



Japan Leasing Association

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December 15, 2010

Sir David Tweedie
Chairman
International Accounting Standards Board

Dear Sir David

Comments on the Exposure Draft *Leases*

Japan Leasing Association (JLA) appreciates the efforts of the International Accounting Standards Board and the Financial Accounting Standards Board on the project on lease accounting.

Leases have assisted various entities in acquiring equipments and have significantly contributed to economic growth in each country. Under the circumstance that leases are globally used, JLA would like to make a contribution to improvement of the lease accounting standard conducted by the boards.

However, the exposure draft is far in excess of the purpose to improve the lease accounting standard, and there are many problems in the exposure draft from the standpoint of both rationale and practicality. Although JLA continued to express its view even after submitting its comment to the discussion paper, JLA's concerns still remain in the exposure draft unfortunately.

The main issues that JLA especially insists on in the attached comment letter are as follows.

1. A single accounting model should not be applied to all the leases. Several accounting models should be appropriately applied to each of various leases.
2. For a short term lease, a lessee should be allowed to recognize lease payments in profit or loss over the lease term instead of recognizing right-of-use asset and the liability to make lease payments from the standpoint of costs and benefits or potential impacts on economy. Regardless of whether a lease is a short term lease or not, an immaterial lease (That is, both a lease of a non-ccre asset and a lease of a core asset which is immaterial compared to the total assets recognized by the lessee) should be similarly accounted for as proposed by JLA for a short term lease.
3. A purchase/sale of the underlying asset should not be excluded from the scope of the new lease accounting standard. If excluded from the scope, a purchase/sale of the underlying asset is limited to a lease that transfers title to the underlying asset to the lessee.
4. The recognized lease term should be a contractual non-cancelable term. Recognition of options should be limited to intentionally structured leases.



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If the proposed accounting model is finalized without any modification, there could be difficulties and confusions in properly preparing or using financial statements. Furthermore, JLA is highly concerned that leases, which are important tools for business activities, could be lost.

Not only lessors but also lessees have expressed this kind of concern after the exposure draft was published. In addition, it would become clear that almost all the stakeholders support Mr. Stephen Cooper's view in Basis for conclusion on recognition of options, which is the most concerning.

JLA believes that the boards would be fully considering many views submitted to the exposure draft. Especially, JLA proposes that the boards should pay attention to needs for much more practicable accounting methods and simplified transition from the standpoint of lessee accounting. JLA plans to compile "the survey on the exposure draft for lessees" in order to promote the boards to pay attention to the needs.

According to the latest project milestone, the boards plan to finalize the new lease accounting standard by June 2011 at the latest. However, JLA strongly wishes that the boards would carefully proceed with the discussion and would come to a conclusion, reflecting views from preparers.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'Naotaka Obata'.

Naotaka Obata

Chairman

Japan Leasing Association

JLA's Comments on the Exposure Draft Leases

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<JLA's comprehensive views on the exposure draft>

I. Accounting model for both a lessee and a lessor - A single accounting model should not be applied to all the leases. Several accounting models should be appropriately applied to each of various leases.

i.i Adopting the right of use model is supported by the rationale that “unless a lessee breaches the contract, the lessee has the unconditional right to use the underlying asset and the unconditional liability for the obligation to make lease payments during the lease term, while a lessor has completed its performance obligation by delivering the underlying asset to the lessee”. Consequently, if the right of use model is applied to lessee accounting, the derecognition approach would be rationally consistent with the right of use model. The performance obligation approach, in which a lessor has a performance obligation to continue to permit the lessee to use the leased asset during the lease term, is clearly inconsistent with the right of use model to lessee accounting.

i.ii However, JLA agrees that there are some leases to which the derecognition approach is not appropriate. Similarly, applying a single accounting model to all the leases from the standpoint of lessee accounting would also cause new problems, which has been proven by the difficulty the boards have faced with when trying to apply a single accounting model to lessor accounting. If a lessor is required to assess whether a lease is accounted for in accordance with the performance obligation approach or the derecognition approach on the basis of whether the lessor retains exposure to significant risks or benefits associated with the underlying asset, several accounting models should be appropriately applied to each of various leases from the standpoint of not only lessor accounting but also lessee accounting. JLA's proposal is as follows.

		Lessee Accounting	Lessor Accounting
A. a lease that is neither B nor C		The right of use model	The derecognition approach
B. a lease with non-distinct services (except C)		The right of use model or a simplified right of use model (※1)	The performance obligation approach or a simplified performance obligation approach (※1)
C. a lease in which an asset is leased to multiple lessees over the useful life of the asset	(a) a lease which has a contractual non-cancelable term	The right of use model or a simplified right of use model (※1)	Recognize neither lease receivable nor lease liability in SFP. Continue to recognize the underlying asset in accordance with other IFRSs and recognize lease payments to be received in profit or loss over the lease term (※2).
	(b) a lease cancelable at any time (a rental transaction), A lease of a real estate (including investment property)	Recognize neither ROU asset nor liability to pay lease payments in the statement of financial position (SFP). Recognize lease payments in profit or loss over the lease term (※2).	Recognize neither lease receivable nor lease liability in SFP. Continue to recognize the underlying asset in accordance with other IFRSs and recognize lease payments to be received in profit or loss over the lease term (※2).

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(※1) (※2) Refer to 1.1.2 and 1.2.2.

i.iii For "B. a lease with non-distinct services", taking into account the cost incurred by the lessee that attributes to the executory services, it would be also appropriate for the lessee to initially measure the right-of-use asset and the liability to make lease payments at the undiscounted amount of the lease payments including services, and to subsequently measure them on a straight line basis, instead of initially measuring them at the present value of the lease payments and subsequently measuring them at amortized cost using the effective interest method. Therefore, a lessee should be allowed to choose account for a lease with non-distinct services in accordance with this simplified right-of use model.

Similarly, taking into account the revenue recognized by the lessor that attributes to the executory services, it would be also appropriate for the lessor to initially measure the right to receive lease payments and the lease liability at the undiscounted amount of the lease payments, and to subsequently measure them on a straight line basis, instead of initially measuring them at the present value of the lease payments and subsequently measuring them at amortized cost using the effective interest method. Therefore, a lessor should be allowed to choose account for a lease with non-distinct services in accordance with this simplified performance obligation approach.

i.iv Typical leases of "C. a lease in which an asset is leased to multiple lessees over the useful life of the asset" are "(a) a lease which has a contractual non-cancelable term", "(b) a lease cancelable at any time (a rental transaction), and a lease of a real estate (including investment property)".

Under a lease that has a contractual non-cancelable term included in the entire lease term, the lessee is able to cancel the lease without paying penalty after the contractual non-cancelable term has passed. Although the right-of-use asset and the liability to make lease payments during the non-cancelable term are fixed, the lessee should be allowed to account for this type of lease in accordance with the simplified right of use model rather than the right-of-use model, which is similar to the existing accounting for a finance lease. This would be able to resolve the problem related to off-balance treatment. On the other hand, it would be the most appropriate that a lessor under this type of lease recognizes lease payments to be received as revenues over the lease term and depreciates the underlying asset in accordance with other IFRSs, instead of recognizing any asset and liability arising from this type of lease. This is why the lessor would re-lease the same asset to another lessee over and over if each lease is terminated (although each of right-of-use assets and liabilities to make lease payments recognized by each lessee is fixed.). Furthermore, recognizing the lease payments to be received as revenues would better reflect the economics of that transaction.

Under "a lease cancelable at any time", all the liabilities to make lease payments during the lease term are not fixed. Therefore, a lessee should not be required to recognize any asset and liability arising from a lease cancelable at any time in accordance with the right-of-use model.

