement uncertainty and volatility (as variables are continuously reassessed). It will also lead to over-capitalization and produce false indicator of Lessees' financial leverage. We recommend that the Boards require the incorporation of such contingent periods only
in the event that extensions are “reasonably assured”, consistent with the current guidance, as we believe this is more conceptually aligned with the definition of a liability.

We question the utility of incorporating highly subjective estimates of future contingent payments into the calculation of the ROU. Contingent rental payments based on variables other than observable indices should be recognized as they occur, not in advance, due to a lack of reliable forecast data.

We are not persuaded that breaking a single lease contract into multiple units of account, especially for purposes of performance recognition, accurately portrays the true economics of a lease arrangement. Amortization of the ROU and corresponding liability on different bases artificially creates a timing mis-match between the benefits received and the associated expense. We believe that the substance of most lease contracts is for payment to be made as the benefit is delivered. Therefore, the Right of Use asset and Lease Payment Obligation should be linked in the income statement and amortized on a consistent basis, as they are not separate instruments.

**Lessors:**

We are concerned that the Boards’ performance obligation (“PO”) approach to Lessor accounting may as much result in over-statement of reported lease obligations on the global balance sheet as the current guidance understates them. We would encourage the Boards to consider whether it might be more appropriate to use a single Lessor model, consistent with the current accounting for finance type leases or the proposed de-recognition approach, i.e., eliminating the non-residual portion of leased assets against the contractual lease receivable.

**General:**

We suggest that the Boards re-consider the concept of utilizing a traditional operating lease model for “non-core” leases; i.e., those that are non-essential to the primary operations of the Lessee. The requirements of the proposed models will impose an immense operational burden on preparers at a significant incremental cost, for which the benefits to users may not be fully justified.

**Transition:**

We are very concerned that, given the ED’s asymmetric income statement recognition guidance for lease assets and liabilities, its simplified retrospective adoption method will result in overstatement of lease expense for Lessees and lease revenue for Lessors in the years immediately following adoption. We believe that a prospective adoption approach would result in more meaningful information for users.

Finally, we believe that a significant amount of lead time will be required to implement the new guidance. Substantial effort and cost will be required to train staff, analyze contracts, validate data, and formulate estimates. Furthermore, managements may need to re-assess legacy lease v. buy decisions and restructure certain contracts; this is especially pertinent to regulated banks for which the ED’s proposals may have a detrimental capital impact. In addition, we will need to design and develop new systems to sustain a robust level of control around future application of the standard. As such, we encourage the Board to consider setting an adoption date in 2014 or later, which would alleviate some of the conversion and maintenance efforts.
We have provided more detailed responses to the specific questions raised in the ED in the appendix to this letter. If you have any questions regarding our comments, please do not hesitate to call Ralph Odermatt at +41 44 236 8410 or John Gallagher at +1 203 719 4212.

Regards,

UBS AG

Ralph Odermatt  John Gallagher
Managing Director  Managing Director
Group Accounting Policy  Group Accounting Policy
**Appendix**

**The Accounting Model**

**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 amortization 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 agree that an obligation to make lease payments creates a liability and that it gives rise to a corresponding right-of-use asset. While we support this general notion, we believe that the measurement approach, which requires preparers to make significant and judgmental estimates concerning the lease term and contingent rentals, is fundamentally flawed. Please refer to our responses to questions 8-10 for our response to the measurement proposals.

b) We disagree that the right-of-use asset and the associated lease liability should be amortized differently. We believe that the asset and liability are inextricably linked. Unlike other types of liabilities, the lease liability is inseparable from the ROU asset; it cannot be separately settled or transferred. Therefore, while achieving consistency with the accounting for financial liabilities, the yield-based revenue recognition pattern proposed by the Boards causes the value of the lease to be “under water” immediately after initial recognition. The economic substance of most lease contracts is for payment to be made as the benefit is delivered, similar to executory contracts for other services. We believe that the proposed revenue recognition pattern is not faithful to the underlying business model and that it is not incrementally informative for users.

**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?

(a) We strongly disagree with the ED’s Performance Obligation (“PO”) approach. We are concerned that this methodology does not provide symmetry with the proposed Lessee model and that it may as much result in over-statement of reported lease assets and obligations on the global balance sheet as the current guidance may understate them.

