



September 12, 2013

International Accounting Standards Board  
30 Cannon Street  
London, EC4M 6XH  
United Kingdom

Dear Members of the International Accounting Standards Board:

**Re: Comments for Leases Exposure Draft (“ED”) – May 2013**

Thank you for the opportunity to comment on the Leases exposure draft (“ED”). The Canadian Association of Petroleum Producers (“CAPP”) has considered the proposals in the ED. Our comments on specific questions can be found below.

The Canadian Association of Petroleum Producers (CAPP) represents companies, large and small, that explore for, develop and produce natural gas and crude oil throughout Canada. CAPP’s member companies produce about 90 per cent of Canada’s natural gas and crude oil. CAPP’s associate members provide a wide range of services that support the upstream crude oil and natural gas industry. Together CAPP’s members and associate members are an important part of a national industry with revenues of about \$100 billion a year.

**QUESTION 1: Identifying a Lease**

**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.**

**Definition of a Lease:**

This ED 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.

We are concerned that the definition of a lease as proposed by the ED is currently unclear with respect to the following items:

***A. Identified Asset:***

We agree that an identified asset could be a physically distinct portion of a larger asset (e.g. a floor of a building). However, if that portion is not distinct it would appear that it would generally not qualify as an identified asset, and would be excluded from scope (e.g. a percentage of pipeline capacity or tankage).

However, there may be instances where a capacity agreement provides a customer with the right to use “substantially all” of an asset’s capacity, such as a pipeline. The ED does not address the accounting in such situations and therefore, two issuers may arrive at different conclusions as to whether or not the identified asset criteria has been met. This could add to a lack of comparability amongst two entities that are undertaking a similar transaction. Further, the lack of guidance may create an environment where an entity may choose to structure its arrangements to use less than “substantially all” of the asset’s capacity to obtain a preferred accounting treatment.

***B. Control:***

The concept of control is another area of concern within the definition. Under the ED, a lease exists when a contract conveys the right to control the use of an asset for a period of time in exchange for consideration. The ED does not provide sufficient guidance as to how preparers should determine if the specified asset is controlled or not, leading to significant judgment by preparers and therefore, potentially resulting in differing interpretations and practices. For example, oil and natural gas producers frequently contract the use of assets or services from third parties (e.g. trucks, buses, drilling rigs etc.). Under the terms of the contract, producers can direct the use of the underlying asset to a certain extent, by stipulating, where and when activities will be conducted and that the contractor must follow safe operating practices. However the contractor would still possess the risks and rewards of ownership of the asset, as they receive profits from the asset, are responsible for the maintenance of the asset, and hire and train personnel to operate the asset. To classify services to be received as an asset with a related obligation would be a misrepresentation of the underlying economics.

Further, the ability to direct the use of an asset depends on the ability to make the most significant decisions regarding the asset including how and when the economic benefits will be derived from the arrangement. In the oil and natural gas industry, customers and vendors occasionally have joint involvement in design specifications and other terms and conditions that govern the use of the asset. This is necessary to promote the best possible outcome of the contractual agreement for both parties. We believe that the control of an asset is not limited to a customer’s involvement with respect to these parameters as many other decisions regarding the asset and the related maintenance and service will be out of the customer’s control.

Based on the above concerns, we recommend that the IASB develop further application guidance to assist in differentiating lease contracts from service contracts.

### **Industry specific control issue**

In the oil and gas industry, exploration and production activities are often conducted through jointly-controlled arrangements with one or more partners where each party’s investment is managed through a contractual arrangement rather than a separate legal entity. Accounting for such jointly-controlled operations requires recognition of the partner’s proportionate share of assets, liabilities, revenues and expenses. Currently, the income statements and balance sheets for partners exhibit a high degree of comparability. As an example, when an activity occurs on a joint property, the “operator” of the property arranges for the appropriate assets and services and then bills each owner in the property its proportionate share of costs.