For "a lease cancelable at any time" and "A lease of a real estate (including investment property)", it would better reflect the economics of those leases that the lessor depreciates the underlying asset

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and recognizes the lease payments to be received as revenues regardless of whether those leases are short term leases or not. Similarly, it would better reflect the economics of those leases that the lessee recognizes the lease payments in profit or loss over the lease term instead of recognizing any asset and liability arising from those types of leases. Furthermore, there has been no problem related to off-balance treatment for those leases. Consequently, both a lessee and a lessor should be allowed to account for those leases in accordance with the accounting methods above.

For “a lease cancelable at any time” and “a lease of a real estate (including investment property)”, the lessor intends to generate a return from the active management of the underlying asset from leasing the same asset to multiple lessees during the useful life. This type of lessor is usually required to maintain/repair the leased asset for the useful life of the asset, and takes no risks associated with the credit for lessees but risks associated with the underlying asset such as maintaining/repairing the underlying asset and inventory risks. Therefore, this type of lessor should depreciate the underlying asset and recognize the lease payments to be received as revenues. This would better reflect the economics of the transaction. In addition, it is pointed out that if a lessor applies the performance obligation approach to a lease of an investment property, the rental income generated by the investment property would be replaced with interest income and amortization of the performance obligation, which would not provide useful information to users of financial statements.

This is why a lessor should be allowed to depreciate the underlying asset in accordance with other IFRSs and recognize the lease payments to be received as revenues over the lease term for both a lease cancelable at any time” and “a lease of a real estate (including investment property)”, regardless of whether those leases are short term leases or not (That is, the lessor does not recognize either asset or liability arising from those leases.). In addition, a lessor that applies the cost model to a lease of an investment property should be also allowed to apply IAS 40 on the condition that the lessor discloses information about the fair value of the investment property as required by the existing IAS 40.

II. For short term lease, a lessee should be allowed to recognize lease payments in profit or loss over the lease term instead of recognizing right-of-use asset and the liability to make lease payments from the standpoint of costs and benefits or potential impacts on economy.

ii.i Due to that the proposed new lease accounting standard is focusing on providing useful information to users of financial statements, the new lease accounting standard results in being excessively complex and burdensome for both a lessor and a lessee. As a result, the proposed new lease accounting standard would reduce a number of leases and would critically influence the economic growth in each country. But for leasing industries all over the world, the purpose of the lease project would not be achieved. There could be some regions where the leasing industry could not play its role unless the proposed new lease accounting standard would be simplified. This is the most critical issue.

ii.ii Therefore, JLA proposes that both a lessor and a lessee should be allowed to account for a short

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term lease by recognizing lease payments as expenses or revenues over the lease term instead of recognizing asset and liability from the standpoint of costs and benefits or potential impacts on economy (JLA also proposes that an immaterial lease should be accounted for as proposed by JLA for a short term lease (refer to 10.1.1.)).

- ii.iii A short term lease is defined in the Exposure Draft (ED) as “a lease that has a maximum possible lease term including options to renew or extend, of twelve months or less”. However, the definition should be “a lease that has a lease term of twelve months or less”, excluding options. The definition proposed in the ED should be applied only to an intentionally structured lease with renewal options (Refer to 4.1.5.).

III. A purchase/sale of the underlying asset should not be excluded from the scope of the new lease accounting standard. If excluded from the scope, a purchase/sale of the underlying asset is limited to a lease that transfers title to the underlying asset to the lessee.

- iii.i JLA disagrees with the criteria for classification as a purchase/sale of an underlying asset in paragraphs 8(a), B9 and B10. Distinguishing between a lease and a purchase/sale had been introduced at that time in order to resolve the problem arising from the tentative decision that the boards decided to adopt only the performance obligation approach. However, there is no need to introduce the criteria for classification as a purchase/sale of an underlying asset now, because the ED proposes that the derecognition approach should be applied to some leases. Therefore, JLA proposes that the criteria should not be included in the new lease accounting standard.

- iii.ii If a purchase/sale of the underlying asset is excluded from the new lease accounting standard, the criteria should be limited only to “a contract that results in transferring control of the underlying asset to the lessee at the end of the contract term (That is, the contracts specified in paragraph 10(a) and 10 (b) below.)”. This classification would be consistent with the exposure draft “Revenue from Contracts with Customers”. A contract that results in transferring all but a trivial amount of the risks and benefits associated with the underlying asset to the lessee should not be included in the criteria for classification as a purchase/sale of an underlying asset.

- (a) Automatically transfers title to the underlying asset to the transferee at the end of the contract term.
- (b) Includes a bargain purchase option. It would be reasonably certain that such options will be exercised.

IV. The recognized lease term should be a contractual non-cancelable term. Recognition of options should be limited to intentionally structured leases.

- iv.i A lessee is not obligated to exercise its options, while a lessor does not have a right to compel the lessee to exercise the options. Therefore, the lessee does not have any “present obligation” to make lease payments during the optional periods at the inception of the lease. In addition, the lessee is

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not expected to result in an outflow of economic benefits due to that obligation. Even if a lessee expects to exercise its options more likely than not to occur, any liability to make lease payments including uncertainty would not meet the definition of a liability under the current Framework.

- iv.ii In addition, it would be almost impossible to estimate the probabilities to exercise the options. Requiring both a lessee and a lessor to estimate the probabilities or to revalue the lease terms would reduce the advantages inherent in leases. As a result, this could prevent a number of entities from acquiring machines and equipments through leases and would critically influence the management of lessees that have difficulty in acquiring machines and equipments by other financing methods such as bank borrowings. It would be also quite burdensome for a lessor who has multiple leases to estimate each probability for the options. The costs associated with estimating each probability would clearly exceed the benefits to users of financial statements.
- iv.iii Furthermore, requiring both a lessee and a lessor to estimate uncertain options would reduce comparability for users of financial statements. An allocation of depreciation costs recognized by a lessee or revenues recognized by a lessor could be intentionally structured and distorted. Consequently, not recognizing options would increase and assure the comparability and reliability of financial statements.
- iv.iv Based on the reasons below, the ED proposes to account for a purchase option only when it is exercised instead of applying a single asset and liability approach. However, the reasons pointed out in both (b) and (c) below would apply to accounting for a renewal option. Therefore, any other options should be also accounted for only when they are exercised.
 - (a) A purchase option is an option to terminate the lease contract. Consequently, it would be unreasonable and inappropriate for a lessee to include the exercise price of the purchase option in its right of use asset and liability to make lease payments (If the purchase option ends up not being exercised, the depreciation of the right-of-use asset may not reflect the economics of the usage of the right-of-use asset.).
 - (b) There is a concern that a lessor under the derecognition approach would recognize its revenue prior to a purchase option being exercised.
 - (c) There is a concern that a right to receive lease payments, a lease liability (under the performance obligation approach), a right of use asset, and a liability to make lease payments would be grossed up (overstated).
- iv.v In order to maintain consistency between a purchase option and other options, all the options should be accounted for only when they are exercised. Generally, an option to renew/terminate the lease is included in order to cope with uncertainty associated with business factors with no intention to structure the lease. It is not appropriate to require all the lessees and lessors to recognize options, which would be excessively burdensome, for the purpose of reducing structured leases that are not the majority of leases. Both a lessee and a lessor should be required to recognize

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- options only when a lease is an intentionally structured lease with renewal options (Refer to 4.1.5.).
- iv.vi It would be possible to objectively judge whether a lease is intentionally structured or not, based on the factors to be considered in determining the lease term (That is, contractual factors, non-contractual factors, business factors and other lessee-specific factors).

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<JLA's comments to questions in the ED>

1. The accounting model

Question 1: Lessees

- (a) Do you agree that a lessee should recognise a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?
- (b) Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

1.1 A single accounting model should not be applied to all the leases. Several accounting models should be appropriately applied to each of various leases.

1.1.1 JLA basically agrees that the right of use model is applied to lessee accounting (That is, (a) and (b) in the question 1.). However, taking into account the fact that the boards had difficulty in trying to apply a single accounting model to lessor accounting, it is clear that new problems would arise from applying a single accounting model to all the leases from the standpoint of lessee accounting.

