

中 国 会 计 准 则 委 员 会  
China Accounting Standards Committee

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Mr. Hans Hoogervorst  
Chairman  
International Accounting Standards Board  
30 Cannon Street  
London, EC4M 6XH  
United Kingdom

13 September 2013

Dear Mr. Hans Hoogervorst,

**Re: Comment on ED/2013/6 Leases**

Thank you for offering the opportunity to the Ministry of Finance of China and China Accounting Standard Committee to comment on the IFRS Exposure Draft on Leases (“the ED”). We sincerely support and appreciate IASB’s tremendous effort in improving the international financial reporting standard for leasing transactions. Compared with the initial ED, the lessee and lessor accounting in this ED has been simplified, and the accounting for short-term leases and the measurement of variable lease payments are easier to apply. However, the proposed classification of leases lacks conceptual basis and is more complex. We believe both the lessee accounting and the lessor accounting need further improvement.

Our main comments are as follows:

**1. Classification of leases.** The proposed classification principle, which is based on the nature of the underlying assets, lacks sound theoretical basis to substantiate such conclusion. Firstly, the economic life used in classification criteria for property is *remaining economic life*, while *total economic life* is used for other assets. This difference causes inconsistency. Secondly, the judgment used to substantiate what is a property and the new terminologies of *insignificant*, *substantially all* and *major part* may result in practical diversity in classification and reduce comparability in financial statements. Thirdly, for a lease containing both land and a building, the ED requires the economic life of the building to be used as the economic life of the underlying assets when applying the classification criteria. Such requirement may not reflect the substance of the transaction. Lastly, the ED requires reassessing lease term under certain circumstances while precludes reclassification after the commencement date, which may result in conflicts with the classification principle.

**2. Lessee accounting.** We generally support the right-of-use (“ROU”) asset model, but we disagree with the dual approach to Type A and Type B leases. In our view, there is no substantive difference between the ROU asset of a Type A lease and that of a Type B lease for a lessee.

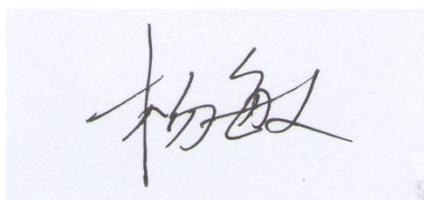
Moreover, the amortization of ROU assets of Type B leases neither reflects the consumption model of the ROU assets, nor it is consistent with the amortization principle of non-financial assets set out in other IFRSs. Besides, the lessee accounting and lessor accounting for Type B leases are not symmetric, which would mislead users of financial statements and add complexities to the accounting treatment on sublease transactions and elimination of intercompany transactions in consolidated financial statements.

**3. Lessor accounting.** The dual approach for Type A and Type B leases may lead to different accounting treatments for similar transactions and result in reduced comparability in financial statements. Moreover, it is not reasonable to (i) recognize day 1 gain for Type A leases; (ii) include variable lease payments (which are expected by a lessor in determining the rate the lessor charges the lessee but are excluded from lease receivables) in the initial measurement of residual assets; and (iii) recognize interest income of residual assets in subsequent measurement. In addition, it is difficult and costly to obtain the fair value of lease assets and estimations in the measurement of residual assets. Such data, even if obtained, may be unreliable especially when there is no active market and valuation is primarily based on third party's estimations. This may bring new opportunities for earnings management.

Based on the above, the ED still needs much improvement on a large number of significant issues. The Type A and Type B classification leads to different accounting treatments for transactions with similar economic substance, which is precisely one of the criticisms of current lease standard and a key driving force for this joint project. Hence, we suggest that IASB reconsider the schedule of this project and take more time and effort to develop a single symmetric model for both lessee and lessor accounting. If the major objective of this project is to resolve the off-balance-sheet financing issue, alternatively, we would suggest making minimum revision to the existing standard to require a lessee recognize rights and liabilities arising from operating leases on the balance sheet. However, this may lead to asymmetric treatments under certain circumstances.

Please refer to the attachment for our detailed feedback on listed questions.

Yours Sincerely,

A handwritten signature in black ink on a light blue background. The signature is stylized and appears to be the Chinese characters '杨敏' (Yang Min).

Yang Min

Director-General of the Accounting Regulatory Department of Ministry of Finance, China  
Secretary-General of the China Accounting Standards Committee

**Attachment:**

**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) fulfilment 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.

**Answer 1:** We agree with the definition of a lease and the proposed requirements for how an entity determines whether a contract contains a lease. We support that an entity shall account for each lease component as a separate lease, separately from non-lease component of a contract. However, we disagree with the requirement that a lessee shall combine the components and account for them as a single lease component if there are no observable stand-alone prices for any component of the contract, because it's not reasonable if the non-lease component of a contract is apparently more significant than the lease component. Therefore, we would suggest IASB provide further guidance on the accounting of such contracts.

**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?

**Answer 2:** We generally support the right-of-use asset model (ie recognize right-of-use assets and lease liabilities for all leases), but we disagree with the dual approach to Type A and Type B leases. Our major reasons are as following:

- (1) As for a lessee, there is no substantive difference between the right-of-use asset of Type A lease and that of Type B lease, which means dual approach is not needed.
- (2) For Type B leases, the amortization of right-of-use assets is recognized as the difference of the lease expense (evenly recognized during the lease term) and the unwinding of discount on lease liability, which neither reflect the consumption model of right-of-use assets, nor it is consistent with the amortization principles of non-financial assets set out in other IFRSs.
- (3) Lessee accounting and lessor accounting for Type B leases are not symmetric, which would mislead users of financial statements. Take sublease for example, one entity should recognize right-of-use assets and lease liabilities as a lessee, but could not recognize lease receivables as a Type B lease lessor. Similarly, there would be problems for elimination of intercompany

lease transactions in consolidated financial statements.