We remind the Boards that it was the Lessee model, not the Lessor’s, which prompted the improvement project in the first place. Further, it is the bright line differentiation between operating and finance leases under IAS 17 which has given rise to the greatest concerns. We believe that the current Finance Lease method under IAS 17 is well understood and has not proven to be inadequate in practice. We believe that method would best complement the ROU approach for Lessees.
We do not agree with the boards’ proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting. Our response is effectively the same as the one given to question 1 (b) re: the Lessee model.

**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 lease payments in profit or loss over the lease term.

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?

(a) – (b) We agree with the simplified requirements regarding lessee and lessor accounting for short-term leases.

**Question 4: 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. The exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale and on distinguishing a lease from a service contract.

(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 generally agree with ED’s definition of a lease. However, we recommend that the Boards provide additional application guidance in the final draft.

b) We agree with the criteria for distinguishing a lease from a contract that represents a purchase or sale.

c) While we do not disagree with the guidance for distinguishing a lease from a service contract from a theoretical standpoint, we are generally skeptical from a practical perspective. We feel that the ability to
ascribe a fair value to typical services associated with lease contracts (maintenance in particular) will be highly problematic given the multitude of service permutations and the lack of transparent pricing in most markets. Such allocations will be subject to high levels of uncertainty and will therefore lead to inconsistent practice, thus damaging the credibility of the lease accounting model. For that reason, we encourage the Boards to re-consider a scope exception for non-core leases (see question 5, below), as we believe that would alleviate some of the operational and financial impact of this issue.

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 do not object to the ED’s scope exclusions, which include leases of intangible assets, leases to explore for or use natural resources and leases of biological assets. Also, we agree that a sublease is in scope, as it is in fact a lease.

However, we request that the Boards re-consider a scope exemption for “non-core” assets. The proposed standard will create tremendous operational challenges for both Lessor and Lessees. To ease the significant operational burden of the Proposed ASU, we strongly recommend that non-core leasing activities continue to be accounted for as operating leases by both lessees and lessors. In order to ensure a principles-based approach, non-core activities could be defined generally as those leases that are not essential to an entity’s operations. Companies would then be required to identify core versus non-core activities for their particular business and fully disclose what is included in each category in the footnotes to the financial statements.

Question 6: Contracts that contain service components and lease components

The exposure draft proposes that a lessee or a lessor 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 that, if the service component can be easily separated and is clearly distinct from the lease component, it should be allocated to the separate contract. However, we believe that in many lease contracts the service components can be unclear, and the market values of these components are uncertain. In particular for maintenance services related specifically to the leased asset, and which have no stand-alone benefit other than to support the functionality of the leased asset, we propose that the lessee and lessor treat the contract as combined. We therefore recommend that the Boards’ should clarify explicitly the executory and operating costs that are to be considered distinct.

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<th>Question 7: Purchase Options</th>
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<td>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).</td>
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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 with the ED that a lessee or a lessor should account for purchase options only when they are exercised. The lessor no longer owns the asset and no longer has any risk associated with this asset.

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<th>Question 8: Lease term</th>
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<td>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?</td>
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We strongly disagree with the proposal that the lease term should be determined 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. This requirement is inconsistent with the Framework’s definition of a liability, as cancellable/optional extension periods do not constitute a present obligation.

Further, such estimates are likely to be extremely unreliable, especially for long duration contracts (as are common to the real estate industry). Extensions are highly dependent on business models, which themselves are influenced by macro-economic & market-specific trends, technological developments, success in execution of strategy, preferences of current management teams, etc., etc. The base terms of many real estate leases frequently span multiple business cycles. As such, the subjectivity required to formulate the probability assertions for lease terms will lead to inconsistent measurements, thus damaging the comparability of financial statements,

Our concern is that the proposal, as drafted, will lead to significant over-capitalization and volatility (as estimates are re-assessed). In turn, this will unnecessarily inflate leverage ratios and create a capital constraint for banks that are subject to regulatory capital limitations.

We propose that the lease term should include the non-cancellable lease term in the leasing agreement and any extension periods that are reasonably certain (consistent with current guidance in IAS 17), and be adjusted when the extension options are actually exercised. This will decrease the potential earnings volatility, and therefore be more consistent and simple for users of financial statements.
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 do not 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. Similar to our comment regarding lease extension options above, we believe that the level of subjectivity required to forecast future outcomes and related probability-weightings is so great that the resulting amounts reported in financial statements will be completely unreliable. We believe this is especially pertinent to performance-related rent adjustments, but is also relevant for all contingencies other than those based on observable indices.

