12 September 2013

Sir Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC 4M 6XH
United Kingdom

<u>Comments on Exposure Draft (ED/2013/6)--Leases</u>

Dear Sir Hoogervorst,

Minsheng Financial Leasing Company Limited ("MSFL" or "we") appreciate the opportunity to comment on the International Accounting Standards Board ("IASB")'s Exposure Draft (ED/2013/6)**—**Leases (the "Exposure Draft" or "ED").

MSFL is a leading leasing company in China in terms of both profitability and asset size. We have been awarded as China's Best Financial Leasing Company for several times in recent years. As of June 2013, our total assets amounted to more than RMB 106 billion (USD 17.3 billion). With more than 130 business aircraft valued over USD 4 billion, we are currently the largest business jet lessor within Asia and the largest ship leasing company in China. MSFL has been continuously paying attention to the revision of lease accounting standards and has submitted our comments to domestic/regional accounting standard-setting bodies from time to time.

IASB issued the industry's long-awaited 2nd version of the Leasing Standard ED (ED/2013/6) on 16 may 2013. We established a task force to review the ED immediately, and submitted our preliminary comments at a seminar held by the Ministry of Finance of China on June 3. We were pleased to explain our views to you face to face at the seminar. Since then, we further revised our comments and certain new points are added. For more details, please refer to the appendix.

We concur with the objective set by the Board for the revision of leasing standard, and we notice that the second ED makes significant improvement from the earlier version in many aspects. However, this revised ED is still over complex, both in terms of its "dual model", and the many concepts and disclosure requirements newly introduced. We are concerned about its impacts to our current business and the potential high implementing costs it may cause. Besides, we also feel unsure about whether the revised ED could achieve its goal to provide more relevant information to the users of financial statements. Based on communications with our clients and industry peers, most professional leasing companies and representative lessees in China share similar views and concerns.

We set out below our major comments to the ED:

- Lessor accounting: the accounting attribute of "residual asset" is not in line with common senses, and relevant measurement requirement is highly impracticable.

- Lessee accounting: the dual approach in lessee's income statement for Type A and Type B leases lack a reasonable basis.
- Asymmetry between lessor and lessee accounting for Type B leases.
- The complexity and implementing costs for lessees to change its accounting for operating lease contracts.
- The classification criteria of leases is unnecessarily complicated
- The simplified model of short-term leases may bring structuring opportunities
- The definition of "lease term" may cause certain problems in practice.
- The disclosure requirements are too complicated and burdensome.

Our detailed responses to the specific questions raised in the ED are further discussed in the attachment. In discussing these issues, we extend our analysis both from a lessor and lessee perspective.

In short, we still support the Board's initial objective, i.e. to establish a unified accounting approach to all leases, instead of creating a new "dual approach" between property leases and non-property leases. We strongly recommend that IASB reconsider certain proposed changes in the ED so as to weaken the challenges for the public to understand and implement the new standard. As a result, further deliberation might be necessary beyond the current consulting period deadline in order to avoid any deviation from the initial goal as a result of time pressure.

IASB has made significant efforts to establish a set of high quality accounting standards worldwide since the breaking of 2008 global financial crisis, which is highly appreciated. To express our support to this objective, we invested considerable resources to review the ED, and we hope that our responses can be helpful to the Board. We would highly recommend that IASB stay open to the opinions of different stakeholders, especially those from emerging economies, and reaches worldwide consensus to the largest extent so that the new leasing standard could be widely accepted by the industries and withstand the testing of time and history.

Finally, we appreciate the opportunity to comment on the ED and present the views and concerns from the leasing industry of China. Please contact Tang Min at 86-10-68485396 or William Zhang at 86-10-68940066-9740 if you have any questions regarding our response.

Yours sincerely

Minsheng Financial Leasing Company Limited

<u>Appendix: Responses to detailed questions raised in the ED</u>

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MINSHENG FINANCIAL LEASING CO.,LTD.

Responses to detailed questions raised in the ED Appendix

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.

MSFL response:

We agree with the proposed definition.

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?

MSFL response:

Our comments on lessee accounting are set out below:

(A) <u>The structuring risks brought by the simplified model of short-term leases</u>

In many different occasions, IASB has expressed that the biggest problem of the existing accounting model for lease is that the classification between finance lease and operating lease is over complex, which has brought structuring opportunities. If that is the case, we are concerned that the simplifying of short-term leases in the ED may bring another structuring opportunity: to shorten the lease term in order not to capitalize the operating leases in the balance sheet.

