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United Kingdom

Financial Accounting Standards Board
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Norwalk, CT
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United States of America

13 September 2013

Dear Sir / Madam,

Comments on the Exposure Draft “Leases”

The Japan Chain Store Association (“the Association” or “We”) consists of chain store operations engaged in retail business operations. We respect the efforts made by the International Accounting Standards Boards (IASB) and the Financial Accounting Standards Boards (FASB) to improve lease accounting. We provide our comments below on classification of leases, determining lease terms, impairment of right-of-use asset and construction assistance fund as it is necessary for our business to have practical solutions in place for accounting of these items.

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Specific Questions:

Question4: classification of leases

Do you agree that the principle on the lease’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?

- The Association (a member company of the Association is defined as a retail business whose business model is management and operations of more than eleven stores under the same capital ownership) supports the boards' proposal that, as indicated in the ED, classification of leases should be depended on whether the underlying asset is property. In a lease of the property, the term of the lease contract is generally long and a lessee does not have the intention to own the property. It is therefore appropriate for a lessee to recognize the expense in the profit and loss account evenly over the lease period as the traditional operating lease accounting does.
- As indicated in paragraph 30 of the ED, if the underlying asset is property, an entity shall classify a lease as a Type B lease unless one of the following two criteria is met (a) the lease term is for the major part of the remaining economic life of the underlying asset; or (b) the present value of the lease payments accounts for substantially all of the fair value of the underlying asset at the commencement date. If either criterion above is met, the lease is classified as a Type A lease. The Association disagrees with the board's assessment. The Association proposes an alternative approach that, if both criterion (a) and (b) in the paragraph 30 of the ED are met, the lease is classified as a Type A lease.
- In the chain store business, the asset of a lease contract is a store (building) and land and the feature is that the contract usually integrates both building and land in one contract. In a case including the used assets and renovated assets, the remaining economic life of the building relatively tends to have a short term. In such a case, the term will easily constitute most of the remaining economic life of the underlying asset in the paragraph 30 (a) of the ED. As a result, such a lease may be classified as a Type A lease only based on criteria of (a). However, the Association believes that these leases should not be classified as a Type A lease only based on criteria of (a) because a Type B lease is classified by a property being the real estate (land) and the building is used together with land with increased value.
- Therefore, the Association believes that both criteria of (a) and (b) in the classification of the lease should be met in order to avoid these problems.
- In addition, the Association believes that it should be acceptable to classify the land component as a Type B lease if it is possible to separately identify the land component in the lease contract that combines land and building, even if such an integrated contract is classified to be as a Type A. The classification of the lease is based on whether the underlying asset is property (land) and therefore it should not be denied that a land component in the lease is classified as a Type B lease.
- In determining whether the lease term is the major part of the remaining economic life of the underlying asset in the paragraph 30 (a) of the ED, the example 13 of Illustrative Examples uses a very low ratio (i.e., the lease term of 15 years represents 37.5% of the remaining economic life

of 40 years). The Association believes that this example is not appropriate because this example gives a user misunderstanding that the ratio could be very low in determining whether the lease term is “the major part of the remaining economic life”. The Association proposes that the ratio used in an example should be a higher ratio (i.e., 75%: lease term is 30 years or 80%: lease term is 32 years) that indicates “the major part of the remaining economic life”.

- In addition, the Association proposes that the ratio used in the example 12 should be reconsidered because this example gives a user misunderstanding by using an inappropriate ratio in determining whether the lease term and the present value of the lease payments are the “more than an insignificant part”.

Question5: 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, what alternative approach would you propose and why?

- As indicated in the paragraph 25 of the ED, an entity shall determine the lease term as the non-cancellable period of the lease, together with periods covered by an option to extend (terminate) the lease, if the lease has a significant economic incentive to exercise that option. The Association supports the boards’ proposal, assuming that the concept called “a significant economic incentive” is the same high threshold as reasonable certain in the current standard.
- Furthermore, the threshold is not clearly defined to identify “a significant economic incentive” in the ED. Therefore the Association suggests that the finalized standard should clearly state that the threshold is the same high threshold as defined in the current standard, as described in paragraph BC140 of the ED.

In addition, as described in paragraph BC143 of the ED, the Association believes that we should determine the lease term by considering “when measuring lease assets and lease liabilities if the lessee has a significant economic incentive not to exercise the option to terminate the lease” at the inception of the lease. We should not focus on the past example where the lease turned out not to be terminated for a lease engagement with an option to terminate the lease.

- The Association supports the boards’ assessment that, as indicated in the paragraph B5 of the application guidance, “an entity assesses whether the lessee has a significant economic incentive to exercise, or not to exercise, an option by considering all factors relevant to that assessment contract-based, asset-based, market-based and entity-based factors. And an entity’s assessment will often require the consideration of a combination of those factors because they are interrelated”.
- The Association is concerned about the following point in entity-based factors.

