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September 3, 2013

Via website posting: <http://www.iasb.org/>

**Re: IASB Exposure Draft: Leases ED/2013/6**

Dear Sir/Madam:

The Certified General Accountants Association of Canada (CGA-Canada) welcomes the opportunity to comment on the **IASB Exposure Draft: Leases ED/2013/6**

We have restricted our responses to the questions that relate to either the IASB or to both the IASB and the FASB. We have also provided additional comments on certain related matters.

**Question 1: identifying a lease**

*This revised Exposure Draft defines a lease as “a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration”. An entity would determine whether a contract contains a lease by assessing whether:*

- (a) fulfillment of the contract depends on the use of an identified asset; and*
- (b) the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.*

*A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.*

*Do you agree with the definition of a lease and the proposed requirements in paragraphs 6–19 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.*

**Response**

We note that the ED proposes a definition and criteria to identify a lease similar to the guidance provided in IFRIC 4. Without prejudice to our observations articulated in additional comments on the right-of-use model, we are in general agreement with the definition of a lease and the proposed requirements in paragraphs 6–19 for how an entity would determine whether a contract contains a lease. However, we further contend that:

- The definition should be robust enough to clearly differentiate between a lease contract and a service contract. We are concerned that the proposed definition in the ED is inadequate in this regard.
- The definition as proposed in the ED involves subjective judgements. We suggest more guidance on the application consistent with other on-going IASB projects.
- Guidance on identification of a lease contract (Paragraph 19) and that on identification of a component in a lease contract (Paragraph 20) seem to overlap because of similar narration. We suggest more clarity on these issues.
- The proposal in this ED regarding accounting for contracts that contain service components and lease components is not consistent with the ED on Revenue Recognition. We believe that, in the absence of separate observable prices for any of the contract components, an entity should allocate lease payments on some reasonable estimate based on available information, and not allocate all payments to the lease component.
- We suggest scoping out the contracts when it is expected that the lessee will consume insignificant economic benefits embedded in the underlying asset (Type-B contracts) and scope in only contracts when it is expected that the lessee will consume significant economic benefits embedded in the underlying asset (Type-A contracts). Please also refer to our response to Question 2 below.

## **Question 2: lessee accounting**

*Do you agree that the recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?*

## **Response**

Without prejudice to our observations on the right-of-use model, we contend that, in order to maintain integrity of this model, there should be only one measurement approach and, accordingly, we do not support the single lease expense approach in instances when it is expected that the lessee will consume insignificant economic benefits embedded in the underlying asset (Type-B contracts). Instead, as suggested in our previous response, such contracts should be scoped out of the proposed new standard. We also believe that there is no sound conceptual basis reinforcing single lease expense approach, and that such approach will not provide any decision-useful information. We suggest that, for Type-B contracts, accounting for lessees can be greatly simplified by treating payments under the contract as an expense over the contract term. We believe that such treatment will result into symmetrical accounting by lessors and lessees as enumerated in our response to Question 3 below:

### **Question 3: lessor accounting**

*Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?*

#### **Response**

We concur with the proposed different accounting approaches that lessors should apply for Type A and Type B contracts. We also note that the proposed accounting for lessors aligns with the alternative accounting for lessees for Type B contracts as suggested by us in our response to the previous question.

### **Question 4: classification of leases**

*Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 28–34, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?*

#### **Response**

We believe that the classification of leases should be based on a common set of principles, and not contingent upon the nature of the underlying asset. Hence, we suggest that the classification of leases will be greatly simplified if, instead of prescribing rebuttable presumptions regarding nature of assets, the proposed standard describes Type A and Type B lease contracts as follows:

Type-A Leases:

- (i) The lease term is for the major part of the remaining economic life of the underlying asset;
- AND
- (ii) The present value of fixed lease payments accounts for substantially all of the fair value of the underlying asset.

Type-B Leases:

- (i) The lease term is for an insignificant portion of the remaining economic life of the underlying asset;
- AND
- (ii) The present value of the fixed lease payments is insignificant relative to the fair value of the underlying asset;

We believe that for both types of leases, criteria (i) and (ii) are complimentary in economic sense, and it is highly improbable that only one of the criteria will be satisfied for any given contract.

### **Question 5: lease term**

*Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?*

#### **Response**

We believe that the proposals on lease term involve highly subjective judgements and are not aligned with other Standards. For example, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* requires that an entity have a present obligation before recognising a liability. Also, the proposals consider a fixed term lease contract as economically equivalent with another contract of the same total term but including an optional period. We do not agree that such is the case.

Hence, we suggest that the options in a lease contract should be accounted separately as financial instruments in accordance with the relevant standard. We are aware of the practical difficulties in recognition and measurement of such options but believe that the same can be mitigated by appropriate disclosures.