1.1.2 If a lessor is required to assess whether a lease is accounted for in accordance with the performance obligation approach or the derecognition approach on the basis of whether the lessor retains exposure to significant risks or benefits associated with the underlying asset, several accounting models should be appropriately applied to each of various leases from the standpoint of not only lessor accounting but also lessee accounting. JLA's proposal for lessee accounting is as follows.

A. A lease that is neither B nor C		The right of use model
B. A lease with non-distinct services (except C)		The right of use model or a simplified right of use model (※1)
C. A lease in which an asset is leased to multiple lessees over the useful life of the asset	(a) A lease which has a contractual non-cancelable term	The right of use model or a simplified right of use model (※1)
	(b) A lease cancelable at any time (a rental transaction), A lease of a real estate (including investment property)	Recognize neither ROU asset nor liability to make lease payments in the statement of financial position (SFP). Recognize lease payments in profit or loss over the lease term (※2).

※1 Under the simplified right-of-use model proposed by JLA, a lessee does not recognize any interest payments. The lessee initially recognizes the right-of-use asset and the liability to make lease payments at the undiscounted amount, and the lessee depreciates the right of use asset at the amount of the lease payments and amortizes the liability to make lease payments at the amount of the lease payments.

※2 A lessee is not required to recognize the right-of-use asset and the liability to make lease

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payments at the undiscounted amount. Therefore, this accounting method is easier than the simplified requirements to a short term lease proposed by the boards.

1.1.3 For “B. a lease with non-distinct services”, taking into account the cost incurred by the lessee that attributes to the executory services, it would be also appropriate for the lessee to initially measure the right-of-use asset and the liability to make lease payments at the undiscounted amount of the lease payments including services, and to subsequently measure them on a straight line basis, instead of initially measuring them at the present value of the lease payments and subsequently measuring them at amortized cost using the effective interest method. Therefore, a lessee should be allowed to choose account for a lease with non-distinct services in accordance with this simplified right-of use model.

1.1.4 Typical leases of “C. a lease in which an asset is leased to multiple lessees over the useful life of the asset” are “(a) a lease which has a contractual non-cancelable term”, “(b) a lease cancelable at any time (a rental transaction), and a lease of a real estate (including investment property)”. Under a lease that has a contractual non-cancelable term included in the entire lease term, the lessee is able to cancel the lease without paying penalty after the contractual non-cancelable term has passed. Although the right-of-use asset and the liability to make lease payments during the non-cancelable term are fixed, the lessee should be allowed to account for this type of lease in accordance with the simplified right of use model rather than the right-of-use model, which is similar to the existing accounting for a finance lease. This would be able to resolve the problem related to off-balance treatment.

Under “a lease cancelable at any time (a rental transaction)”, all the liabilities to make lease payments during the lease term are not fixed. Therefore, a lessee should not be required to recognize any asset and liability arising from a lease cancelable at any time in accordance with the right-of-use model.

For “a lease cancelable at any time” and “a lease of a real estate (including investment property)”, the lessor should depreciate the underlying asset and should recognize the lease payments to be received as revenues, regardless of whether those types of leases are short term leases or not. This would better reflect the economics of those leases (Refer to 1.2.5.). For those types of leases, the lessee should be allowed to recognize the lease payments as expenses over the lease term instead of recognizing the right-of-use asset and liability to make lease payments. Furthermore, there has been no problem related to off-balance treatment for those leases. Consequently, both a lessee and a lessor should be allowed to account for those leases in accordance with the accounting methods above.

Question 2: Lessor

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| (a) Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after |
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- the expected lease term, and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?
- (b) Do you agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

1.2 The accounting model to lessor accounting that is consistent with right-of-use model is the derecognition approach. However, several accounting models should be appropriately applied to each of various leases for lessor accounting as well as lessee accounting.

1.2.1 Adopting the right of use model is supported by the rationale that “unless a lessee breaches the contract, the lessee has the unconditional right to use the underlying asset and the unconditional liability for the obligation to make lease payments during the lease term, while a lessor has completed its performance obligation by delivering the underlying asset to the lessee”. Consequently, if the right of use model is applied to lessee accounting, the derecognition approach would be rationally consistent with the right of use model. The performance obligation approach, in which a lessor has a performance obligation to continue to permit the lessee to use the leased asset during the lease term, is clearly inconsistent with the right of use model to lessee accounting.

1.2.2 However, JLA agrees that there are some leases to which the derecognition approach is not appropriate. Therefore, JLA proposes that several accounting models should be appropriately applied to each of various leases for lessor accounting as well as lessee accounting. JLA's proposal for lessor accounting is as follows.

A. A lease that is neither B nor C		The derecognition approach
B. A lease with non-distinct services (except C)		The performance obligation approach or a simplified performance obligation approach (※1)
C. A lease in which an asset is leased to multiple lessees over the useful life of the asset	(a) A lease which has a contractual non-cancelable term	Recognize neither lease receivable nor lease liability in SFP. Continue to recognize the underlying asset in accordance with other IFRSs and recognize lease payments in profit or loss over the lease term (※2).
	(b) A lease cancelable at any time (a rental transaction), A lease of a real estate (including investment property)	Recognize neither lease receivable nor lease liability in SFP. Continue to recognize the underlying asset in accordance with other IFRSs and recognize lease payments in profit or loss over the lease term (※2).

※1 Under the simplified right-of-use model proposed by JLA, a lessor does not recognize any interest revenues. The lessor initially recognizes the right to receive the lease payments and the lease liability at the undiscounted amount, and the lessor amortizes both the right to

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receive the lease payments and the lease liability at the amount of the lease payments to be received in each fiscal period. The lessor should present the underlying asset, the right to receive lease payments, and the lease liability separately in the SFP totaling to a net lease asset or a net lease liability in the statement of financial position (SFP).

※2 The proposal by JLA is same with the proposal by the boards for a short term lease in paragraph 65.

- 1.2.3 For “B. a lease with non-distinct services”, taking into account the revenue recognized by the lessor that attributes to the executory services, it would be also appropriate for the lessor to initially measure the right to receive lease payments and the lease liability at the undiscounted amount of the lease payments including services, and to subsequently measure them on a straight line basis, instead of initially measuring them at the present value of the lease payments and subsequently measuring them at amortized cost using the effective interest method. Therefore, a lessor should be allowed to choose to account for a lease with non-distinct services in accordance with this simplified performance obligation approach. In addition, JLA believes that a lessor would be basically able to distinguish a service component from a lease component (Refer to 3.2.2.).
- 1.2.4 “C. a lease in which an asset is leased to multiple lessees over the useful life of the asset” includes “a lease that has a contractual non-cancelable term included in the entire lease term”. Under this type of lease, if the lessee terminates the lease, the lessor would re-lease the same asset to another lessee (although each of right-of-use assets and liabilities to make lease payments recognized by each lessee is fixed.). Therefore, the lessor should depreciate the underlying asset and recognize the lease payments to be received as revenues. This would better reflect the economics of this type of lease. This is why JLA proposes that a lessor should depreciate the underlying asset in accordance with other IFRSs and recognize the lease payments to be received as revenues over the lease term for a lease that has a contractual non-cancelable term included in the entire lease term.
- 1.2.5 For “a lease cancelable at any time (a rental transaction)” and “a lease of a real estate (including investment property)”, the lessor intends to generate a return from the active management of the underlying asset from leasing the same asset to multiple lessees during the useful life. This type of lessor is usually required to maintain/repair the leased asset for the useful life of the asset, and takes no risks associated with the credit for lessees but risks associated with the underlying asset such as maintaining/repairing the underlying asset and inventory risks. Therefore, this type of lessor should depreciate the underlying asset and recognize the lease payments to be received as revenues. This would better reflect the economics of the transaction. In addition, it is pointed out that if a lessor applies the performance obligation approach to a lease of an investment property, the rental income generated by the investment property would be replaced with interest income and amortization of the performance obligation, which would not provide useful information to

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users of financial statements.