We are concerned that the proposed standard could reduce comparability across partners in a specific well or project for Type A leases. When an operator of a joint arrangement uses equipment determined to be subject to a lease contract under the proposed standard, the operator will generally be required to reflect the entire right-of-use asset and related liability on its Balance Sheet (since the operator alone is typically the sole entity who enters into the contract with the asset owner). Meanwhile other non-operating joint owners may only reflect their proportionate cash costs as billed by the operator as it may be inappropriate for the non-operating joint owners to recognize a portion of the right-of-use asset or related liability on their own balance sheets because the non-operating partners do not meet the proposed standard’s definition of “control” over the leased asset. As such, income statements will not be comparable because the operator’s recognition of periodic lease costs, whether capitalized or expensed, will be front-end loaded for Type A leases, while the non-operating joint owners will reflect the cash costs they are billed.

In addition, an operator’s Cash Flow Statement would reflect Type A lease related cash flows in the Operating and Financing sections. Non-operating joint owners who are billed for cash lease costs from an operator would reflect the cash flows entirely in the Investing section or Operating section (depending upon whether or not the costs are capitalized), consistent with existing standards. The proposed standard will therefore reduce the transparency and comparability within companies, and across companies, even for those involved in the same joint development.

### **Short Term Leases**

In relation to the definition of a lease, we disagree with an arbitrary inclusion of contracts with terms that extend past 12 months. Leasing an asset for short periods, relative to the asset’s useful life, does not carry the same risks and rewards of long-term ownership. By including the asset and corresponding commitment on the balance sheet, the ED does not provide users with more useful information.

### **Scope Exclusions**

The ED provides the following scope exemptions:

1. Lessor’s leases of intangible assets
2. Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources.
3. Leases of biological assets
4. Service concession arrangement

The ED references each scope exemption to the applicable standards that apply, indicating these items should be accounted for under those standards. We note that for the second item, the IASB version of the ED refers to IFRS 6 which applies only to exploration and evaluation assets (“E&E”), therefore, leaving the proposal open to different interpretations for oil and gas assets outside this phase of their lifecycle. The FASB version of the exposure draft refers to Topics 930 and 932, which applies to both E&E and development or production phase assets. The basis of conclusions discusses both IFRS 6 and Topics 930 and 932 in the same context and we do not believe that the Board intended to create a GAAP difference in this area.

We, therefore, recommend the scope exclusion be clarified to include both E&E and developing and producing phases of mineral, oil, natural gas and similar non-regenerative resources as well as arrangements to facilitate the production of such resources (e.g. “right of way” arrangements that facilitate access to a well). This is consistent with the current scope exclusions under IAS 17, which does not specifically highlight only IFRS 6.

## **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?**

We agree with the current IAS 17 model that there are two classifications of lease arrangements with different underlying economics and they should be accounted for accordingly based on the substance of the transaction (i.e. whether risks and rewards of ownership have transferred).

This ED is proposing a Type A and Type B model (“Dual Type Model”) which classifies and accounts for lease arrangements based on the type of the assets rather than the substance of the transaction. This poses several issues for preparers and users of the financial statements.

1. The Dual Type Model requires judgment and will result in similar arrangements being reported differently between issuers. Further, this will create a new environment to structure leases to be Type A or Type B to obtain a preferred expense profile. In addition, the opportunity to structure arrangements outside of the proposed lease accounting will continue to exist (i.e. off-balance sheet).
2. Certain arrangements where the risks and rewards of ownership have not transferred will be accounted for as assets, contradicting the underlying economics, resulting in less meaningful information.
3. Grouping assets and liabilities that have different underlying economics will make the financial statements less transparent.

Collectively, these differences will impact both earnings and key performance indicators, including operating costs per unit, EBITDA, debt-to-equity and operating cash flows potentially reducing comparability between entities. The proposed changes will also have a significant impact on the statement of cash flows. Currently, lease costs from contracts utilized in the development phase, such as contracts for drilling services, are capitalized to PP&E. Under the proposed standard, lease payments would be reflected in the financing section

as debt repayments and no longer viewed as capital expenditures. This is a significant change for the petroleum industry as a major portion of an entity’s annual capital spending is attributed to drilling services. The omission of such expenditures in the investing section of the cash flow statement could lead to misunderstanding about the amount and timing of an entity’s capital expenditures by financial statement users.

Changing key metrics used by management and external analysts will reduce financial statement usability and comparability across the oil and gas industry, potentially resulting in financial statement users making their own adjustments to achieve comparability amongst companies in conducting their analysis. In addition, it could result in an increased use of additional non-GAAP adjustments in other contracts and disclosures such as financial press releases, debt covenant calculations and Management’s Discussion and Analysis.

