

15 December 2010

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

Email: CommentLetters@iasb.org

Dear Sir/Madam

SAICA SUBMISSION ON EXPOSURE DRAFT ON *LEASES*

In response to your request for comments on the IASB's exposure draft on *Leases*, attached is the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director – Accounting

cc: Moses Kgosana (Chairman of the Accounting Practices Board)
Prof Alex Watson (Chairman of the Accounting Practices Committee)

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GENERAL COMMENTS

We generally support the proposals contained in the exposure draft for leases. We acknowledge that the current accounting for leases, in particular operating leases, would change significantly. Nevertheless, we believe these proposals are an improvement to the current financial reporting of leases.

Our responses to the specific questions are set out below.

SPECIFIC COMMENTS

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?*

We agree in principle that a lessee should recognise a right-of-use-asset and a liability to make lease payments.

(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?*

Conceptually we are generally supportive of the proposals to recognise amortisation of the right-of-use-asset and interest on the liability to make lease payments. However, some of the commentators questioned the extent to which the proposals reflect the economic reality of the lease transaction because the further into the lease term the lower the finance charges, and therefore the combined expense recognised in profit and loss is likely to be. In their view, this is likely to result in the combined expense to decrease over time when in an inflationary economic environment it should be expected to increase. These commentators, while accepting that this impact is similar to what would occur were an entity to purchase an asset financed by borrowings, believe that as the proposed definition of a lease excludes an asset that is acquired, the expense should reflect the right of use on a systematic basis in real terms. As many other items of expense increase over time due to inflation, these commentators believe the right of use expense should also increase over time as inflation occurs.

Question 2: Lessors

(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 the expected lease term, and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?*

One of the practical challenges, in some instances, associated with the current leases model under IAS 17 – *Leases*, is the application of the classification requirements in determining whether the lease should be classified as a finance or an operating lease. While we are of view that the proposed lessor model could introduce even further complexities in applying the criteria to assess whether an entity retains significant risks or benefits, due to the lack of guidance in making such assessments, we agree

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that the lessor should apply the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term, and the derecognition approach otherwise. To reduce the problems that could potentially be encountered in practice and to eliminate any possible inconsistencies in making the assessment, we recommend that determining whether an entity retains significant risks and rewards should be determined with reference to an entity's business model, similar to the approach in IFRS 9 – *Financial Instruments*. As lessors are likely to have many similar leases it should be easier to make the required classification despite having less guidance than in the current IAS 17 when lessees might not have many similar leases. This is as a result of the lessors' leases likely to be aligned to their business model (i.e. financing operations or leasing assets to many lessees).

A minority of the commentators were opposed to the two approaches, noting that making the distinction, given the minimal guidance provided in this regard, would not reduce complexity to the accounting of leases by lessors. According to these commentators, the derecognition approach would be preferable as it is to a large extent symmetrical with the model proposed in the exposure draft for lessees. In addition, as the entity derecognises a portion of the underlying asset and recognises a residual asset, this approach removes many of the complex accounting requirements associated with the underlying asset, such as revaluations and depreciation imposed by other accounting standards, other than impairment.

- (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?*

Subject to the minority view as noted above, we agree with the Boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting.

Question 3: Short-term leases

The exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is twelve months or less:

- (a) *At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognise lease payments in profit or loss over the lease term (paragraph 64).*
- (b) *At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognise assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit or loss over the lease term (paragraph 65).*

(See also paragraphs BC41–BC46.)

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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?

We welcome the Boards' proposal to introduce an exception for the accounting of short-term leases. In some instances it may not be clear whether a lease is a short term lease. An example is a situation where an entity enters a lease agreement to hire a car for a specific period of time, less than 12 months and has the option to extend the lease period beyond this period, but is not guaranteed that it would be supplied with the same car (underlying asset leased) in the secondary lease period. The question is whether this lease should be accounted for as a short term lease or not, in terms of the proposals contained in the exposure draft. We believe that the guidance provided in the exposure draft should be sufficient to avoid any potential ambiguities and thus reduce the possibility of such a lease being accounted for differently by different entities.

We also believe there is merit in changing the lease term for short-term leases to the longest possible term that is more likely than not to occur at initial recognition being twelve months or less to be consistent with the measurement requirements for other leases, other than the requirement to present value lease payments. Accordingly the definition of the lease term should be the same for short-term leases and other leases.

Definition of a lease

The exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1–B4 and BC29–BC32). The exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59–BC62) and on distinguishing a lease from a service contract (paragraphs B1–B4 and BC29–BC32).