For “a lease cancelable at any time (a rental transaction)” and “a lease of a real estate (including investment property)”, regardless of whether those leases are short term leases or not, JLA proposes that the lessor should be allowed to recognize the lease payments to be received as revenues over the lease term and to depreciate the underlying asset in accordance with other IFRSs instead of recognizing any asset and liability from those types of leases. For a lease of an investment property, JLA proposes that even if a lessor measures an investment property using the cost model, the lessor should be also allowed to apply IAS 40 on the condition that the lessor discloses information about the fair value of the investment property as required by the existing IAS 40.

1.2.6 JLA proposes as follows. Therefore, JLA disagrees with the proposal to assess whether a lease is accounted for in accordance with the performance obligation approach or the derecognition approach on the basis of whether the lessor retains exposure to significant risks or benefits associated with the underlying asset in paragraphs 28 and 29.

- The accounting model to lessor accounting that is consistent with the right-of-use model is the derecognition approach as explained in 1.2.1.
- A lease to which the performance obligation approach should be applied is a lease with non-distinct services as explained in 1.2.2 (JLA believes that a lessor would be basically able to separate a service component from a lease component (Refer to 3.2.2.)).
- The other accounting model should be applied to “C. a lease in which an asset is leased to multiple lessees over the useful life of the asset”.

Question 3: Short term lease

Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not?
If not, what alternative approach would you propose and why?

1.3 For short term lease, a lessee should be allowed to recognize lease payments in profit or loss over the lease term instead of recognizing right-of-use asset and the liability to make lease payments from the standpoint of costs and benefits or potential impacts on economy.

1.3.1 Due to that the proposed new lease accounting standard is focusing on providing useful information to users of financial statements, the new lease accounting standard results in being excessively complex and burdensome for both a lessor and a lessee. As a result, the proposed new lease accounting standard would reduce a number of leases and would critically influence the economic growth in each country. But for leasing industries all over the world, the purpose of the lease project would not be achieved. There could be some regions where the leasing industry could not play its role unless the proposed new lease accounting standard would be simplified. This is the most critical issue.

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1.3.2 Therefore, JLA proposes that a lessee should be allowed to account for a short term lease by recognizing lease payments as expenses over the lease term instead of recognizing asset and liability from the standpoint of costs and benefits or potential impacts on economy (Regardless of whether a lease is a short term lease or not, JLA also proposes that an immaterial lease should be accounted for as proposed by JLA for a short term lease (refer to 10.1.1.)).

1.3.3 A short term lease is defined in the ED as “a lease that has a maximum possible lease term including options to renew or extend, of twelve months or less”. However, the definition should be “a lease that has a lease term of twelve months or less”, excluding options. The definition proposed in the ED should be applied only to an intentionally structured lease with renewal options (Refer to 4.1.5.).

2. Definition of a lease

Question 4: Definition of a lease, a purchase/sale of the underlying asset, and distinguishing a lease from a service

- (a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?
- (b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?
- (c) Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

2.1 The definition of a lease should not include the concept of uncertainty.

2.1.1 JLA proposes that a lease should be defined as a contract in which the right to use a specified asset is conveyed “for a contractually agreed period of time”, although the ED defines a lease as “for a period of time”. There is no rationale to change the current treatment and the definition of a lease should not include the concept of uncertainty. Paragraph B1(b) says, “the contract conveys the right to control the use of a specified asset for an agreed period of time”, while paragraph B4 says, “a contract conveys the right to use an asset if it conveys to an entity the right to control the use of the underlying asset during the lease term.”. JLA proposes that “the lease term” in paragraph B4 should be a contractually agreed period of time (Refer to 2.1.2.) and a period for which a right-of-use asset is transferred should be a contractually agreed period of time. An example of a lease of a retirement village was given to discuss the definition of a lease, concluding that a period of time was not always agreed in the contract. However, the example of a lease of a retirement village does not specify only the expiration date. There is no lease term

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that is not agreed in the contract.

2.1.2 A lease term is an agreed period of time. A lease term should not be defined as “the longest possible term that is more likely than not to occur”. A lessee is not obligated to exercise an option for an optional period, while a lessor does not have a right to compel the lessee to exercise its option. Consequently, the definition of a lease should not include the concept of uncertainty such as an option which is quite uncertain (Refer to 4.1.).

2.1.3 Lease payments also should not include uncertainty related to contingent rentals. Lease payments should be the fixed amount that is stated in the contract (Refer to 4.2.).

2.2 A purchase/sale of the underlying asset should not be excluded from the scope of the new lease accounting standard. If excluded from the scope, a purchase/sale of the underlying asset is limited to a lease that transfers title to the underlying asset to the lessee.

2.2.1 JLA disagrees with the criteria for classification as a purchase/sale of an underlying asset in paragraphs 8(a), B9 and B10. Distinguishing between a lease and a purchase/sale was introduced in order to resolve the problem arising from the tentative decision that the boards decided to adopt only the performance obligation approach. However, there is no need to introduce the criteria for classification as a purchase/sale of an underlying asset now, because the ED proposes that the derecognition approach should be applied to some leases. Therefore, JLA proposes that the criteria should not be included in the new lease accounting standard.

2.2.2 If a purchase/sale of the underlying asset is excluded from the new lease accounting standard, the criteria should be limited only to “a contract that results in transferring control of the underlying asset to the lessee at the end of the contract term (That is, the contracts specified in paragraph 10(a) and 10 (b) below.)”. This classification would be consistent with the exposure draft “Revenue from Contracts with Customers”. A contract that results in transferring all but a trivial amount of the risks and benefits associated with the underlying asset to the lessee should not be included in the criteria for classification as a purchase/sale of an underlying asset.

(a) Automatically transfers title to the underlying asset to the transferee at the end of the contract term.

(b) Includes a bargain purchase option. It would be reasonably certain that such options will be exercised.

2.3 The guidance for distinguishing leases from service contracts should be more clarified.

2.3.1 Paragraph B3 gives an application guidance to judge whether substituting a similar asset for the specified asset after the date of commencement of the lease contains a lease or not. Although paragraph B3 includes a description for providing services, this makes it quite difficult to

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understand paragraph B3. Therefore, JLA proposes that it would be better to simply describe "If fulfillment of the contract does not depend on providing a specified asset, the service contract is not a lease" in another paragraph.

3. Scope

Question 5: Scope exclusions

Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and why?

3.1 There is no rationale to exclude any lease that meets the definition of a lease from the new lease accounting standard.

3.1.1 For a lease of an intangible asset and so on, JLA believes that if a lease meets the definition of a lease, the lease should not be excluded from the new lease accounting standard (There is no rationale to exclude a leases that meets the definition of a lease.). If there are other accounting standards that are more appropriate or applicable than the new lease accounting standard is, the rationale to apply the other accounting standards should be explained.

3.1.2 Paragraph BC34 simply explains the reasons "a lease to explore for or use natural resources, such as minerals, oil and natural gas" and "a lease of a biological asset" are excluded. However, paragraph BC36 says, "the boards have identified no conceptual reason why a lease accounting standard should exclude intangible assets". Under the definition of a lease, a leased asset (an underlying asset) is defined as a specified asset and the specified asset is not limited only to a tangible asset. However, the boards have not seriously discussed whether it is appropriate to exclude a lease of an intangible asset and apply IAS 38 to a lease of an intangible asset. Some propose that the new lease accounting standard should be applied to a lease of an intangible asset. Therefore, it is necessary for the boards to rationally explain the reason to exclude a lease of an intangible asset and to apply IAS38. If the boards starts a project for intangible assets in the future, a lease of an intangible asset should be basically included in the new lease accounting standard at this moment and IAS38 should be also applicable to a lease of an intangible asset.