For this reason, we suggest that initial measurement should only include the base contractual lease payments; and, when a contingent rental occurs, only then should the lease obligation/receivable be adjusted.

Question 10: Reassessment

Do you agree that lessees and lessors should 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 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 believe that reassessment should be performed only if there has been a change to the contract or upon resolution of the contingency. Therefore, a reassessment would be performed if a renewal option is exercised, a contingent rent adjustment is triggered, the lease terms are modified, etc. Assumptions regarding the future exercise of an extension option or contingent rent payment features based on unobservable variables will create significant earnings volatility as the leases are reassessed. This conflicts with the purpose of the ED to provide users with consistent financial statements.

Question 11: Sale and leaseback

The exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents the sale of the underlying asset, the leaseback would also meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66–67, B31 and BC160–BC167).

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.

Presentation

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, totaling 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 agree that a lessee should present the obligation to make lease payments separately from other liabilities. Given the unique measurement principles proposed for the obligation to make lease payments, we do not think that it would be appropriate to present the liability together with other financial and non-financial liabilities. We also agree that the right-of-use asset should be recognized separately from owned property, plant or investment property.

(b) As stated above, we do not agree with the PO approach proposed in the ED.

(c) We agree that the rights to receive lease payments should be presented separately from other financial assets and liabilities. We think that the residual asset should be presented with the lease receivable as an investment in a lease.

(d) We agree on the separate recognition of lease assets and liabilities between the sublease and the head lease because the sublease transaction is in fact a separate contract with different features from a head lease.

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?
The ED would eliminate the income statement caption “rent expense” for lessees and replace it with amortization expense relating to the right-of-use asset and interest expense on the lease payment obligation. We note that for commercial banks, net interest margin is a key metric used by investors to assess the profitability of the bank’s core business activities of accepting deposits and making loans. Accordingly, we are strongly opposed to including interest expense on lease payment obligations relating to non-core leasing activities in net interest margin. We believe that including expenses related to ancillary activities in this key performance metric would reduce the usefulness of the financial statements for investors. We recommend instead that interest expense on lease obligations be permitted to be classified below net interest margin for financial institutions insofar as it relates to non-core leasing activities.

**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 noted instead? Why or why not?

We agree that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows, when significant.

**Question 15: Disclosure**

Do you agree that lessees and lessors should disclose quantitative and qualitative information that:

(a) Identifies and explains the amounts recognized 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

Why or why not? If not, how would you amend the objectives and why?

We agree that both the lessees and lessors should disclose quantitative and qualitative information that identifies and explains the amounts recognized in the financial statements arising from leases, as well as describe how leases may affect the amount, timing and uncertainty of the entity’s future cash flows. However, with the uncertainties created by estimating the lease term and lease payments, significant disclosure will have to be included for users to understand and appreciate how probabilities were determined. As discussed earlier, longer lease terms will create less reliable estimates and confuse users if estimates are changed during the reassessment process.

**Question 16: Transition**

(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 with the dissenting opinion of Stephen Cooper. We think that the simplified approach will be financially misleading to the users of financial statements. Since, under the proposed guidance, all outstanding leases will be given a fresh-start as of the date of initial application, the front loading of every lease’s expense and income (as discussed in our response to question 1 above) will be aggregated together in the years immediately following adoption. This could result in a significant income statement distortion; over-stating earnings for Lessors and understating earnings for Lessees. If the Boards were to adopt a symmetrical approach to the amortization of assets and liabilities, then the front loading anomaly would no longer exist and we would be more amenable to the simplified retrospective approach. However, as the proposal stands, we would suggest applying the new standard either on a prospective or full retrospective basis.

(b) While we think that permitting the full retrospective approach to lease accounting would lessen the anomalous impact to earnings in years immediately following adoption, it will be very costly from an operational standpoint. It can also be very difficult to obtain lease contract details dating back years or decades, which would complicate the restatement balances. Refer to our response to question 17 for the costs that we foresee our firm facing.

(c) Refer to our responses in parts (a) and (b).