Based on the above concerns, we recommend the Board carry forward the criteria from IAS 17 which, in our opinion, appropriately classifies leases based on the underlying economic substance of the leasing transaction.

### **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?**

Based on our understanding of the ED there appears to be a disconnect between lessor and lessee accounting whereby Type B leases will result in both entities recording amounts related to the same underlying asset on their respective balance sheets which will cause confusion among users of the financial statements.

### **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?**

Further to our discussion above, we do not believe that the classification of a lease should depend on the type of the underlying asset. Rather, it should be classified based on the substance of the leasing transaction similar to the IAS 17 model. Therefore, we do not support the approach proposed in the ED where leases are categorized on a default basis unless specified criteria are met as outlined in paragraphs 29 and 30. Our preference would be to categorize leases based on the substance of the leasing transaction (i.e. transfer of risks and rewards).

### **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?**

We recommend that the Boards clarify that a lessee or lessor has a significant economic incentive to exercise extension or termination options when it is “virtually certain” that the option will be exercised. We believe this clarification will increase objectivity and consistency in application while reducing the frequency of assessing changes in the lease term.

### **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?**

We recommend the Board provide additional guidance on the definition of “in-substance fixed lease payments” to avoid preparers arriving at different conclusions for contracts with similar terms.

### **QUESTION 7: Transition**

**Paragraphs C2–C22 state that a lessee and a lessor 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?**

We request the Board to consider the pervasiveness of the proposed changes on an entity in determining the timeline for adoption and therefore, recommend a transition period of at least 3 years from issue date to mandatory effective date to allow time for the development of lease accounting software and to enable companies to assess all leases to input data into the software. Further, we also request the Board to consider deferring the leases project until after the conceptual framework project has been completed to ensure that the right of use asset is aligned with the definition of an asset.

We also recommend the Board to consider a prospective application approach with a grandfathering clause for existing leases, supplemented with selective disclosures that would assist users in modeling comparative periods presented in the financial statements. Otherwise obtaining information necessary for the Dual Type Model for existing leases will be a significant undertaking.

Finally, if issuer comparability is an objective, there is no need for an early adoption option.

## QUESTION 8: Disclosures

**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?**

We acknowledge that the proposed disclosures have been drafted with the aim of providing users more information about an entity’s leverage and lease commitments. However, the preparation required for preparers to comply with all the proposed disclosures would be very onerous and costly. Therefore, we agree with the proposals stating that it should be at the discretion of the lessee or lessor to assess the level of detail necessary to satisfy the disclosure objectives based on their judgments of how useful and relevant the disclosures would be to users by also considering materiality and unusual nature of leases. Generally, users in the oil and gas industry are more interested in the amounts of cash committed in the future, which can be found in a commitments and contingencies note, rather than specific lease terms and continuities.

Considering the onerous nature of the proposed narrative disclosures, we are concerned that preparers may resort to boiler plate disclosure to fulfill the requirements that will serve to further clutter the financial statements while providing little additional information useful to the users.

The requirement to prepare a right of use asset and lease liability reconciliation will be very onerous for the preparer and potentially distracts the user from the more important components of the financial statements, especially for entities where leasing arrangements are an immaterial cost in relation to other aspects of the operations. Therefore, we recommend that instead of preparing a reconciliation, entities should only disclose material changes in the period consistent with most other disclosure requirements.

In summary, CAPP recommends enhancing the disclosure requirements of all commitments, including leases. CAPP also recommends that the Board perform further field studies to determine the needs of users in understanding the substance of an entity’s leasing arrangements.

**Conclusion:**

We appreciate the opportunity to comment on the ED and we appreciate the effort put forth by the Board in proposing alternatives. However, based on our review of the proposed accounting for leases and our responses noted above, we recommend the Board evaluate the merits of continuing with the current IAS 17 model and improving the quality and depth of disclosures for leases so as to provide useful and meaningful disclosures to better meet the needs of users of the financial statements.

Sincerely,

A handwritten signature in cursive script, appearing to read "D. Daly".

David Daly  
Manager, Fiscal Policy