Question 6: Contracts that contain service components and lease components

Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

- (a) the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.
- (b) the IASB proposes that:
 - (i) a lessee should apply the lease accounting requirements to the combined contract.

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- (ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.
- (iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements, and the service component in accordance with the proposals in Revenue from Contracts with Customers.

3.2 Under a contract that a service component and a lease component are non-distinct, the lessee should be allowed to account for the contract in accordance with the simplified right-of-use model, while the lessor should be allowed to account for the contract in accordance with the simplified performance obligation approach.

3.2.1 For a contract that a service component and a lease component are non-distinct, JLA proposes to allow the lessee to account for the contract in accordance with either the right-of-use model or the simplified right-of-use model proposed by JLA. JLA also proposes to allow the lessor to account for the contract in accordance with either the performance obligation approach or the simplified performance obligation approach proposed by JLA (Refer to 1.1.3 and 1.2.3.). Therefore, JLA agrees with neither FASB's proposal nor IASB's proposal. Furthermore, JLA proposes that there is no need to distinguish a lessor that applies the performance obligation approach from a lessor that applies the derecognition approach as proposed by IASB.

3.2.2 A lessor would be basically able to distinguish a service component from a lease component. If a lessor is not able to do so, JLA believes that the performance obligation approach is appropriate, taking into account the fact that the performance obligation to provide services over the lease term is included in the lease liability. In addition, paragraph B23 says, "the existence of material non-distinct services may expose the lessor to a significant risk (that is, in this case, the lessor would apply the performance obligation approach.)". This indicates that, in the case that a lessor is not able to distinguish a service component from a lease component, the lessor would be likely to apply the performance obligation approach. Furthermore, because there would be few cases in which a lessor is expected to apply the derecognition approach to a contract that a service component and a lease component are non-distinct, JLA proposes that there is no need to distinguish a lessor that applies the performance obligation approach from a lessor that applies the derecognition approach as proposed by IASB.

3.2.3 Paragraph B5 says, "An entity shall apply the proposals in the boards' exposure draft Revenue from Contracts with Customers to identify separate performance obligations within a contract that contains both service components and lease components". However, it is inappropriate to refer to the exposure draft that has not been officially finalized yet. The paragraph that preparers of financial statements refer to should be included in the new lease accounting standard. Similarly, paragraph B5 says, "If the service component is distinct (see paragraphs B6 and B7),

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the entity allocates the payments required by the contract between the service components and lease components using the principles proposed in paragraphs 50–52 of Revenue from Contracts with Customers”. The paragraph that preparers of financial statements refer to should be included in the new lease accounting standard.

Paragraph B6 says, “An entity shall determine whether a service component is distinct at the date of inception of the lease considering all concurrently negotiated contracts with another party”. However, there could be cases in which “concurrently negotiated contracts with another party” do not exist. Especially, a lessee would have difficulty in practice. Consequently, JLA proposes to delete paragraph B6, otherwise, JLA proposes that it should be sufficient for an entity to consider whether a service component is distinct or not, only if the entity has information available to estimate or distinguish a service component.

Paragraph B7 gives an application guideline for cases in which a service component is distinct. However, it would be difficult and burdensome for a lessee to determine whether a service component is distinct in accordance with paragraphs B7(a) and B7(b). Under a lease of automobiles, costs related to various service components are included in the lease payments such as inspection/maintenance of the leased item (automobile), repairs, handling of accidents, and replacement of oil, tires and other consumables. In this case, the lessor prices the amount of lease payments by covering all the services components as a whole, rather than by calculating each service component. Therefore, in almost all the cases, lessees would not be able to distinguish service components. This is why JLA proposes that the boards should add more detailed application guidance for lessees who do not have sufficient information for determining service components.

Question 7: Purchase options

Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?

3.3 Accounting for a purchase option is appropriate. However, accounting for a purchase option should be treated as a part of options rather than as a part of scope exclusions in paragraph 8.

3.3.1 JLA agrees with the proposal for accounting for a purchase option, because it is appropriate to account for a purchase option only when it is exercised.

3.3.2 However, as proposed in 4.1, JLA basically proposes that an option to renew/terminate the lease should not be included in the lease term. An option to renew/terminate the lease should be also accounted for only when it is exercised in accordance with accounting for a purchase option.

3.3.3 The ED treats a lease after the lessee has exercised its purchase option as a purchase/sale of the

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underlying asset in paragraph 8. However, a lease after the lessee has exercised an option to terminate the lease should be also excluded from the new lease accounting standard and there is no need to specify only the accounting method for a lease after the lessee has exercised its purchase option in paragraph 8. Consequently, both a purchase option and option to renew/terminate the lease should be comprehensively treated as options and they should be accounted for only when they are exercised (Refer to 4.1.).

4. Measurement

Question 8: Lease term

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

4.1 The recognized lease term should be a contractual non-cancelable term. Recognition of options should be limited to intentionally structured leases.

- 4.1.1 A lessee is not obligated to exercise its options, while a lessor does not have a right to compel the lessee to exercise the options. Therefore, the lessee does not have any “present obligation” to make lease payments during the optional periods at the inception of the lease. In addition, the lessee is not expected to result in an outflow of economic benefits due to that obligation. Even if a lessee expects to exercise its options more likely than not to occur, any liability to make lease payments including uncertainty would not meet the definition of a liability under the current Framework.
- 4.1.2 In addition, it would be almost impossible to estimate the probabilities to exercise the options. Requiring both a lessee and a lessor to estimate the probabilities or to revalue the lease terms would reduce the advantages inherent in leases. As a result, this could prevent a number of entities from acquiring machines and equipments through leases and would critically influence the management of lessees that have difficulty in acquiring machines and equipments by other financing methods such as bank borrowings. It would be also quite burdensome for a lessor who has multiple leases to estimate each probability for the options. The costs associated with estimating each probability would clearly exceed the benefits to users of financial statements.
- 4.1.3 Furthermore, requiring both a lessee and a lessor to estimate uncertain options would reduce comparability for users of financial statements. An allocation of depreciation costs recognized by a lessee or revenues recognized by a lessor could be intentionally structured and distorted. Consequently, not recognizing options would increase and assure the comparability and reliability of financial statements.

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- 4.1.4 Based on the reasons below, the ED proposes to account for a purchase option only when it is exercised instead of applying a single asset and liability approach. However, the reasons pointed out in both (b) and (c) below would apply to accounting for a renewal option. Therefore, any other options should be also accounted for only when they are exercised.
- (a) A purchase option is an option to terminate the lease contract. Consequently, it would be unreasonable and inappropriate for a lessee to include the exercise price of the purchase option in its right of use asset and liability to make lease payments (If the purchase option ends up not being exercised, the depreciation of the right-of-use asset may not reflect the economics of the usage of the right-of-use asset.).
 - (b) There is a concern that a lessor under the derecognition approach would recognize its revenue prior to a purchase option being exercised.
 - (c) There is a concern that a right to receive lease payments, a lease liability (under the performance obligation approach), a right of use asset, and a liability to make lease payments would be grossed up (overstated).
- 4.1.5 In order to maintain consistency between a purchase option and other options, all the options should be accounted for only when they are exercised. Generally, an option to renew/terminate the lease is included in order to cope with uncertainty associated with business factors with no intention to structure the lease. It is not appropriate to require all the lessees and lessors to recognize options, which would be excessively burdensome, for the purpose of reducing structured leases that are not the majority of leases. Both a lessee and a lessor should be required to recognize options only when a lease is an intentionally structured lease with renewal options (※).
- (※) An intentionally structured lease with renewal options is a lease in which a lessor and a specified lessee intentionally structure a lease excessively shorter than the useful life of the underlying asset, providing renewal options to the specified lessee in order that the specified lessee exercises the renewal options over and over in spite that the lessor is unlikely to lease the underlying asset to multiple entities over the useful life of the asset.
- 4.1.6 It would be possible to objectively judge whether a lease is intentionally structured or not, based on the factors to be considered in determining the lease term (That is, contractual factors, non-contractual factors, business factors and other lessee-specific factors).