We understand that a single straight-line lease expense for Type B leases makes sense from certain perspective, but truthful reflection of economic transactions and consistency between IFRSs should prevail. Therefore, we suggest that a lessee adopt Type A approach for all leases.

**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?

**Answer 3:** We disagree with the proposed lessor accounting. Our major concerns are as follows:

- (1) The dual approach for Type A and Type B leases may lead to different accounting treatments for similar transactions and result in reduced comparability in financial statement.
- (2) It is unreasonable to recognize gain or loss at the commencement date for Type A leases. Because lease is different from ordinary assets transfer in that the performance obligation is fulfilled during the lease term, thus the related gain or loss hasn't been realized at the commencement date.
- (3) It is difficult and costly to obtain the fair value of lease assets and estimations in measurement of residual assets. Such data, even if obtained, may be unreliable especially when there is no active market and valuation is primarily based on third party's estimations. This may bring new opportunities for earnings management.
- (4) It's common to view residual asset as a physical asset, but the proposal requires a lessor recognize the unwinding of the discount on residual assets as interest income, which is similar to the accounting of financial assets.
- (5) The initial measurement of residual assts shall include variable lease payments which are expected by a lessor in determining the rate the lessor charges the lessee but are excluded from lease receivables. Such variable lease payments, if exist, arise from lease rather than the residual asset, which make the above requirement illogical and difficult to understand.
- (6) As mentioned in the answer to Question 3, the asymmetry of lessee accounting and lessor accounting for Type B leases may generate problems and mislead financial statements users.

In summary, there are still many aspects for improvement for lessor accounting. The Type A and Type B classification leads to different accounting for transactions with similar economic substance, which is precisely one of the criticisms of current lease standard and a key driving force for this joint project. Hence, we suggest that IASB take more time and effort to develop a single lessor accounting model that is symmetric to the lessee accounting.

**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?

**Answer 4:** We disagree with the proposed classification. Our major concerns are as following:

- (1) Classifying a lease on a basis of the nature of the underlying assets lacks sound theoretical basis and it's a great challenge to identify what is a property in practice.
- (2) The economic life used in classification criteria for property is *remaining economic life*, while *total economic life* is used for other assets. This difference causes inconsistency.
- (3) The judgment of new terminologies of *insignificant*, *substantially all* and *major part* may result in diversity of lease classification in practice and reduce comparability in financial statements. If quantitative criteria are provided as guidance, there will be sharp '*bright-line*' issues similar in the existing standard.
- (4) As for a lease containing both land and a building, it is obvious that the land lease should be a Type B lease. However, the proposal requires that an entity shall regard the economic life of the building to be the economic life of the underlying assets when applying the classification criteria. Such requirement does not reflect the substance of the transaction.
- (5) If a lease contains more than one asset, entities should determine the classification according to the nature of the primary asset. Due to information asymmetry, the lessee and the lessor may make different judgments and there may be situations that entities cannot identify which is the primary asset.
- (6) The proposal requires reassessing lease term under certain circumstances while precludes reclassification after the commencement date, which may result in conflicts with the classification principle.

To some extent, we can understand IASB's consideration for the proposed classification principle. However, it is obvious that the proposal doesn't resolve the classification problems of the existing standard, but is more complex. We doubt that stakeholders can benefit much from such changes. Hence, we would ask IASB to reconsider the classification of leases.

<b>Question 5: lease term</b>
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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?
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**Answer 5:** We basically agree with the proposals on lease term, but we would suggest that IASB provide further guidance on the following issues:

- (1) About *significant economic incentive*. In practice, the judgment by a lessee and a lessor may be different for the same transaction and their judgment at the commencement date may also be different from their final choice, especially for industries subject to high market volatility.
- (2) As mentioned in the Answer to Question 4, the requirement for reassessment of lease term and prohibition of reclassification may be contradictory.

<b>Question 6: variable lease payments</b>
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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?
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**Answer 6:** We basically 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. But as mentioned in Answer to Question 3, including variable lease payments (which are expected by a lessor in determining the rate the lessor charges the lessee but are excluded from lease receivables) in the initial measurement of residual assets is logically unreasonable, thus we suggest that IASB reconsider the requirement.

**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?

**Answer 7:** We generally agree with the transition requirements in Paragraphs C2-C22. However, in consideration of the cost and difficulty in application of the new standard, we suggest that IASB give other simplified transition alternatives, such as prospective approach, allowing lessees and lessors to recognize and measure only newly-signed lease contracts within the scope of the standard since the date of initial application.

**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?

**Answer 8:** We basically agree with the disclosure requirements, but would suggest that IASB make some simplifications. According to the proposal, an entity has to disclose large amount of information for type A and Type B leases respectively, which will greatly increase the cost and burden for disclosure. The situation can be worse when an entity is both a lessee and a lessor. However, too much detailed information doesn't serve the best interest of general financial statements users as it may hinder them from obtaining a whole picture for the lease transactions, especially for entities whose major business is not leasing or leased assets account for only insignificant part of the total assets. Hence, we suggest that IASB simplify the disclosure requirements to balance cost and benefit.

**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?

**Answer 9:** No comment.

**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?

**Answer 10:** No comment.

**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?

**Answer 11:** No comment.

**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?

**Answer 12:** Agree.