

September 12, 2013

International Accounting Standards Board

Financial Accounting Standards Board

Dear Sirs / Madams,

**Comments on the revised Exposure Draft 2013 “Leases”**

We are a group of Japanese companies that is mainly comprised of companies that prepare consolidated financial statements under the accounting principles generally accepted in the United States.

(The names of companies represented are noted at the bottom of this letter)

We appreciate that the IASB and the FASB are trying to improve the lease accounting standard and the opportunity to provide comments to the revised Exposure Draft (ED). The following comments are those on the revised ED.

**Executive Summary**

We appreciate that the IASB and the FASB are trying to improve the transparency of financial reporting by revising the lease accounting standard to treat the material lease transactions as on-balance. In addition, we evaluate that the revised ED has been improved partly from the previous one.

However, the revised ED proposes that substantially all lease contracts should be treated as on-balance except for short-term leases. We are concerned that the revised ED might require preparers excessive cost and burden compared with benefit of investors.

The classification of leases and the accounting approach of lessees are more complicated compared with those of IAS No.17 and might not adequately meet the realities of lease transactions. The lessors would be required to evaluate the fair value of lease contracts and recognize profit at the commencement date. This proposal requires complicated calculation and would be difficult to be persuaded. The burden of preparer to cope with the proposal of accounting and disclosure requirements of the revised ED would be significant.

We hope that the boards will listen to the comments of wide range of related parties, and revise the content of this ED so that it would be supported by related parties and practicable by preparers.

Some of our member companies propose the idea to apply new rules only to leasing companies or the entities in which lease contracts have materiality for their business.

**(Question 1 : Identifying a lease)**

We generally agree with the definition of a lease and the proposed requirements for how an entity would determine whether a contract contains a lease. However, the following three points are required to be improved.

Entities would have significant difficulties in judging whether each contract contain a lease or not, and which type of classification should be applied, generally because they have many lease contracts. Those judgments might be almost impractical. Therefore, the lease identifying rule should be built so that it can limit the objective contracts they must judge.

1. From the viewpoint of realities of transactions, it is not reasonable to request on-balance for lease contracts regarded just as borrowing. For example, property leases can not be alternative method of purchase basically, and its nature is considered similar to “service”.

At least, the leases without period of irrevocability should not be defined to recognize right-of-use assets and lease liabilities on balance sheet (including the property contracts which are cancellable with announcement within 6 months in advance). A property lease which is cancellable should be accepted

2. To distinguish lease from executory contract (e.g. service, which is not correspond to lease), detailed guidelines and illustrated examples are requested, as exemplified bellow :

- (1) fulfillment of the contract depends on the use of an identified asset
- (2) the ability to direct the use and receive the benefits from use of the identified asset

3. We do not agree with the proposed treatment in which a lease shall combine the components and account for them as a single lease component if some or all of components do not have observable prices according to paragraph 23 (b)(ii) and (c). If components of service are greater than those of leases, this accounting treatment is not adequate. The contract should be judged as a lease or service based on whether its major component is a lease or not.

**(Short-term lease)**

We agree with that short-term lease contract is treated as off-balance. However, improvement is requested for the following points.

Under the revised ED, a short-term contract is defined as “a lease that, at the commencement date, has a maximum possible term under the contract, including any options to extend, of 12 months and less” (Appendix A : Defined terms). In this definition, the term of option to extend the lease, whether it has a significant economic incentive to exercise that option or not, is counted as a term when judging a short-term lease. This contradicts the treatment of leases term (paragraph 25). Under this definition, entities would not be able to use the simplified accounting treatment (e.g. off-balance) under paragraph 118 and 119 because most of lease contracts that has options to extend will not be judged as short-term leases. We strongly request to change the definition of short-term lease as “a lease that has a term under the contract, including any options that has a significant economic incentive to exercise, of 12 months or less”. This change would enable the consistent treatment of lease term and short-term leases.