Question 9: Lease payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?

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Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be measured reliably? Why or why not?

4.2 An asset and a liability should not include any uncertain amount arising from a lease. From the standpoint of the costs and benefits, any change in the lease payments during the lease term should be recognized in profit or loss.

4.2.1 JLA proposes in 4.1 that a recognized lease term should be a contractual non-cancelable term and a lessee and a lessor should be required to recognize options only when a lease is an intentionally structured lease with renewal options. Both a lessee and a lessor should not recognize any amount in the SFP that the lessee and the lessor are not sure about on whether the amount arises or not at the inception of the lease term. It would be more comparable for both a lessee and a lessor not to recognize any uncertain amount. This is why JLA proposes that contingent rentals and expected payments under term option penalties should not be included in the initial measurement of assets and liabilities arising from a lease.

For residual value guarantees, JLA proposes that a lessee and a lessor should include the maximum amount that is specified in the contract (and a lessor should also include the maximum amount guaranteed by an unrelated third party.) (Refer to 4.2.3.).

4.2.2 It would be quite burdensome for preparers of financial statements to use an expected outcome technique. JLA believes that the costs related to the measurement of assets and liabilities arising from a lease using an expected outcome technique would exceed the benefits to users of financial statements. From the standpoint of the costs and benefits, any change in the lease payments during the lease term should be recognized in profit or loss.

4.2.3 It would be impossible for a lessee to initially estimate the residual value of the leased asset at the end of the lease, because it is rare for a lessee to have information or knowledge for the residual value. Therefore, JLA proposes that a lessee should include the maximum amount that is specified in the contract as required in the current accounting standard, and this would be the only way that is applicable and practicable.

Regardless of whether residual value guarantees is provided by a lessee or by an unrelated third party, a lessor enjoys a same effect provided by the residual value guarantees (that is, residual value guarantees reduce the exposure the lessor retains when selling the underlying asset at the end of the lease.). The current accounting standard requires a lessor to include residual value guarantees by an unrelated third party. If a lessor does not include the residual value guarantees by an unrelated third party, the lessor would understate its revenues over the lease term. In addition, there would be some distortions for periodic loss or profit, because a lessor recognizes

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loss or profit on sale at the point of selling the underlying asset, in spite that the minimum amount of the estimated selling price is clarified in advance. Furthermore, according to the application guidance on when to apply the performance obligation approach or derecognition approach, a lessor is required to consider residual value guarantees provided by unrelated third party in paragraph B24(b)(ii). However, not including residual value guarantees is not consistent with this application guideline. Consequently, a lessor should include not only contractual residual value guarantees provided by a lessee but also those by an unrelated third party.

Question 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

4.2.4 JLA proposes that a recognized lease term should be a contractual non-cancelable term and a lessee and a lessor should be required to recognize options only when a lease is an intentionally structured lease with renewal options. Similarly, lease payments during the optional period and contingent rentals (except for residual value guarantees) should not be included in assets and liabilities that a lessee and a lessor initially recognize as proposed above. Consequently, JLA disagrees with the proposal for reassessment. If a lease term is renewed due to changes in facts or circumstances since the previous reporting period, the renewed lease term should be accounted for as a new lease. If some changes in the lease payments arise, those changes should be accounted for as profit or loss. JLA proposes that a lessee and a lessor should be required to reassess their assets and liabilities only when a lease is an intentionally structured lease.

5. Sale and leaseback

Question 11: Sale and leaseback

Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?

5.1 The criteria for classification as a purchase/sale of an underlying asset should be limited to “transferring control of an underlying asset”. Accounting for a sale and leaseback with no intention to acquire a financing should be reconsidered.

5.1.1 As proposed in 2.2, JLA proposes that if a purchase/sale of the underlying asset is excluded from the new lease accounting standard, the criteria should be limited only to “a contract that results in transferring control of the underlying asset to the lessee at the end of the contract term”, in

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order to be consistent with the exposure draft "Revenue from Contracts with Customers" (That is, the criterion of "a contract that results in transferring all but a trivial amount of the risks and benefits associated with the underlying asset to the lessee" should not be included.). Therefore, if the criteria for classification as a sale of an underlying asset are applied to a sale and leaseback, only the criterion of "transferring control of the underlying asset" should be applied.

5.1.2 JLA is concerned that there would be some problems in determining whether a leaseback would meet the definition of a lease, only on the basis of whether the transfer meets the criteria for classification as a sale or not. There are many sales and leasebacks in which a lessee does not intend to acquire a financing as follows.

- (a) There are some cases in which a lessee (a transferor) is able to purchase an underlying asset at lower price than a lessor (a transferee) does. In those cases, the lessee intends to minimize the cost associated with introducing the asset and the lessee tentatively purchases the asset from the dealer in order to lease it back from the lessor.
- (b) There are other cases in which a lessee sells its owned assets to a lessor and leases them back in order to streamline administrative procedures associated with owning the assets such as multiple cars.

5.1.3 According to the proposal in the ED, JLA is concerned that most sales and leasebacks specified in (a) and (b) would be accounted for as financings. JLA proposes that it should be inappropriate to account for a sale and leaseback in which a lessee does not intend to acquire a financing as a financing. This type of sale and leaseback should be accounted for as a sale and leaseback. If JLA's proposal for a sale and leaseback is adopted, a lessor should apply the derecognition approach to a sale and leaseback.

In addition, it is necessary to add the detailed reason why only the performance obligation approach is applied to a sale and leaseback in paragraphs 68(a) and BC166.

5.1.4 In paragraph 69, a lessee is required to adjust both the measurement of the right-of-use asset to reflect current rates for lease payments and the gain or loss, while a lessor is required to adjust the carrying account of the underlying asset and the lease liability to reflect current rates for lease payments, which would be almost impossible in practice. In addition, the requirements in paragraph 69 are inconsistent with the fact that the measurement at fair value is not adopted in the new lease accounting standard. JLA proposes that if the consideration for a sale is not at fair value, the lessee should defer the loss or profit on sale as required in the current accounting standard. Furthermore, it would be appropriate for a lessee and a lessor to recognize their assets and liabilities at the present value of the lease payments specified in the leaseback.

6. Presentation

Question 12: Statement of financial position

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- (a) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment or investment property as appropriate, but separately from assets that the lessee does not lease (paragraphs 25 and BC143–BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?
- (b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?
- (c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?
- (d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

6.1.1 Except for both a lease cancelable at any time and a lease of a real estate (including investment property) in 1.1.2 (That is, leases in which a lessee should not recognize a right-of-use asset), JLA agrees that a lessee presents right-of-use assets in the SFP separately from the other assets that the lessee does not lease, because a right-of-use is naturally different from an owned asset. However, JLA proposes that a lessee should be allowed to present all the right-of-use assets as “right-of-use asset” regardless of the classification of the underlying assets, and should be allowed to disclose in footnote each amount of the right-of-use assets in accordance with the classification for owned assets. Furthermore, if right-of-use assets recognized by a lessee are immaterial compared to the total assets recognized by the lessee, the lessee should be allowed to include the immaterial right-of-use assets in the owned assets for the purpose of presentation. If a purchase/sale of the underlying asset is not excluded from the scope as proposed by JLA in 2.2, assets arising from leases specified in paragraphs B10(a) and B10(b) should be included in owned assets (That is, an asset arising from a lease that transfers title to the underlying asset to the lessee at the end of the lease should be included in an owned asset.).

