《Japan Business Federation》

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International Accounting Standards Board (IASB) 30 Cannon Street London EC4M 6XH, United Kingdom

Comments on IASB Exposure Draft "Leases"

Nippon Keidanren pays all respect to the International Accounting Standards Board (IASB)'s effort to improve the accounting for leases and we also appreciate this opportunity to comment on the Exposure Draft "Leases" (ED).

In Japan, various efforts toward IFRS adoption in 2015-2016 or early adoption beforehand have been accelerated, such as a study group to support the expected practice of IFRS application. In order to further gain momentum to introduce IFRS, it is necessary for the accounting standard to be feasible for practical use and acceptable for Japanese business community. We would like to continuously communicate with the IASB toward smooth adoption of IFRS in Japan.

Our comments are as follows.

General Comments

We support the ED's policy to apply the right-of-use model and thereby require lessees to recognize transactions deemed operating leases under current standards in the statement of financial position, as this will contribute to the enhancement of the usefulness of financial statements. Overall, however, the ED would entail excessive burdens on preparers, which can be seen, for example, in its application of the proposals uniformly to all leases other than short-term ones, its provisions on the measurement of lease term and lease payments, and its stricter disclosure requirements. It is doubtful that current business and corporate practices were properly taken into account in formulating the ED, which as a result disproportionately focuses on the needs of financial statement users. If the ED's proposals are adopted as they are, the convenience of leases might be seriously undermined. We request the Boards to carefully reconsider whether there are benefits that justify the costs.

Question 1

We are opposed to the proposal that for all leases, a lessee should recognize right-of-use assets and liabilities to make lease payments, though we support the thrust of the proposal.

If a lease does not have a non-cancellable term and can thus be cancelled at any time,

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the liability to make lease payments over the contractual lease term is indeterminate. It is not appropriate for such a lease with indeterminate maturity of rights and obligations to be recognized as an asset and a liability. In addition, this treatment may reduce the reliability and comparability of financial statements. In cases where a lease does not have a non-cancellable term and can be cancelled at any time, the lessor should manage the asset and recognize the lease payments received as income, which is in line with the economic reality; and the lessee should recognize the lease payments as expenses without recognizing a right-of-use asset and a liability to make lease payments, in the same manner as accounting for rental transactions.

While this relates to Question 6 as well, we are opposed to the proposal that, if service components in a transaction cannot be separated from the lease components, the proposed accounting treatment in the ED should be applied to the whole contract. Many transactions that contain lease components also include service components, and in some cases these two types of components are inextricably linked. If in such cases the whole contract is required to be treated as a lease, components not constituting the right to use the underlying asset—e.g., service components such as services provided to make the underlying asset function properly and the value added by the transaction—would also have to be recognized as part of asset and liability in the statement of financial position. This not only contradicts the definition of leases but may transform the concept of financial statement assets, which will not help improve the usefulness to financial statement users. Therefore, a transaction whose service components cannot be distinguished from the lease components should be treated as the provision and receipt of services, not as a lease.

Furthermore, we believe there are other types of leases that should be permitted to be accounted for similarly to rental transactions. These include leases of noncore assets that are not essential to the lessee's business activities, and immaterial leases. Recognizing right-of-use assets and liabilities to make lease payments for all leases in a uniform manner would impose extremely heavy costs on preparers, and is totally unacceptable.

Ouestion 2

We disagree with the proposal. Further consideration should be given to lessor accounting.

In the case of a lease that does not have a non-cancellable term and can be cancelled at any time, we consider it inappropriate to recognize the right to receive lease payments over the contractual lease term, for the same reason given in relation to Question 1. Such treatment may reduce the reliability and comparability of financial statements. In cases in which a lease does not have a non-cancellable term and can be cancelled at any time, as with the lessee, the lessor also should account for the lease similarly to rental transactions and recognize the lease payments received as income.

As we pointed out in our response to Question 1, a transaction whose service components cannot be distinguished from the lease components should be treated as the provision and receipt of services, not as a lease. In addition, certain leases, such as leases of noncore assets not essential to the lessee's business activities and immaterial leases, should be permitted to be accounted for similarly to rental transactions. Applying the performance obligation approach or derecognition approach to all leases would impose significant costs on preparers and is thus unacceptable.

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We have examined a hybrid model under which the performance obligation approach and derecognition approach are applied on a case-by-case basis, on the premise that the aforementioned certain leases (i.e., the ones to which accounting treatment similar to that for rental transactions should be permitted to be applied) are excluded as exceptions. However, opinions of Nippon Keidanren's member companies are split into three groups: the first supporting the uniform application of the performance obligation approach, the second in favor of the uniform application of the derecognition approach, and the third backing the hybrid model. We believe this matter requires further considerations. The first group supports the uniform application of the performance obligation approach from the perspective of consistency between the lessee's right-of-use asset and the lessor's lease liability. On the other hand, the group supporting the derecognition approach finds it problematic that under the performance obligation approach, a single asset is counted twice—as the underlying asset by the lessor and as the right-of-use asset by the lessee. The group considers the performance obligation approach inconsistent in that this double counting would have to be canceled in cases where a lease transaction is concluded within a consolidated corporate group and the lessor group company adopts the performance obligation approach.

Ouestion 3

We support the intent of the proposal concerning simplified requirements, but request that modifications be made regarding lessee accounting.

We do not think that substantial benefits will be obtained by recognizing as assets and liabilities short-term leases that are defined as "leases for which the maximum possible lease term, including options to renew or extend, is twelve months or less." In spite of that, in order to recognize as assets all short-term leases including the ones whose term is just several days or whose payments are small, lease contracts would need to be comprehensively managed within the consolidated corporate group. This would result in far greater costs than the benefits. We thus request that lessees also be permitted to apply accounting treatment similar to that for rental transaction.