According to the "Basis for Conclusions" (BC110), IASB believes that entities will not add a clause to a lease stating that the lease could be cancelled at any point, As there often is an economic disincentive for the lessor or lessee to do so. However, this is not often the case for short-term leases. In practice, changing a lease term from three years to one year normally will not bring significant loss to both sides (they could simply sign three different one-year contracts on day one and make it under the table). We find that the ED does not explain how IASB plans to solve this problem.

Nevertheless, we appreciate IASB's efforts to keep the short-term lease accounting treatment unchanged to reduce the technical complexity of the new accounting standard.

<u>(B) Whether the "Right-of-Use Model" complies with the conceptual framework of IFRS</u>

We believe that the ED does not explain clearly why the "Right-of-use Model" complies with the IFRS's current Conceptual Framework for Financial Reporting ("Conceptual Framework") regarding the definitions of assets and liabilities, especially in recognition of lease liabilities. According to the paragraph 60-64 of the Conceptual Framework, "The main characteristic of a liability is that the entity has a present obligation that arises from a past event"; "There should be a line between the present obligation and commitment to the future." In our view, the lessee's obligation under the lease contract is a series of future lease payments, which is a future obligation (this is why it is only required to be disclosed as a commitment in the current standards). It is quite difficult to define it as a present obligation, since the lessee would only fulfill the obligation on the condition that the lessor provides the underlying asset and related services in the future. Although the lease contract may include a "non-cancellable" lease term, in the legal sense, if the lessor fails to meet its obligation due to various reasons, the lessee will not be obliged to pay rentals and therefore at commencement date this obligation is still uncertain.

To say the least, even if we agree to regard the lease payable during the "non-cancellable" lease term as the present obligation, it is still difficult to explain in principle why the amount for the extension period is required to be included as well. Instead of being a present obligation, the lease payment for the extension period is just a unilateral option of the lessee, and the lessee can fully decide whether to exercise this option before the end of the non-cancellable lease term.

<u>(C) the dual approach to the recognition of lease expense for Type A and Type B leases lack a reasonable basis.</u>

For Type A leases, the lessee is required to amortize the right-of-use asset on a straight-line basis, as well as recognize interest expenses in accordance with effective interest method. For Type B leases, same interest expenses recognition method will apply, while the right-of-use asset will be amortized in a different way, purposed to keep a single and even lease cost spreading over the lease term.

It is remarkable that lessees' income statement and cash flow statement will look quite different under the above 2 scenarios. In the same time, it also raises unanswered questions about what economics the carrying amount of right-of-use assets would represent for Type B leases. Although IASB explained that different consumption profile apply to different underlying assets, it does not provide persuasive evidence about the amortization pattern of right-of-assets for Type B leases.

In short, we would suggest the Board to withdraw this controversial method stated in paragraph 50 of the ED, and to unify the subsequent measurement approach for the 2 types of leases.

(D) Lessee accounting for Type B Leases

We note that IASB has repeatedly expressed that the accounting for lessor and lessee should be symmetrical. However, such principle is not fully reflected in the ED. For Type B leases, the lessor recognizes the rental income and depreciation expense directly in the income statement without derecognizing of the original asset; while the lessee is required to recognize a lease liability, which is obviously not symmetrical.

We do not intend to discuss much about this issue theoretically. As a simple alternative, we suggest that IASB considers expanding the scope of short term model to all Type B leases. Under this method, both lessees and lessors may apply similar way of accounting as the current operating leases. Our rationales are set out below:

- Property lease is the most widely used form of leases. A further simplified model can help reduce the implementation cost and challenges of the new standard.
- From the perspective of the economic substance, property lease is much closer to asset leasing instead of financing activities, whereby the lessee mainly expects to receive service from the contract. Therefore, maintaining such business off balance sheet actually does not undermine to the objective of the Board;
- In practice, most leases are termed within one year except for limited special cases, as lessors are generally reluctant to sign a long-term lease. As such, the overall impact will be limited even if long-term property leases are accounted for using simplified model.