6.1.2 Except for both a lease cancelable at any time and a lease of a real estate (including investment property) in 1.1.2 (That is, leases in which a lessee should not recognize a right-of-use asset), JLA proposes that a lessee should present right-of-use assets in the SFP separately from the other owned assets. Similarly, JLA agrees that a lessee presents liabilities to make lease payments in

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the SFP separately from the other financial liabilities. Presenting liabilities to make lease payments separately would provide more useful information to users of financial statements. Furthermore, JLA proposes that if liabilities to make lease payments recognized by a lessee are immaterial compared to the total liabilities recognized by the lessee, the lessee should be allowed to include the immaterial liabilities to make lease payments in the other financial liabilities for the purpose of presentation because there would be no problems arising from the presentation proposed by JLA.

If a purchase/sale of the underlying asset is not excluded from the scope as proposed by JLA in 2.2, assets arising from leases specified in paragraphs B10(a) and B10(b) should be included in owned assets (That is, an asset arising from a lease that transfers title to the underlying asset to the lessee at the end of the lease should be included in an owned asset.). Similarly, JLA proposes that liabilities arising from leases specified in paragraphs B10(a) and B10(b) should be included in the other financial liabilities.

- 6.1.3 JLA agrees that a lessor applying the performance obligation approach presents underlying assets, rights to receive lease payments and lease liabilities gross in the SFP, totaling to a net lease asset or lease liability, because doubling up underlying assets and rights to receive lease payments should be avoided.
- 6.1.4 JLA agrees that a lessor applying the derecognition approach presents rights to receive lease payments separately from other financial assets and presents residual assets separately within property, plant and equipment. Furthermore, JLA proposes that all residual assets should be presented as "residual asset", instead of separately presenting residual assets in accordance with the classification for property, plant and equipment (PP&E), because residual assets are immaterial. In addition, JLA proposes that a lessor applying the derecognition approach does not need to disclose in footnote each amount of the residual assets in accordance with the classification for PP&E.
- 6.1.5 Regardless of the performance obligation approach or the derecognition approach, distinguishing assets and liabilities arising from subleases would be hardly useful. A lessor who operates various leases would separately present its assets and liabilities arising from leases under the performance obligation approach, those arising from subleases under the performance obligation approach, the rights to receive lease payments and residual assets arising from leases under the derecognition approach, and those arising from subleases under the derecognition approach. This presentation would be quite complex and burdensome. It would be acceptable for an intermediate lessor to separately present liabilities to make lease payments arising from head leases. However, it would not provide benefits to users of financial statements that a lessor operating both leases and subleases (as an intermediate lessor) presents assets arising from leases separately from those arising from subleases. In order to avoid the complexity and burden associated with this separate presentation, JLA proposes that a lessor should not be required to

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present assets and liabilities arising from subleases in accordance with this separate presentation. Furthermore, there is no need to separately disclose assets and liabilities arising from subleases in footnote.

Question 13: Statement of comprehensive income

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

- 6.1.6 JLA proposes that it is hardly useful for a lessee to present a lease expense (an interest expense on the liability to make lease payments and a depreciation expense of the right-of-use asset) separately from other expenses in the statement of comprehensive income (SCI). The costs arising from separately presenting a lease expense would exceed the benefits to the users of financial statements. Consequently, JLA proposes a lessee should include an interest expense on the liability to make lease payments and a depreciation expense of the right-of-use asset in other interest expenses or other depreciation expenses. In addition, only if a lease expense is material, a lessee should be required to disclose a depreciation expense and interest expense arising from a lease in footnote.
- 6.1.7 JLA agrees that a lessor presents a lease income (an interest revenue on the right to receive lease payments and a lease income as the lease liability is satisfied under the performance obligation approach) and a lease expense (a depreciation expense of the underlying asset under the performance obligation approach) separately from other interest revenues, other incomes, and other depreciation expenses in the SCI. However, there could be some cases in which the separate presentation is hardly useful based on the circumstance of a lessor's business. Consequently, JLA proposes that a lessor should be also allowed to choose to include a lease income and a lease expense in other incomes and other expenses and should be allowed to disclose in footnote a lease income and a lease expense.
- 6.1.8 JLA agrees that a lessor applying the derecognition approach presents a lease income (representing the present value of the lease payments) and a lease expense (the cost on sale for the portion of the underlying asset that is transferred to the lessee at the inception of the lease) in profit or loss either in separate line items or net in a single line item so that it provides information that reflects the lessor's business model. However, it is not so simple to classify the lessor's business models as proposed in paragraphs 61(a) and 61(b). Consequently, it would be better to define only the business model in which a lessor intends to use a lease as equivalent to selling the asset such as a manufacturer or dealer, and a lessor in the other business models should present a lease income and a lease expense net in a single line item. In addition, a lessor

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who does not intend to use a lease as equivalent to selling the asset should be allowed to include a lease income and a lease expense in other incomes and other expenses, and should be allowed to disclose a lease income and a lease expense in footnote, because there could be some cases in which the separate presentation is hardly useful based on the circumstance of a lessor's business.

Question 14: Statement of cash flows

Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

6.1.9 JLA agrees that a lessee classifies cash payments for a lease as financing activities in the statement of cash flows (SFC) and presents them separately from other financing cash flows. JLA also agrees that a lessor classifies the cash receipts from lease payments as operating activities in the SCF and presents those cash receipts separately from other cash flows. However, a lessee should be allowed to include cash payments for a lease in other financing cash flows. A lessor should be also allowed to include the cash receipts from lease payments in other operating cash flows, because there could be some cases in which the separate presentation is hardly useful based on the circumstance of a lessor's business.

7. Disclosure

Question 15: Disclosure

Do you agree that lessees and lessors should disclose quantitative and qualitative information that:

- (a) identifies and explains the amounts recognised in the financial statements arising from leases; and
- (b) describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows

(paragraphs 70–86 and BC168–BC183)? Why or why not? If not, how would you amend the objectives and why?

7.1.1 JLA proposes that the disclosure requirements for leases should not be more burdensome, compared to other disclosure requirements for other similar contracts such as a purchase contract or a borrowing contract, those required in other accounting standards, and those required in the current standard. The comments that JLA especially insists on are as follows.

7.1.2 The disclosure requirements for an option, contingent rentals, and residual value guarantees should be on the same level as required in the current standard.

7.1.3 For paragraph 74, it is hardly useful to separately disclose information for subleases.

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- 7.1.4 For paragraph 75, the ED allows a lessee and a lessor to apply the simplified requirements to short term leases, because short term leases are naturally immaterial. It would be sufficient to only disclose the fact that a lessee or a lessor accounts for short term leases in accordance with paragraphs 64 and 65. In addition, JLA proposes that a lessee should be allowed to account for a short term lease recognizing lease payments as expenses over the lease term, instead of recognizing any asset and liability arising from the short term lease (Refer to 1.3.3.).
- 7.1.5 For paragraph 76, JLA proposes that it would be sufficient for a lessee who enters into a sale and lease back to recognize the loss or profit on sale separately from other disposals of assets only when it is objectively clear that the consideration for a sale is substantially different from the fair value of the underlying asset. Even if the consideration for a sale is substantially different from the fair value, the disclosure requirements for terms and conditions for a sale and leaseback would be quite burdensome. In addition, JLA proposes that if the consideration for a sale is not at fair value, the lessee should defer the loss or profit on sale as required in the current accounting standard. Furthermore, JLA proposes that it would be appropriate for a lessee and a lessor to recognize their assets and liabilities at the present value of the lease payments specified in the leaseback (Refer to 5.1.4.).
- 7.1.6 JLA proposes that an option, contingent rentals (except for residual value guarantees), and expected payments under term option penalty should not be included in an asset and liability arising from a lease. Therefore, there is no need to disclose the minimum obligations specified in the lease (ie excluding an option, contingent rentals, and expected payments under term option penalty) separately from the amount including those. The maturity analyses in paragraphs 85 and 86 should be limited only to the amount specified in the contract (That is, the undiscounted lease payments including only the maximum amount of residual value guarantees specified in the contract).