**(Judgment of materiality)**

BC405 states “the IASB expects lessees to apply a similar materiality threshold to leases as it does to items of properties, plant and equipment. This would result in a lessee not applying the proposal to leases considered to be immaterial on a basis similar to that applied to items of property, plant and equipment.” However, in a jurisdiction such as Japan where small amount of property, plant and equipment is required to be capitalized, the proposal of BC405 would require lessees to treat immaterial amount of leases as on-balance. We think that the judgment of materiality should be based on the materiality of total financial statements. This should be stated in the revised standard rather than in the basis of conclusions of the standard.

**(Question 2 & 4 : lessee accounting)**

We understand the intension of the revised ED and partially appreciate it. However, we hope that the boards will listen to the comments of wide rage of related parties, and revise the content of this ED so that it would be supported by related parties and practicable by prepares.

Under the revised ED, lease contracts are classified not only by the way of “whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset” but also by the way of “whether the underlying asset is property”. We understand that this classification might be proposed

because the boards considered the different nature of property such as land would not be depreciated.

However, this proposed classification would result in complicated classification, because it has practically 4 segmentations. In addition, the rules of classification differ slightly between property and other leases.

Furthermore, there are differences not only in measurement method but also in presentation on PL and CF, between Type A and Type B. It might cause confusion.

From such reasons, our member companies have some different views such as listed below, and the classification method proposed by the revised ED does not have acceptance of a majority.

- 1 Classification method proposed by the revised ED is accepted.
- 2-(1) The classification of IAS No.17 should be kept. Type A is applied to current capital lease. Type B is applied to others.  
<Reason> Current IAS No.17 reflects the economic substances of leases, better than the revised ED. Under the proposal of the revised ED, most of the leases classified as operating leases under IAS No.17 would be classified as Type A leases. As a result, lessees would be required to recognize the total lease cost on a front loading basis compared with a straight-line basis under IAS No.17. This recognition pattern of the total lease cost does not reflect the economic substances of these leases.
- 2-(2) Judgment for on-balance should be based on “whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset”. Type A is applied to the lease in which interest is material, and Type B is applied to others. It is not necessary to classify whether the underlying asset is property or not.  
<Reason> There is no reason to distinguish property from other assets, because it is not different from others assets in that its economic benefit is expected to be consumed, and that practical judgment of property (such as “whether the consumption is for more than an insignificant portion or not”) is not impossible, as well as other assets.
- 2-(3) The classification of lease should be based only on “whether the underlying asset is property”. Type A is applied to the assets other than property, and Type B is applied to property.  
<Reasons> It is not realistic to judge the type of leases of each of many lease contracts by their economic life and gross lease payments. The judgment should be completed only by “whether the underlying asset

is property”.

3-(1) Classification is not necessary. Type A alone should be applied.

<Reason> For Type B, back-loading depreciation cost of the right-of-use asset is not calculated based on the consumption pattern of the assets. As the result of this depreciation, the book value of the right-of-use asset also would become a meaningless balance. Furthermore, significantly complicated calculation is required in practice.

3-(2) Classification is not necessary. Type B alone should be applied.

<Reason> It is complicated to have two different accounting approaches by types. In addition, under the revised ED, total lease cost of most of leases would be recognized on a front loading basis, because most of operating leases under IAS 17 would be added as Type A.

4 Current IAS17 should be maintained. It is sufficient for the convenience of financial statement users to expand disclosure requirement.

<Reason> The revised ED still has many problems and would force preparers excessive burden. In addition, it is possible to provide enough information of leases to financial statement users by expanding disclosure requirement.

Furthermore, regarding the classification of lease assets proposed by the revised ED, we require the following improvement.

1. For the description “whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset”, the concrete threshold is not provided. It might cause confusion in practical judgment. In reference to such numerical criterion as shown in current US-GAAP, the words such as “insignificant”, “major” and “substantially all” should be defined clearly in provision 29 and 30.
2. The revised ED requires, for Type B leases, the complicated calculation process to recognize the right-of-use assets and the lease liability on the entity’s statement of financial position although the total lease cost is recognized on a straight-line basis on the entity’s statement of comprehensive income. The back-loading depreciation cost of the right-of-use asset is not calculated based on assets’ consumption pattern. As the result of this depreciation, the book value of the right-of-use asset also would become a meaningless balance. We propose that simplified calculation such as the

amount of right-of-use asset is regarded as approximated amount of lease liability.