(E) The complexity and implementation costs of the proposed lessee accounting model

We understand the primary objective of the ED is that the lessee should capitalize the operating lease in the balance sheet. However, the proposed changes would bring significant impacts to our clients in following aspects:

(1) *Technical complexity.* **A**ccounting terms in the ED, including “right-of-use asset”, “lease liability”, “variable lease payment” and the whole new models are all fresh ideas and terms to our clients. It is already quite difficult to understand these new terms for us as a professional lessor For most our clients, leasing is not a core business activity and thus it is even more challenging for their management and finance department to understand and apply correctly these new accounting terms.

(2) *Implementation incentive and cost.* In addition to the low acceptance of the new accounting model, lessees are generally of little motivation to adopt the new measurement model. For those lessees who manage a large number of leased

asset (such as large commercial banks, which generally lease office spaces for branches and numerous electronic devices), they are facing with a challenging task to remeasure thousands of lease contracts one by one; this will not only significantly increase their workloads, but also incur a huge cost in the process of collecting information and upgrading IT systems.

(3) *The impact to the lessee's balance sheet*

For general enterprises, they would have to explain to their creditors about the rise of all debt ratios. As a result, they may encounter unfavorable conditions when raising fund in the future.

The impacts to commercial banks may be more complex. On the one hand, the scale of risk assets will increase significantly due to the recognition of the right-of-use assets on the balance sheet; On the other hand, the introduction of the right-of-use assets may also undermine their core capital. In accordance with current regulations, intangible assets (except for land use right) should be excluded in calculating of the Capital Adequacy Ratio ("CAR") for commercial banks. Since right-of-use asset is implied to be an intangible asset per the ED, it has caused much concern of our commercial bank clients. Predictably, the leverage ratio of commercial banks will significantly increase, the CAR will also be undermined (both these two indicators are subject to regulatory restrictions). Under the current macro-economic circumstances, as the level of capital adequacy of commercial banks are already at marginal level, such proposed changes are likely to be unacceptable.

In summary, we believe that the proposed changes in the ED will considerably reduce the demands for leasing businesses, and bring significant depressing effect to the whole leasing industry. Although the share of operating leases businesses varies among different leasing companies, we are still concerned about the impact to our business.

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?

MSFL response:

Our comments on lessor accounting model are set out below:

<u>(A) the accounting attributes of residual assets should be further examined.</u>

For Type A leases, the ED requires lessors to recognize a lease receivable and a residual asset respectively at the commencement date. A complex formula is used in the initial measurement to calculate the residual asset carrying amount. In the subsequent measurement, a lessor shall recognize the unwinding of the discount on the gross residual asset as interest income, similar to the treatment of lease receivable.

It is our concern that the Board still has not make it clear what "residual assets" is. Although it is not explicitly stated in the ED, residual assets are to some extent treated as financial assets, as a lessor is required to recognize the unwinding of the discount on the gross residual asset as interest income in the subsequent measurement.

Frankly speaking, we could not accept such an implied view. From our understanding of the leasing business, the residual assets are indeed physical assets rather than financial assets, which are evidenced in the following aspects:

- At the end of the lease term, what the lessor will recover is a physical assets, rather than cash.
- The residual assets are not exposed to credit risk, a typical characteristics of financial assets.
- The recoverable amount of lease receivables is fixed or identifiable at due date, yet the fair value of the residual assets at the end of lease term can only be estimated.
- The fair value of residual assets may change with the market, while the lessor never regarded it as an asset which will add its value smoothly by way of interest generating.
- Even if the residual asset is viewed as a right-of-use asset (similar to an intangible asset), there are no requirements to recognize interest income in the subsequent measurement of the right-of-use asset in other existing standards.

In summary, we do not agree with the proposals in the ED about the residual assets measurement. We would suggest that IASB make necessary adjustment to the proposed model, taking into consideration the physical assets attributes of the residual assets. That is, in addition to assessing impairment of the residual assets periodically, an entity would generally measure residual assets at historical cost in accordance with the "IAS16 - Property, Plant and Equipment". In addition, an entity shall neither recognize interest income subsequently, nor include the effects of variable lease payments in initial measurement.

<u>(B) The complexity of the residual assets measurement and high volatility of the measurement results.</u>

The most notable change in the ED to lessor accounting model is perhaps Type A leases. For leases of assets other than property which is currently classified as operating leases, the new model is even more complex than the current accounting treatment of financial leases, especially in the measurement of the residual assets. Although the current standard (IAS17) require the lessor to recognize unguaranteed residual value separately, such asset is almost negligible in lessors' balance sheets in practice. The lessors' management experience on how to quantify the value of residual asset is also quite limited.