8. Transition

Question 16: Transition

- (a) The exposure draft proposes that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186–BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?
- (b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?
- (c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

8.1.1 Transition for a lessee.....For leases that are accounted for as operating leases before the date

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of initial application, it would be quite burdensome to require a lessee to recognize right-of-use assets and liabilities to make lease payments at the present value of the outstanding lease payments. Therefore, a lessee should be allowed to recognize right-of-use assets and liabilities to make lease payments at the undiscounted amount of the outstanding lease payments for those leases that are accounted for as operating leases before the date of initial application. This would resolve the problem related to off-balance treatment.

In addition, a lessee should be allowed to discount the outstanding lease payments using the rate at the inception of the lease, if the lessee chooses the measurement at the present value (That is, the lessee's incremental borrowing rate or the rate implicit in the lease.).

JLA disagrees with recognizing an option, contingent rentals, and residual value guarantees (Refer to 4.1 and 4.2.). When a lessee recognizes liabilities to make lease payments for outstanding leases as of the date of initial application, any option, contingent rentals, expected payments under term option penalty should not be included in the liabilities to make lease payments. For residual value guarantees, a lessee should include the maximum amount specified in the contract as required in the current standard. Therefore, right-of-use assets and liabilities to make lease payments arising from the current finance leases should be recognized at the carrying amounts at the date of initial application regardless of whether those leases have options, contingent rentals, and residual value guarantees.

For a short term lease, JLA proposes that a lessee should be allowed to recognize lease payments in profit or loss over the lease term, not recognizing any asset and liability arising from the short term lease (Refer to 1.3.3.). Therefore, a lessee should be allowed to account for short term leases that are entered into before the date of initial application in accordance with the current requirements even after the date of initial application.

8.1.2 Transition for a lessor.....For leases that are accounted for as operating leases before the date of initial application, it is rare for a lessor to have information for the rate that the lessor charges the lessee and it is almost impossible for the lessor to discount the lease payments for those leases at the present value. Consequently, a lessor should be allowed to recognize the rights to receive lease payments (and lease liabilities under the performance obligation approach) at the undiscounted amount of lease payments.

JLA disagrees with the proposal for recognizing an option, contingent rentals and residual value guarantees (Refer to 4.1 and 4.2.). A lessor should recognize a right to receive lease payments (and a lease liability) for outstanding leases at the date of initial application, excluding any option, contingent rentals and expected payments under term option penalty. For residual value guarantees, a lessor should include the maximum amount guaranteed by both a lessee and by an unrelated third party.

If a lessor recognizes a right to receive lease payments under the derecognition approach, the amount recognized by the lessor at the date of initial application under the current accounting standard should be unnecessary to be adjusted. It would be quite burdensome to require a lessor to classify the amount recognized under the current accounting standard into a right to receive

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lease payments and a residual asset, because the amount has already included the portion of the residual asset. Furthermore, the costs associated with classifying the amount recognized under the current standard into a right to receive lease payments and a residual asset would exceed the potential benefits to users of financial statements.

9. Benefits and costs

Question 17: Assessment of benefits and costs

Paragraphs BC200–BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?

9.1.1 The proposals in the ED are quite complex and it would be almost impossible to apply the proposals to leases in practice. Furthermore, it is clear that the costs would overwhelmingly exceed the benefits to users of financial statements. Even if JLA's proposal were to be adopted, the costs associated with improving the treatment for an operating lease would still exceed the benefits to users of financial statements.

10. Other comments

Question 18: Others

Do you have any other comments on the proposals?

10.1.1 Regardless of whether a lease is a short term lease or not, a lessee should be allowed to account for the leases written below, recognizing lease payments as expenses over the lease term, instead of recognizing any asset and liability arising from those leases from the standpoint of costs/benefits and the impacts on economy.

(a) A lease of a non-core asset (the asset is immaterial for the lessee's business activity).....Some think that different entities may interpret the meaning of a non-core asset differently and they think that a lease of a non-core asset should not be treated separately. However, defining a non-core asset as an immaterial asset for a lessee's business activity would be able to prevent a lessee from subjectively or intentionally determining whether a lease is a lease of a non-core asset or not.

(b) A lease of a core asset which is immaterial compared to the total assets (PP&E and intangible assets) recognized by the lessee.....Even if a leased asset is a core asset for a lessee, there are some cases in which the lease is immaterial compared to the total assets (PP&E and intangible assets) recognized by the lessee. In those cases, there would be no material impacts on the assets recognized by the lessee.

For both a lease of a non-core asset and a lease of a core asset immaterial to the total assets recognized by the lessee, some may think that applying the materiality principle is sufficient. However, some auditors would apply the proposals in the ED to all the leases without any exclusion and they could misunderstand or determine that the materiality principle is not applied

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to the new lease accounting standard. Consequently, it should be clarified in the new lease accounting standard that a lessee is allowed to account for a lease of a non-core asset and a lease of a core asset immaterial to the total assets recognized by the lessee recognizing lease payments as expenses over the lease term, instead of recognizing any asset and liability.

10.1.2 Depreciation for a right-of-use asset.....If a purchase/sale of the underlying asset is not excluded as proposed by JLA in 2.2, a lessee should depreciate the right-of-use asset arising from “a contract that results in an entity transferring control of the underlying asset (That is, leases defined in paragraphs B10(a) and B10(b).)” over not the lease term but the economic life of the underlying asset, applying the depreciation method that the lessee applies to its owned assets.

10.1.3 Discount rate to measure the present value of lease payments.....It would be easy for a lessee to determine its incremental borrowing rate for a lease classified as a finance lease under the current standard. However, in the case of a lease classified as an operating lease under the current standard such as a real estate, the lessee would have to determine its incremental borrowing rate as if the lessee acquires funds by collateralizing not the underlying asset but the right-of-use asset during the lease term. It would be quite difficult to define the incremental borrowing rate that is workable and applicable to various leases. This is why JLA believes that the accounting models proposed by JLA would be appropriate (Refer to 1.1.).
In addition, the ED defines the rate the lessor charges the lessee as a discount rate that takes into account the nature of the transaction as well as the specific terms of the lease such as lease payments, lease term and contingent rentals. However, JLA proposes that more detailed application guidance needs to be added, because it is unclear for a lessor to determine its discount rate in accordance with only the application guidance in the ED.

10.1.4 Initial direct cost.....ED proposes that a lessor should measure the right to receive lease payments at the present value, discounted using the rate the lessor charges the lessee, plus any initial direct costs incurred by the lessor. However, it is unclear whether a lessor should re-measure the discount rate taking the initial direct costs into account, when the lessor subsequently measures the right to receive lease payments at amortized cost. JLA proposes that this point should be clarified.

10.1.5 Accounting for a residual asset under the derecognition approach.....ED proposes that a lessor should not re-measure the residual asset unless there would be a significant change in the right to receive lease payments or unless the lessor recognizes any impairment on the residual asset. Unless a lessor accretes the carrying amount of the residual value asset up to its expected value at the end of the lease in order that the valuation of the residual asset reflects the time value of money, the lessor would understate its revenues over the lease term. JLA proposes that a lessor under the derecognition approach should accrete a residual asset up to its expected value

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at the end of the lease. Otherwise, the revenues arising during the lease term would not be recognized and those revenues would result in being recognized when the underlying asset is sold. Consequently, there would be some distortions on the revenues that a lessor recognizes.

- 10.1.6 Accounting for a sublease.....In the case that a head lease and a sublease have approximately same conditions and the intermediate lessor intends to generate fees from the differences between the head lease and sublease, the intermediate lessor should be allowed to recognize “the right to receive the lease payments” and “the liability to make lease payments” at the amount of undiscounted lease payments respectively.