Question 4

(a) *Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?*

We do not agree that the proposed definition of a lease is broad enough to explicitly capture the arrangements with an investor involving the legal form of a lease, currently dealt with in SIC 27 - *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. We recommend that the Board clarify this aspect before the proposed standard is finalised.

(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?*

We agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale.

(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?*

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We believe that the guidance provided in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient.

Scope

Question 5: Scope exclusions

The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33–BC46).

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?

We are generally supportive of these proposed scope exclusions for the proposed standard on leases.

Paragraph 7(b) of the exposure draft also excludes investment properties that are measured at fair value from its scope. A minority of commentators are of the view that investment properties should not be exempted from the proposed standard. They believe that if the principles in the exposure draft are sound, then it means the lessor has a liability at a period end that is not recognised if it uses fair value accounting for its investment property. In this case, they believe the lessor should, at initial recognition of the lease, account for the liability and recognise the asset as an increase in the investment property. Thereafter it should be measured in accordance with the fair value model.

Question 6: Contracts that contain service components and lease components

The exposure draft proposes that lessees and lessors should apply the proposals in Revenue from Contracts with Customers to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B5–B8 and BC47–BC54). If the service component in a contract that contains service components and lease components is not distinct:

- (a) *the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.*

We are not supportive of the FASB's proposal.

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

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?

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We agree with the IASB's proposals contained in (b)(i) and b(iii) above. We are of the view that lessors under either the performance obligation or the derecognition approach should follow the same accounting in respect of service components identified in a contract as there is no apparent reason for such a distinction. Our recommendation is that the service components under performance obligation should also be accounted for under the revenue standard. Thus a lessor that applies the performance obligation approach should follow the same approach outlined in (b)(iii) above.

Question 7: Purchase options

The exposure draft proposes that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraphs 8, BC63 and BC64).

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?

We agree with the proposals to account for a purchase option under the proposed lease standard as purchase (by the lessee) and a sale (by the lessor) as we believe that the proposed treatment reflects the changes in the nature of the agreement.

Measurement

The exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that:

- (a) *assumes 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 (paragraphs 13, 34, 51, B16–B20 and BC114–BC120).*
- (b) *includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21 and BC121–BC131). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be measured reliably.*
- (c) *is updated 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 (paragraphs 17, 39, 56 and BC132–BC135).*

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?

We agree that the lease term should be determined 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 and not the most probable outcome. We are however concerned that the proposed principle for determining the longest lease term contained in paragraphs 13, 34 and 51 is not clear. In particular, the implication of the application of the principles as illustrated in B17

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read with the principles in paragraphs 13, 34, and 51 can be difficult to understand. For example, it could be argued that the probability of a 10-year term is not 40% as shown, but 100% seeing that the non-cancellable term is 10 years. It is also, in our view, an area where diversity could occur and we suggest that the Board clarify this within the above mentioned paragraphs.

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?

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?

Conceptually we agree that lease payments should include contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease using an expected outcome technique, on the basis that this is the best estimate of expected future cash flows. In addition, as regards lessors we agree that amounts determined on a similar basis should be included in the measurement of the right to receive lease payments, but only if these amounts can be measured reliably as it is not appropriate for the receivable to include amounts for which there is no reasonable assurance that they will be received.

We are however concerned that paragraph 14(a) and 52(a) are not clear. In our view, it is unclear how ‘*readily available forward rates*’ in these paragraphs should be interpreted in certain circumstances. An example where this would be relevant is where an entity enters into a long term lease agreement (e.g. 25 years) and is required to estimate the contingent rentals based on forward rates. The question is whether an entity would be permitted to apply the prevailing rates at the date the estimate is made where forward rates beyond say 10 years, are not available or whether forward rates beyond year 10 should be extrapolated from the rates available for that 10 year period.

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?

We 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. A practical question is how to determine whether a change should be considered to be

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significant. It would assist the application of the standard if the final standard could include what should be considered in this regard (e.g. whether significance is to be considered in relation to each right-of-use asset individually or collectively, or how significance can be determined without having to perform a revised right-of-use calculation).

Sale and leaseback

The exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents the sale of the underlying asset, the leaseback would also meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66–67, B31 and BC160–BC167).

Question 11

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?

We agree with the proposed criteria for classification as a sale and leaseback transaction, as we are of the view it is an improvement to the current guidance provided in IAS 17 – *Leases*.

Presentation

The exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25–27, 42–45, 60–63 and BC142–BC159).