As indicated in the paragraph B5 (d) of the application guidance, “the importance of that underlying asset to the lessee’s operations, considering, for example, whether the underlying asset is a specialized asset and the location of the underlying asset”. In chain store business (retail business operations), the asset of the lease contract is often a store (building) and land. The Association is concerned about a case where a significant economic incentive to exercise is considered to exist based on excessive focus on the location of the underlying asset (land). The Association believes that it is necessary for lessee to consider all factors in determining lease term to ensure that a lease term should not be unnecessarily longer and, as a result, lease assets and liability should not be overstated.

Furthermore, the Association is concerned that an excessive focus on the location of the underlying asset (land) will lead to identification of a significant economic incentive and a longer term of the lease period, and as a result, the lease may meet a criteria of paragraph 30 (a) of ED. In that case, the Association has a concern that the purpose of ED classifying the lease as a Type B lease based on a property of the land would be lost.

Others: impairment of right of-use asset

- As indicated in paragraph 51 of the ED,” a lessee shall determine whether the right-of-use asset is impaired and shall recognize any impairment loss in accordance with IAS36 *Impairment of Assets*”. The Association disagrees with the boards assessment that IAS36 should be applied a right-of-use asset that is in a Type B lease (real estate lease).
- The Association believes that the objective of paragraph 1 of IAS 36 is to ensure that assets are carried at no more than their recoverable amount. The assets under IAS36 should be an asset that an entity acquires for the purpose of owning the asset or an asset which is equivalent to such an asset. Therefore, the Association suggests that right-of-use asset in a Type B lease should not be applicable for IAS 36 because the nature of as assets of both Type A and B lease are greatly different in terms of an entity’s intention for ownership.
- As described in paragraph BC188 of the ED, the benefits of application of impairment accounting to leased asset for users of financial statements of better comparability between assets that an entity owns and those that it leases outweigh this disadvantage. This purpose is to increase the comparability between assets which an entity owns and those it leases and the leased asset here is intended to be a Type A lease. The Association believes that a Type B lease has no significance for better comparability.
- In chain store business, the asset of the lease contract is a store (building) and land and the major component is land. The right-of-use assets of the land is not consistent with impairment asset accounting because an entity does not acquire land and the value of land will not decrease. In

addition, the Association has a concern that impairment of right-of-use asset (a Type B lease) would be substantially constitute an accelerated recognition of future rental fee.

Others: construction assistance fund

- In chain store business (retail business operations), the asset of the lease contract is a store (building) and land and the feature is that the contract integrates both assets. There is a case where a lessee pays guarantee money to an owner of the underlying asset, which is equivalent to the building acquisition value, for the purpose of the construction of the building and the return of the guarantee deposit and the payment of lease charges are offset in the lease term. In such a case, the relationship between the paid guarantee and the right-of-use associated with a lease contract would need to be addressed.
- As indicated in paragraph 39 of the ED, “At the commencement date, the lease payments included in the lease liability shall consist of the following payments relating to the use of the underlying asset during the lease term that are not yet paid”. Therefore, in a case where it is obvious that this guarantee money is offset against the lease payments in the future, at the commencement date, (i.e., the lease contract explicitly states that the guarantee money and the lease payments are offset or it is highly likely that the offset is made), the lease payments should be measured at the commencement date based on the total lease payments minus the guarantee fund.
- The guarantee money has the nature of the prepayment for lease payment and should be considered in the lease accounting. In addition, recognition of right-of-use asset and the guarantee money on a balance sheet may lead to overstatement of the right-of-use asset and the lease liability. This overstatement might have a considerable influence on a management index.
- In addition, IAS32 (Financial Instruments: Presentation) and IFRS7 (Financial Instruments: Disclosures) include a rule for offset treatment of financial instruments. The Association believes that the guarantee money should not be offset against the lease liability as financial instruments capacity: rather, the guarantee portion should be treated as paid cash, which will decrease the lease liability for its measurement at the commencement date.
- Question8: disclosure
Paragraph 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?

- The Association believes that ED will significantly improve the comparability of financial information by recognizing a right-of-use-asset in balance sheet.
- On the other hand, however, the Association believes that, if the ED requires more detailed information in the notes than required by the current standard, the benefits for users of financial statements would outweigh the costs and work load for preparers.
- The Association proposes that the disclosure requirements should be reconsidered because it will become a heavy burden for preparers to disclose a reconciliation of right-of-use-assets (paragraph 61 of the ED), a reconciliation of the lease liability (paragraph 64 of the ED), and a maturity analysis of the lease liability (paragraph 61 of the ED) and these disclosures are not required in the current lease standard.