According to our preliminary assessment, in practice, the lessor will face significant challenges to measure the residual assets:

1) The measurement results are highly dependent on the estimation of fair value. According to the ED, for Type A leases, a lessor shall initially estimate the fair value of the underlying asset at both the commencement date and the end date of the lease term, which will directly affect the lessor's financial performance both in the current (through realized profit) and each subsequent accounting period (through interest income, which is recognized based upon IRR). We believe that it is not only inoperable n practice, but also bring unacceptable implementation costs.

   The difficulty to obtain the fair value depends on whether underlying assets have active markets. For assets other than property, whether it is aircraft, ships or types of machinery and equipment, active market does not exist in most cases. Lessors may have to use valuation results by professional appraisal firms, and the costs are often quite expensive. More importantly, in practice, even the results given by the most well-known professional firms could often depart significantly from the actual transaction price.

   On the other hand, even for properties where active market exists, current IFRS only require fair value remeasurement for those properties explicitly using fair value model. For assets other than properties, entities only need to assess their fair value in cases that impairment indicators exist. Obviously, the requirements proposed in the ED are already beyond the existing standards, well the Board does not provide enough rational basis to support such challenging requirements.

2) It may impose high volatility to the lessor's financial statements. It is observable that fair values of different assets categories may change in completely different patterns due to their business nature. A well-maintained aircraft under normal operation may keep a stable value over several years (for example, some helicopters manufactured in the 1970's in Europe are still in service, where their current market price is even higher than the original price). As contrast, the fair value of a Panama dry-bulk carrier may be highly volatile as impacted by various factors around international shipping market. Under these circumstances, the estimates of fair value at lease commencement date could hardly reflect subsequent changes, and even lead to dramatic fluctuations on its income statement. According to our calculations (based on example 20 in the ED), operating profit might drop by over 50% for certain operating lease contracts, which is totally unacceptable for any lessor. In such scenarios, the lessor would have a strong motivation to manipulate the estimates of fair values, which would be a total disaster for both regulators and investors.

<u>(C) Asymmetry between lessor and lessee accounting for Type B (property) leases.</u>

In a Type B lease a lessee recognizes a financial liability for its obligations to make lease payments; however, the lessor does not recognize a corresponding financial asset for its right to receive those payments. Thus, the lessor and the lessee accounting treatment are asymmetric and mismatched. We believe this is inconsistent with the accounting model for financial assets /financial liabilities under current IFRS, neither it is consistent with the Board's initial objective of recognizing the assets and liabilities arising from lease contracts.

For Type B leases that occur within a business group, the ED does not state clearly how to make proper offsetting in the consolidated statements. In addition, the asymmetry would be particularly obvious for a head lease and sub-lease that are classified as Type B leases. The ED argues that entities should treat sub lease contracts differently from the original lease contracts. In property sub lease transactions, which are very common in practice, a sub lessor would recognize the lease payments as a financial liability, but is not required to recognize a financial asset for its right to collect rentals from sub-leases.

We believe that IASB should take actions to address above issues. Furthermore, we would draw attention of the Board to our suggestions in question 2, i.e. the lessees for Type B leases are exempted to recognize asset/liabilities on the balance sheet. By this way the lessor/lessee accounting treatment would be matched and above issues will be resolved naturally.

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?

MSFL response:

At first glance, the ED proposes to classify all leases into 2 types (A/B), simply based on the nature of underlying assets. However, it also requires judgment be made regarding whether the lease term is for a significant or insignificant part of the total economic life of the underlying asset, where no clear definitions for "significant" or "insignificant" are provided.

We are concerned that this might result in confusions and complexities in practice, which both imply potential structuring opportunities and undermine the comparability of financial statements. Frankly speaking, we have already heard voices that the new classification criteria would lead to at least five different outcomes (including the simplified approach for short-term leases), which is unnecessarily complex in our view.

Consequently, we would still encourage that IASB make utmost efforts to provide a single/unified accounting model for all leases (i.e. no classification needed at all), so as to avoid various new problems deriving from the proposed classification criteria.

Nevertheless, if the Board insists on the above classification criteria, we suggest that the Board provide operational guidelines regarding how to assess "significant" or "insignificant" in lease classifications.

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?

MSFL response:

Lease term is an important basic parameter in the lease accounting model, which directly affects the measurement of the lease assets and lease liabilities. We are concerned that the emphasis of "non-cancellable period", a key part of the lease term, may result in problems in practice.