Question 12: Statement of financial position

- (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?*

We do not agree that lessees should be required to present the assets, liabilities, income and expenses and cash flows arising from leases separately from other similar assets, liabilities, income and expenses and cash flows. We believe that the materiality requirement in paragraph 29 of IAS 1 – *Presentation of Financial Statement*, should be the overriding factor to consider in this regard. This paragraph provides for items of dissimilar nature to be presented separately unless they are immaterial, while paragraph 30 states “An item that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes.” Disclosures by way of note, would in our opinion, suffice in many instances.

Not all commentators supported the right-of-use asset being shown as a tangible asset. Some commentators supported this asset being shown as an intangible asset

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and based this on the right-of-use asset being similar to the intangible asset required in terms of IFRIC 12 - *Service Concession Arrangements*.

- (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?*

Whilst, subject to the comments below, we are supportive of the proposals, we believe that an entity should also be allowed to present a separate line item for the lessors being the total of the net lease asset or lease liability. The reconciliation of the gross to net amount could be disclosed in the notes to the financial statements. We believe, as noted in our response to question 12(a) above, that the materiality requirements in IAS 1 – *Presentation of Financial Statement* should be the overriding factor to consider in relation to the net lease asset or liability in deciding whether the gross or net amounts should be presented on the face of the statement of financial position.

- (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?*

Similar to our response in question 12(a), the rights to receive payments should not be required to be separately presented.

Paragraph BC155 states that the residual asset should be presented separately from property, plant and equipment because it represents the lessor's interest in the underlying asset at the end of the lease term, but has a risk profile and measurement approach that is different from other property, plant and equipment. From our point of view, there seems to be no clear distinction between the *residual value* as defined in IAS 16 – *Property, plant and equipment*, which does not call for a separate presentation on the face of the statement of financial position, and the *residual asset* as defined in this exposure draft. In light of this, we are not convinced that the residual asset should be presented separately as it not likely to be material in the majority of the cases. Therefore separate disclosure within the property, plant and equipment note would, in our view, provide the user with adequate information.

- (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?*

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We recommend that the presentation of assets and liabilities under a sublease follow the same the presentation requirements as for assets and liabilities under the main lease, taking into account our responses to question 12 above.

In addition, B29 proposes that the reconciliation of the net sublease asset be presented on the face of the statement of financial position (SFP). We again suggest that this reconciliation be disclosed in the notes and the one line item, being the net sublease amount be presented on the face of the SFP. We believe that the materiality requirement in IAS 1 – *Presentation of Financial Statement*, should be the overriding factor to consider in this regard.

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?

We do not support the proposal that lessees and lessors should be required to separately present the lease income and lease expense from other income and expense in profit or loss. Separate disclosure in the notes should suffice. We believe that the materiality requirement in IAS 1 – *Presentation of Financial Statement*, should again be the overriding factor to consider in this regard.

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?

We do not support the proposal that cash flows arising from leases should be required to be presented in the statement of cash flows separately from other cash flows. In our view, separate disclosure in the notes would be sufficient. We believe again that the materiality requirement in IAS 1 – *Presentation of Financial Statement*, should be considered in this regard.

Disclosure

Question 15

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?

We agree with the proposed disclosure requirements, but as indicated in our response to question 12, we believe the amounts could be disclosed in the notes rather than being shown separately on the face of the statement of financial position. However, in addition

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we propose that the following words be added to paragraph 83 of the exposure draft “*An entity shall disclose information about significant assumptions and judgements and any changes in assumptions and judgements relating to renewal options, contingent rentals, term option penalties, residual value guarantees and the discount rate used when determining the present value of lease payments including any significant changes from the prior year.*”

Transition

Question 16

- (a) *The exposure draft proposes that lessees and lessors should recognise 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?*

We support the simplified retrospective approach.

- (b) *Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?*

Whilst this is a conceptually sound principle, we envisage that could be difficult to apply in practice. Accordingly, it might only apply in a limited number of cases. Therefore a consistent application of the requirements is likely to be a more important consideration. On that basis, we do not support a full retrospective application approach.

- (c) *Are there any additional transitional issues the boards need to consider? If yes, which ones and why?*

Yes, to provide entities with sufficient time to consider and implement system changes to deal with the proposals, as well as to test the procedures required to obtain the various estimates required. We are of the opinion that a mandatory effective date for the proposed standard should be three years post issuance of the final IFRS.

Benefits and costs

Question 17

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?

In the short to medium term the costs of implementing the proposals will most likely exceed the benefits. This could be particularly true for entities with large volumes of operating leases. Some of these costs, which may not be insubstantial, may not necessarily be once off, but could be incurred on an ongoing basis.

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Other comments

Question 18

Do you have any other comments on the proposals?