Ouestion 5

We disagree with the proposal.

Leases of intangible assets should be included in the scope of the ED, because the treatment of these leases will become unclear when IAS 17 is abolished.

Question 6

We disagree with the proposal.

As commented in our responses to Questions 1 and 2 above, we believe that a transaction whose service components cannot be distinguished from the lease components should be treated as the provision and receipt of services, not as a lease. While it cannot be denied that a transaction containing lease components also include financing components, the lessor's primary purpose of the transaction is the provision of value added, not financing. Similarly, the benefits the lessee expects from the transaction are the expanded effects brought by the services received, rather than financing effects. We do not agree with the ED's proposal that does not reflect these realities of business.

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Ouestion 8

We are strongly opposed to the proposal.

If a lessee or a lessor is required to rationally determine the lease term as the longest possible term that is more likely than not to occur by estimating the probability of occurrence for any options to extend or terminate the lease, the determination and verification processes would place a significant burden on financial statement preparers and such processes are impracticable for auditors as well. It is also not appropriate to require a reporting entity to recognize uncertain liabilities for an estimated period that is longer than the contract term in the statement of financial position, as this deviates from the concept of liabilities. Furthermore, accounting treatment based on a lease term that is changeable depending on the estimating method used would allow room for arbitrariness and not ensure comparability. A lease term should be defined as the contractual lease term.

Ouestion 9

We are opposed to the proposal concerning the use of the expected outcome technique.

If a lessee or a lessor is required to estimate contingent rentals and expected payments under term option penalties and residual value guarantees using the expected outcome technique and to include them in the measurement of assets and liabilities, the processes of estimating, measuring, and verifying them would be heavily burdensome for financial statement preparers and such processes are impracticable for auditors as well. The estimation process would allow room for arbitrariness and not guarantee comparability. In addition, the lease payments calculated using probability-weighted average do not reflect the actual cash flows paid and received and thus have little usefulness to the management and users. We believe that an estimate of lease payments should be made based on the entity's best estimate.

Question 10

We disagree with the proposal. Remeasurement should be limited to cases where there are significant changes.

Question 11

We agree with the proposed criteria for classification as a sale and leaseback transaction. We, however, disagree with the requirement to adjust the measurement of a right-of-use asset and the gain or loss on sale of an underlying asset to reflect current market rates for lease payments, as the requirement would entail excessive burdens on preparers.

Ouestion 12

We believe that presentation in the statement of financial position should be left to the discretion of preparers depending on materiality.

Question 13

We do not agree with the proposal regarding presentation in the statement of comprehensive income. Presenting lease income and lease expense separately from other income and expense would be extremely burdensome for preparers, and the

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benefits would not justify the costs.

Ouestion 14

We believe that presentation in the statement of cash flows should be left to the discretion of preparers depending on materiality.

Question 15

Overall, the proposed disclosure requirements would result in excessive administrative burdens. For that reason, we do not support the proposal.

Specifically, our views on the proposed requirements are as follows. Regarding notes to right-of-use assets, we consider it sufficient to provide a similar level of information to current notes to tangible fixed assets; as such, while we agree with the disclosure of a reconciliation of opening and closing balances, we disagree with the disclosure of the total cash lease payments paid during a period. Similarly, as for notes to liabilities to make lease payments, it should be sufficient to provide a similar level of information to current notes to interest-bearing liabilities; we thus agree with the disclosure of a maturity analysis, but disagree with the disclosure of a reconciliation of opening and closing balances. With regard to a lessor's right to receive lease payments, we disagree with both the disclosure of a reconciliation of opening and closing balances and the disclosure of a maturity analysis. As no analysis information on the timing of collection is currently disclosed concerning assets, it is hard to believe that maturity analyses regarding the right to receive lease payments alone would constitute useful information to users. Also, we consider it unnecessary to disclose a reconciliation of the opening and closing balances for residual assets arising from leases to which the lessor applies the derecognition approach, because that has little importance as quantitative information. It is also noted that, if these views of ours are adopted, the disclosure requirements will be substantially simplified, for example, regarding short-term leases.

Ouestion 16

Although we support the simplified retrospective approach stated in Question 16 (a), the proposal is still likely to lead to heavy administrative burdens. It should also be permitted to recognize a liability to make lease payments measured at the undiscounted amount of the remaining lease payments.

Question 17

We completely disagree with the Boards on their assessment that the benefits of the proposals would outweigh the costs.

If the ED's proposals are adopted, the scope of leases would broaden and greater administrative burdens would be placed on reporting entities to measure the lease term and lease payments on a contract-by-contract basis. This means that the concerns indicated in paragraph BC203(d) would become a reality. The process through which the Boards analyzed the relationship between the costs and benefits are shown in paragraphs BC200 to BC205. The ED, however, does not provide the reasons why the Boards judged that the benefits would outweigh the costs. Preparers should make every effort, if the proposed standard is to provide users with the benefits outweighing the additional costs to preparers. But, under the current proposals it seems totally

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impossible to obtain the benefits offsetting the costs.

Ouestion 18

When securitizing an operating lease receivable, the current treatment is to sell the off-balance-sheet lease receivable and recognize cash and a loan payable in the balance sheet. According to the ED, we understand the right to receive lease payments to be derecognized and the cash to be recognized, if securitization is made in cases where the performance obligation approach is adopted. Another way to view this case, however, is that assets and liabilities are reduced as a loan payable is not recognized. We request the accounting treatment on securitization to be clarified.

Sincerely,

Nippon Keidanren Business Infrastructure Bureau