In practice, especially in many developing countries where legal systems are not sound enough, lease terms stated in lease contracts are not often considered as truly "non-cancellable". On the contrary, the lessee and lessor either do not specify the commencement date and ending date, or keep flexibility in terms of changing/terminating contract terms. For example, a property lease contract could specify the lease term as one year, while also stating that both the lessee and lessor have the right to cancel the contact with one month's notice. According to the ED - Basis of the conclusion (see BC107 - BC111), the Board believes that in such case the lease term is deemed as the notice period (i.e. 30 days), rather than the explicitly stated one year term. We believe that such treatment may not truly reflect its economic substance; In fact, in most cases the lease term will be enforced as agreed upon in the contract.

In addition, in the definition of lease term, an entity shall determine "*if a lessee has a significant economic incentive*" either to exercise an option to extend a lease, or not to exercise an option to terminate a lease. In our view, such expression is somewhat too academic. In fact, people would rather focus on the possibility to exercise the option than the reason or incentive behind their actions. In IAS 17, lease term is defined as below:

> *"The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease* **it is reasonably certain that the lessee will exercise the option**."

In our view, the current definition is easier to understand and implement.

Based on above analysis, we hereby provide the following two suggestions:

(1) The definition of the lease term should keep some flexibility. An entity should be allowed to make reasonable judgment based on economic substance when the lease term is loosely defined in the contract. The exclusive reliance on the "non-cancellable period" in legal sense would be inappropriate and somehow arbitrary.

(2) To keep the wording about renewal options as used in current IFRS. That is to say,

as long as it is reasonably certain that the lessee will exercise the option to extend, the extended period should be included in the lease term. By this way entities need not make judgment/guesses on the economic incentive of the other party of the contract, where unnecessary complexity can be avoided.

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?

MSFL response:

We generally agree with the proposals regarding variable lease payments in the ED.

Compared to the early version, the current ED narrows down the scope of variable lease payments that should be included in the initial measurement (only if they are dependent on an index or a rate.) Besides, the ED states that variable lease payments should be measured using the index or rate as at the commencement date (no need to estimate their future changes). We would support this proposal.

The variable lease payments are actually still rare in China's business practice. We are also aware that most lessees disagree with the introduction of variable lease payments in initial measurement. However, we note that certain lease contracts do contain variable payment components that are linked to external index. We believe that the measurement of variable lease payments should not be excluded; otherwise it will undermine the comparability of financial statements among different industries.

At the same time, we would urge the Board to further clarify that "an index or a rate used to determine lease payments" should be limited to those **beyond the control of both the lessor and lessee.** Given that lease liability is a financial liability in nature (albeit not explicitly stated in the ED), we believe the treatment on the variable lease payments should be consistent with that of contingent settlement provisions of a financial liability as stated in IAS32 (Paragraph 25).

Lastly, we would remind the Board again that the measurement of variable lease payments would impose considerable complexity and workload to account for each lease contract, especially for subsequent measurement. We expect significant amount of time be invested to meet this changed requirement.

Question 7: Transition

Paragraphs C2--C22 state that a lessee and a lesser would recognize 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?

MSFL response:

We basically agree with the transition arrangement proposed in the ED. However, both lessees and lessors would have to invest enormous time and resources to collect data and make complex judgments during the transition period, whether they adopt a modified retrospective approach or a full retrospective approach. In this regard, we recommend that the Board allow a grace period of **at least three years** for us to make preparations after the release of final standard.

Meanwhile, based on materiality and cost-effectiveness principles, we would suggest that IASB permits the adoption of prospective approach in limited cases, for example, for those lessees that leasing constitutes only an insignificant part of the overall business, and for lessors where certain type of leases are insignificant to their overall business.

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 recognized 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?

MSFL response:

The ED uses multiple paragraphs to set out the disclosure requirements for lessees and lessor respectively. The proposed disclosures include maturity analysis of lease receivables / payables, reconciliations of opening/closing balances and the narrative description about nature of leases.

We agree with the ED's objective on the disclosure requirements is to provide more relevant information to users of financial statements. However, the benefits of this shall still be weighed against the implementation costs to achieve such objective. Based on our evaluation, the proposed disclosures requirements are over detailed, which will inevitably trigger the implementation costs and reporting workload for both lessors and lessees to an unnecessary extent.