Foreign currency transactions

From our reading of the exposure draft, the interaction between this proposed standard and IAS 21 – *The Effects of Changes in Foreign Currency Exchange Rates* (IAS 21) is not clear. We recommend that guidance should be provided for how an entity, acting either in the capacity as lessee or lessor, should account for any foreign currency changes that arise from entering into a lease transaction that requires payments to be made in a currency that differs from the entity's functional currency. We recommend that the Board consider and provide for the accounting treatment for the following items in the final standard so as to eliminate any possible confusion in practice, as well as to avoid possible different applications:

1. It is assumed that a lessee should account for changes in exchange rates even when there is no change in expected foreign denominated lease payments. This is based on the requirement in paragraph 17 to reassess the carrying amount of the liability. Whilst the paragraph requires a reassessment of the lease term and expected payments, it is presumed that the expected payments would be the foreign denominated payments and not the payments translated at an exchange rate. It is suggested that paragraph 17 should also make reference to changes in exchange rates as well. The same comment would also apply to paragraph 39 dealing with a lessor who uses the performance obligation approach for foreign denominated lease receipts, when reassessing the carrying amount of the asset.

When a foreign denominated lease liability (asset), which represents future lease payments (receipts) is re-measured for changes in spot exchange rates the question is whether the change should be accounted for through profit or loss in a similar way to that required in terms of IAS 21 for a monetary item, or as an adjustment to the lessee's (lessor's) right of use asset (performance obligation) in accordance with the exposure draft paragraphs 17 (39).

Some of our respondents believed that the adjustment should be recognised in profit or loss in line with IAS 21's requirements for monetary items whilst others believed that it should be regarded as an adjustment to the right of use asset and (performance obligation).

2. With regard to changes in future contingent rentals in a foreign denominated lease where it is assumed that the whole change in exchange rates should be accounted for in profit or loss, it was questioned whether changes in the foreign denominated amounts should be accounted for as adjustment to the right of use asset (performance obligation) and if so whether the adjustment should be accounted for the using either the prevailing spot rate of exchange or the historical exchange rate that existed at the date of the commencement of the lease.

There was support for these subsequent changes in future contingent rentals to be measured using the current spot rate of exchange and that such changes should be accounted for as an adjustment to the right of use asset (performance obligation).

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This was analogised to a change in the acquisition price of the right of use asset (obligation) to provide use of an underlying asset.

Deferred tax implications

Given significant changes in both lessee and lessor accounting, we recommend that the Boards consider including guidance on the deferred tax implications of the proposed standard and specifically, the deferred tax requirements on initial recognition of a lease, as it appears that there are different views as to whether the initial exclusion exemption in terms of IAS 12 applies or not.

Examples in IFRIC 4 – *Determining whether an Arrangement contains a Lease* – also see question 4

It is suggested that the illustrative examples in the current IFRIC 4 be included in the application guidance, as the current examples from an utility perspective are regularly used in practice.

Other examples

It is suggested that the examples in the application guidance be expanded also to include, inter alia, examples on the following:

- Contracts that contain both service and lease components; and
- Lessee examples

Background information on the lease definition - see also question 4

The current basis of conclusion for IFRIC 4 explains the background on how some of the principles were developed for the proposed lease definition in this proposed standard. It is believed that this information is useful in understanding the definition of the proposed lease definition and it is suggested that the proposed standard be expanded to include relevant sections of the IFRIC 4 basis for conclusions.

Paragraph 23 – revaluation of a right-to-use asset

It is suggested that the paragraph be amended to mention that the gain and loss on revaluation be recognised in other comprehensive income, with reference to the additional conditions in IAS 16 paragraphs 39 and 40.

Nature of liabilities arising in terms of the exposure draft

It is suggested that it be clarified as to whether liabilities that arise in terms of the exposure draft are to be regarded as arising in terms of IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets* or IFRS 9 – *Financial Instruments*, as it appears that by including lease terms beyond the non-cancellable period, portion of the lease liability may go beyond what would be regarded as a liability in terms of IFRS 9. This being the case, it could cause difficulty in applying hedge accounting given the different treatment for financial and non-financial hosts.

Investment property

Paragraph 7 of the exposure draft refers to an entity applying the proposed standard “*to investment property it holds under a lease.*” The definition of an investment property in IAS 40 – *Investment Property* refers to the property being held by the owner or by the lessee under a finance lease. As a result of paragraph 7 referring to a lease it is possible that it could be questioned whether this paragraph is only applying to property held by a lessee under a finance lease, and not property held by an owner. While paragraph 7(b) refers to

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property held by a lessor, it is suggested that the wording could be improved; for example
“to leases of investment property.”

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