3. Regarding the reassessment of the lease liability due to the change of the lease payments (paragraph 44) and the discount rate (paragraph 45), the description of “if there is a change” should be modified to “if there is a significant change”.

For the reasons above, to provide the approach which the majority of related parties would accept, we think that alternative approach of lessee accounting, including such realistic method as the on-balanced treatment of material leases by the limited modification of accounting treatment of operating leases of IAS No.17 should be studied, rather than proposing a radical change by a new model.

**(Question 3 : Lessor accounting)**

Although we understand that lessors should apply a different accounting approach to different leases depending on the economic substance of leases. We believe that existing accounting approach of IAS No.17 should not be changed since the issues pointed out regarding lessor accounting is limited. In particular, we do not support the proposal by the revised ED for Type A leases, from the viewpoints below :

1. To cope with the proposals of the revised ED, entities would be required to calculate the fair value of the lease contract of Type A at the commencement date. This would be a complicated and time consuming process.
2. Lessors would be required to recognize profit at the commencement date if the fair value of the lease assets is higher than their book value. It is not rational to recognize profit at the commencement date. Furthermore, we are concerned that the risk of recognizing losses including impairment losses in the future for lessors would increase if profit is recognized for Type A leases at the commencement date.

We believe, at least, that lessors should not recognize profit at the commence date if the fair value of the Type A leases is not significantly different from their book value. In those cases, entities should not be required to calculate fair valued of leases.

Even if profit must be recognized at the commencement date, it should be limited to the “sales-type lease” defined in current US-GAAP. Furthermore, in this case, it should be cleared that selling price of the entity can be used as the fair value.

**(Question 5 : Lease term)**

For this point, we understand that the revised ED has been improved from the ED 2010. However, the followings are required to be improved.

In the case that the contract contains the option of extension or midterm cancellation, the revised ED requests to reflect the extended (or shortened) contract term on lease term, if lessee has a significant economic incentive to (or not to) exercise the option.

However, the definition of the word “significant economic incentive” is not clear, resulting in extremely subjective judgment. Therefore, it should be made clear that it is limited to highly certain case. On that regard, current IAS No.17 prescribe it as “reasonably certain”, and it is not necessary to modify this provision. BC140 describes “the concept of ‘significant economic incentive’ would provide a threshold that is similar to the concepts of ‘reasonably assured’ and ‘reasonably certain’ in existing US GAAP and IFRS”. Thus, on the revised ED, the word “significant economic incentive” should be replaced by the word “reasonably assured / certain incentive”.

In addition, reassessment of the lease term should be requested only in the case considered material.

Some of our member companies prefer to treat the extension of contract term by exercising the option as newly started lease, rather than reassessment of original lease contract, because contract conditions change from original in many cases.

**(Question 6 : Variable lease payments)**

For this point, we support the proposal of the revised ED, since it has been improved from the ED 2010. However, the definition of “c) variable lease payments that are in-substance fixed payments” (paragraph 39) is not clear. Clear guidance is required.

**(Question 7 : Transition)**

Although we evaluate the proposed transition accepts a modified retrospective approach considering practical burden, we are concerned that the burden of the preparers to cope with the proposals of this ED would remain significant.

We hope the following transition treatment to alleviate the burden of prepares should be considered:

- i) the revised standard should be applied to new lease contracts after the application date,
- ii) the revised standard should be applied prospectively to lease contract including existing contracts
- iii) the revised standard should be applied retroactively. However, the adjustment on

financial statement is not made for comparative past terms but only from the beginning balance of financial position of the term from which the new standard is applied.

In addition, at least three years should be given to the preparers to cope with the revised standard when considering the application date.