Question 17: Benefits and costs

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 believe that the burden that Lessees and Lessors will face in preparing financial statements under the new model, as proposed, will outweigh the benefits to users.

Initial transition will require companies to re-train staff, re-analyze all lease (and potential lease) contracts, build new cash flow forecasts, establish methodologies to ensure consistent application of estimates, design and develop new management reporting systems and cost & balance sheet allocation tools, etc. Additional headcount will be required to maintain the ongoing support for re-assessments and processing. Further, many companies will need to re-consider their lease v. buy strategies and re-negotiate financial covenants which will be impacted by new guidance. Regulated financial institutions that are subject to regulatory capital constraints (Basel III, FINRA, etc.) will need to consider assignments of contracts amongst legal vehicles and restructuring of contracts to mitigate potentially onerous capital charges resulting solely from the proposed model. These steps will come at an extremely high cost. For instance, we have preliminarily estimated that the cost to convert and establish an ongoing systems infrastructure for 1,200 leases could easily exceed $10 million as follows:
A significant amount of the anticipated cost is attributable to the proposal’s requirements to formulate estimates relating to extension options and contingent payments. As we’ve stated above, such estimates are likely to be highly unreliable and inconsistent from company to company given a general lack of objective market information. Thus, while users will derive some benefit from more quantitative and qualitative disclosure, we believe that the end result of these uncertain estimates will be less comparability and more volatility. This will ultimately create confusion among users and diminish public confidence in the decision-utility of the numbers.

Note: In the event the Boards choose a full retrospective approach to transition (see our comment in Question 16 above), the additional costs of mining historical data could substantially exceed the estimate above.

We strongly believe that the cost-benefit trade-off would be better balanced if the Boards were to apply the recommendations we’ve incorporated above in our responses to questions 8 and 9 above.

Finally, we believe that a significant amount of lead time will be required to implement the new guidance. The requirements of the ED’s proposal will result in a full paradigm shift in which new skills and new systems must be carefully developed. As such, we encourage the Board to consider setting an adoption date in 2014 or later.

**Question 18: Other Comments**

Do you have any other comments on the proposals?

We suggest, in general, that the Boards provide greater levels of application guidance and practical examples. Areas in which we would find this helpful, in particular, are as follows:

- **Definition of a lease:** Under the ED, the differentiation between lease arrangements and other executory contracts has become more critical due to the different accounting now afforded to each.
• Incremental borrowing rate: The proposed guidance offers the lessee the option of utilizing its incremental borrowing rate to initially measure the lease asset and liability if the rate implicit in the leasing arrangement cannot readily determined. It is unclear in the proposed guidance whether the incremental borrowing rate should be the lessee’s incremental borrowing rate for general corporate purposes or a non-recourse, i.e., asset specific, rate. If a non-recourse rate is permitted, we recommend that the Boards provide additional implementation guidance as such a rate will be difficult to reliably estimate.

• Lease Term

The application guidance in the ED proposes that the lease term should be measured based upon “implicit options included in the contract and given effect by the operation of statutory law.” An example of this concept would be very useful.

Additionally, many real estate lease contracts provide “expansion” options to allow Lessees to take on additional space should their capacity needs increase over the course of the arrangement. The terms of the expansion are pre-determined within the original lease. If such expansion were instead a stand-alone contract, we would not recognize the right of use until such time as the date of commencement. However, we are uncertain as to how this would interrelate with the probability-oriented guidance for extensions where the feature is embedded in an existing lease.

We further note that many of our European real estate leases contain clauses which permit the Lessee and Lessor to extend the agreement on an annual basis under specified terms. In practice, annual roll-over is very common; however neither party is obligated to do so. We are uncertain how the notion of an implicit option would be applied in this situation.

• Contingent Rentals:

As the use of forward looking information is not common under the current lease accounting paradigm, we believe that the Board should provide clear examples of the application of these new concepts for preparers.

• Transition:

In the after-math of the recent credit crisis, many companies have recorded onerous contract provisions against their leases, pursuant to IAS 37, Provisions, Contingent Liabilities and Contingent Assets. We suggest that the Boards provide specific application guidance as to how such provisions should be presented upon adoption of the ED; net against the ROU?; separately as a liability? Further, to the extent that extension options have been incorporated into the lease term under the new guidance, how should the provision impact the amortization of the ROU, if at all?