### **Question 6: variable lease payments**

*Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?*

#### **Response**

We support the proposal to exclude usage and performance-based variable lease payments from the measurement of lease liability and lease receivable. We agree that variable lease payments should not be recognised only because they are highly probable. We also support the proposal for inclusion of variable payments based on an index or a rate. However, we believe that more clarity is required on the concept of “in-substance fixed payments.” We suggest that guidance should also be provided for presentation of lease payments not included either by the lessee in the lease liability or by the lessor in the lease receivable. We further suggest that the IASB should make consistent proposals on the treatment of contingent and variable payments across different ongoing projects such as Revenue Recognition.

### **Question 7: transition**

*Paragraphs C2–C22 state that a lessee and a lessor would recognise and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why? Are there any additional transition issues the boards should consider? If yes, what are they and why?*

## Response

We understand that the existing lease arrangements may have long duration and the lessees may not have necessary information to apply full retrospective approach. Hence, we support modified retrospective approach on practical considerations, although we believe that full retrospective approach is conceptually superior. Also, the proposal for carrying forward amounts of leases recognised as finance leases before transition date would avoid double counting.

We further suggest that the proposals for operating leases (Paragraphs C8-C9 and C13-C15) should not be made applicable in the instances when the term expires before the end of the period in which the entity transitions to the new standards.

## Question 8: disclosure

*Paragraphs 58–67 and 98–109 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments; reconciliations of amounts recognised in the statement of financial position; and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?*

## Response

We are in general agreement with the objectives of the disclosures as stated in paragraphs 58 and 98. However, we note that the requirements are highly prescriptive and rules based. We strongly encourage the board to reconsider the disclosure requirements and streamline them to a manageable level. We also recommend clarifying that not each of them apply to every reporting entity.

## Question 12: Consequential amendments to IAS 40

*The IASB is proposing amendments to other IFRSs as a result of the proposals in this revised Exposure Draft, including amendments to IAS 40 Investment Property. The amendments to IAS 40 propose that a right-of-use asset arising from a lease of property would be within the scope of IAS 40 if the leased property meets the definition of investment property. This would represent a change from the current scope of IAS 40, which permits, but does not require, property held under an operating lease to be accounted for as investment property using the fair value model in IAS 40 if it meets the definition of investment property.*

*Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?*

## Response

As stated in our response to Question 2, we believe that a lessee should not recognise Type-B leases as real assets. However, if Type-B leases are scoped in the new standard, then the proposed amendment to IAS 40 is coherent and consistent. We note that, under the current requirements, IAS 40 is usually applied only to interest in investment property held under a finance lease. As noted in BC 312 of the ED, finance leases typically do not include variable

lease payments or unrecognised optional lease payment. Hence, at present the application of fair value model does not usually need to deal with these components. This issue would become more important following the proposed amendment because existing operating leases of investment property are more likely to include options or variable payments. Applying IAS 40 measurement requirements would involve measuring the market value of the options which may present measurement challenges because of their diversity as noted in BC 137.

### **Additional Comments**

We note that the ED advances the goal of the IASB to report leases on the statement of financial position. The proposals may affect key financial metrics, debt covenants and an entity's decisions about whether to lease or buy an asset.

However, we are concerned that the achievement of this goal is accompanied by compromise on the conceptual integrity of the standards, increased complexity and high cost of transition and compliance. The implementation of proposals will involve subjective judgments and provide structuring opportunities.

The ED proposes a dual model of lease accounting for lessees as well as lessors which is inconsistent with the initial stated objective of the two Boards to introduce a single lease accounting model. A dual measurement approach and adoption of asymmetrical accounting treatments for lessors and lessees are likely to increase the complexity of the proposals as well as costs associated with their implementation.

The right-of-use model has not been evaluated conceptually and may preempt the ongoing IASB project on Conceptual Framework. Also, this model may not be appropriate for all leases. We believe that the on-going Conceptual Framework project provides an opportunity to define the right-of-use asset, and to differentiate it from other assets.

We note that there is a wide diversity of views on the proposals made in this ED. This is evidenced by the fact that two of the IASB's fourteen voting members and three of the seven FASB members voted against issuing these proposals for comment. We hope that the two Boards will be able to further refine the proposals, and make them more acceptable on the basis of their intensive outreach activities and feedback received from their constituents.

Should you wish to discuss the contents of this comment paper or require further elaboration on any of the items presented herein, please do not hesitate to contact Kamallesh Gosalia at [kgosalia@cga-canada.org](mailto:kgosalia@cga-canada.org) or alternatively the undersigned at [rlefevre@cga-canada.org](mailto:rlefevre@cga-canada.org).

Sincerely,

[Original signed by:]

Rock Lefebvre, MBA, CFE, FCIS, FCGA  
Vice-President, Research & Standards