Furthermore, enough consideration is necessary for the first-time adoption of IFRSs. For example, the company which adopts IFRSs before the effective date of this standard of "Lease" would be required to prepare three different accounting treatments, by its own country's standard, current IAS No.17 and the revised standard, in a short time. The transitional measures such as earlier application "before the effective date" should be prepared.

#### **(Question 8 : Disclosure)**

We strongly oppose to the proposal of disclosure. We believe the most important objective of the revised ED is to attain the on-balanced treatment of material leases for the improvement of transparency of financial reporting. Thus, disclosure requirement should be diminished than that of before. However, the revised ED tries to expand disclosure requirement. As preparers, we have significant concern over this point.

Currently, "Disclosure Framework" is under discussion by the IASB. Considering the materiality principle, the disclosure rule should be designed to be efficient with limited practical burdens.

The following disclosure requirements for lessees should be eliminated from the perspective of cost and benefit:

i) information about the nature of the leases

The detailed information such as (ii) (the basis, terms and conditions, on which variable lease payments are determined), (iii) (the existence, and terms and conditions, of option to extend or terminate to the lease), (iv) (the existence, and terms and conditions, of residual value guarantees provided by the lessee) of paragraph 60 (a) should not be required to disclose because entities that have many lease contracts would have significant difficulties to disclose this information. Cost of preparing this information would outweigh the benefit for investors. The usefulness of this information for investors would be limited.

ii) a reconciliation of opening and closing balances of right-of-use assets (paragraph 61) and a reconciliation of opening and closing balances of the lease liability (paragraph

64)

The cost of preparing this information would be significantly higher than the benefit for investors. IAS No.17 does not require these reconciliations.

iii) a maturity analysis of the lease liability, showing the undiscounted cash flow of on an annual basis for minimum of each of first five years (paragraph 67)

Disclosure of the undiscounted cash flow of later than one year and not later than five years as a total would be sufficient as the disclosure requirement of IAS No.17.

The following disclosure requirements for lessors should be eliminated from the perspective of cost and benefit:

iv) information about the nature of its leases

Detailed information such as paragraph 100 (a) (iii) (the existence, and terms conditions, of options to extend or terminate the lease) should not be required because lessors that have many lease contracts would have significant difficulties to disclose this information. Cost of preparing this information would overweight the benefit for investors. The usefulness of this information for investors would be limited.

v) a reconciliation of the opening and closing balances of the lease receivable (paragraph 103) and a reconciliation of the opening and closing balances of the residual asset (paragraph 104)

The cost of preparing this information would be significantly higher than the benefit for investors.

vi) a maturity analysis of the lease receivable, showing the undiscounted cash flows to be received on an annual basis for a minimum of each of the first five years (paragraph 106)

Disclosure of the undiscounted cash flow of later than one year and not later than five years as a total would be sufficient as the disclosure requirement of IAS No.17.

**(Question 12 : Consequential amendments to IAS 40)**

We support that a right-of-use asset arising from a lease of investment property

would be within the scope of IAS 40. However, the disclosure of fair value should not be required for the following reasons.

- While the practice for leases of investment property is not established, the disclosure requirement of fair value might force preparers excessive cost and burden.
- The right-of-use asset arising from a lease of investment property is just insignificant portion of the economic benefits embedded in the underlying asset. Therefore, the disclosure of fair value would not be useful to users of the financial statements.

We hope that our comments contribute to your forthcoming deliberations in this project.

Sincerely yours,

**A Group of Japanese Companies:**

CANON INC.

Hitachi, Ltd.

Honda Motor Co., Ltd.

ITOCHU Corporation

Komatsu Ltd.

KONAMI CORPORATION

KUBOTA CORPORATION

Makita Corporation

Mitsubishi Electric Corporation

Mitsubishi UFJ Financial Group, Inc.

Murata Manufacturing Co., Ltd.

NIDEC CORPORATION

Nippon Meat Packers, Inc.

ORIX CORPORATION

Panasonic Corporation (Representative)

Sony Corporation

Wacoal Holdings Corp.