We noted that FASB has proposed in the ED to exempt nonpublic entities from certain disclosure requirement (reconciliation of opening/closing balance of lease liabilities). We highly support this proposal and strongly recommend that IASB make more efforts to simplify the disclosure requirements of both lessors and lessees to a reasonable level. Our detailed suggestions are as below:

- Firstly, the ED requires a lessee to disclose a reconciliation of opening and closing balances of the right-of-use assets/lease liability separately for Type A and Type B leases. We believe the above requirements are even higher than that of the assets owned by the entities. Meanwhile, the disclosure requirements about lease liabilities are also much greater than that of other financial liabilities.

For the majority of our clients, the right-of-use assets are insignificant relative to their total assets. In such cases, the benefits are quite limited to separate the disclosure into different types of leases. Although the current IAS 17 actually does not require finance lease assets/liabilities to be reported on the balance sheet as separate lines, users of financial statements did not express much concerns about it. Besides, users of financial statements place more importance on the remaining maturity of lease liabilities rather than the addition and settlements of leases in any specific period. To sum up, we would recommend an aggregated disclosure of reconciliation of right-of-use assets and to exempt lessees from the requirement to disclose reconciliation of opening/closing balance of lease liabilities

- The ED proposes that lessees and lessors shall disclose maturity analysis of lease receivables / payables separately for Type A leases and Type B leases, including the undiscounted cash flows on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years.

  We note that the proposed maturity analysis requires a shorter interval of payment disclosure than the current practice. It also differs from the maturity analysis of financial instruments required under the IFRS 7, which may confuse users of financial statements. We further question the rationale why the maturity analysis should be classified into Type A and Type B leases if all these receivables/payables are treated as financial assets/liabilities. In short, we suggest that the maturity analysis of lease receivables/payables should be consistent with other financial instruments, and no need to be separated for Type A/B leases.

- In addition, the ED also adds detailed requirements of qualitative disclosures on leases, such as the general description of an entity's leasing activity; the basis, terms and conditions on which variable lease payments and options are determined, significant estimates and judgments such as how to determine a contract contains a lease and components of its lease and non-lease part, etc. We propose the Board to consider simplifying above requirements and provide implementation guidance and examples for us to follow.

Question 9 (FASB-only): Nonpublic Entities

To strive for a reasonable balance between the costs and benefits of information, the FASB decided to provide the following specified reliefs for nonpublic entities:

(a) To permit a nonpublic entity to make an accounting policy election to use a risk-free discount rate to measure the lease liability. If an entity elects to use a risk-free discount rate, that fact should be disclosed.

(b) To exempt a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability.

Will these specified reliefs for nonpublic entities help reduce the cost of implementing the new lease accounting requirements without unduly sacrificing information necessary for users of their financial statements? If not, what changes do you propose and why?

MSFL response:

We highly support the proposals by FASB. We would also recommend IASB to consider adopting such proposal, and further simplify other disclosure requirements. In fact, we believe that these two exemptions should be applied to listed companies as well. In practice, it is not easy to calculate incremental borrowing rate for those companies with sound operating records and no debt at all.

Question 10 (FASB-only): Related Party Leases

Do you agree that it is not necessary to provide different recognition and measurement requirements for related party leases (for example, to require the lease to be accounted for based on the economic substance of the lease rather than the legally enforceable terms and conditions)? If not, what different recognition and measurement requirements do you propose and why?

MSFL response:

We agree and believe that it is not necessary to provide different recognition and measurement requirements for related party leases.

Question 11 (FASB-only): Related Party Leases

Do you agree that it is not necessary to provide additional disclosures (beyond those required by Topic 850) for related party leases? If not, what additional disclosure requirements would you propose and why?

MSFL response:

We agree and believe that there is no need to provide additional disclosures for related party lease transactions.

Question 12 (IASB-only): 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?

MSFL response:

We generally agree with the proposal. However, there are obvious technical differences between valuing a property and valuing a property lease contract. Therefore, we request that IASB highlight the differences, and provides more guidance on how to reliably measure right-of-use assets by using a fair value model.

Additionally, in IAS 40 - Investment Property, investment property is defined as *property held to earn rentals or for capital appreciation or both*. If a leased property is only used for operation and administration purposes, it may not meet the above definition. Therefore, we suggest IASB to clarify that only a right-of-use asset arising from a lease of property, which is held for sub-lease purpose only, be within the scope of IAS 40.