



December 6, 2010

Via website posting: <http://www.iasb.org/>

Re: Exposure Draft Comment: **Leases(ED/2010/9)**

Dear Sir/Madam:

The Certified General Accountants Association of Canada (CGA-Canada) welcomes the opportunity to comment on the Exposure Draft: **Leases(ED/2010/9)**.

### Question 1

- (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?*

### Comments

- (a) CGA-Canada agrees that a lessee should recognise a right-of-use asset and a corresponding liability to make lease payments when recording a leasing transaction. We believe that this proposal will remedy off-balance sheet accounting of leases and facilitate the work of financial analysts who routinely adjust the financial statements prepared under the exiting requirements including current IAS 17 provisions. We also believe that the proposals will make computation of leverage, asset turnover and other accounting ratios more reliable.
- (b) CGA-Canada agrees that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments. We believe that measuring right-of-use asset (a non-financial asset) at fair value would be highly complex and costly without commensurate benefit of incremental decision-useful information. Similarly, employing incremental borrowing rate and amortizing interest on liability to make lease payments is appropriate for subsequent measurement of this liability as it is unlike other financial liabilities and has some unique attributes like linkage to the right-of-use asset.

### Question 2

- (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?*

- (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?*

### **Comments**

- (a) CGA-Canada agrees that a lessor should apply (i) the performance obligation approach and (ii) the derecognition approach under specified conditions. We believe that the proposed approach is consistent with the "risk and rewards" model of ownership. However, we do not subscribe to the view that the proposals suggest a single model of lessor accounting, and that the performance obligation approach and the derecognition approach differ only in the application of this single model. We believe that there will be significant differences in the accounting outcomes under these two different methods of lessor accounting and it would be inappropriate to describe them as a single model.
- (b) CGA-Canada notes that, in case of the performance obligation approach, the initial measurement of lease payments by lessor and lessee may be significantly different on account of their different expectations and information. We also note that under this approach, the subsequent measurement proposals are complex and not aligned to the revenue ED. For example, the amortisation proposals are geared to the use of the underlying asset by the lessee in contrast to the proposals in the revenue ED which are geared to the discharge of the performance obligation by the seller. Also, in the absence of clear implementation guidance, the impairment losses calculated for lease assets under IAS 39 and impairment losses calculated for the underlying asset under IAS 36 may result in double counting. We also do not support the proposal under derecognition approach to remeasure residual asset for impairment only. We believe that such requirement will exacerbate volatility in profit or loss under this approach.

### **Question 3**

*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.)*

*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?*

## Comments

CGA-Canada supports the proposals related to the accounting for short-term leases in the ED on the considerations of costs and benefits. However, we suggest providing more guidance and clarifying whether these proposals will also apply when the lessor and lessee enter into a series of identical short-term leasing contracts which *de facto* replicate a long-term leasing contract for the underlying asset. We believe that such a series of short-term leasing contracts should not be exempted from the requirements of the main proposals of the ED because there will otherwise be an opportunity to structure accounting transactions which circumvent the requirements of the main proposals of this ED.

## 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?*
- (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?*

## Comments

- (a) CGA-Canada agrees with the proposed definition of a lease. We note that the proposed definition incorporates principles articulated in IFRIC 4 as well as ASC Topic 840.
- (b) CGA-Canada agrees with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale. We believe that the proposals are consistent with the proposed standards on revenue recognition and consolidation.
- (c) CGA-Canada contends that the guidance in paragraphs B1–B4, although sufficient for distinguishing between purchases or sales and leases, is insufficient for distinguishing leases from service contracts. We suggest providing additional guidance on the exclusive features in a contract that will render it either a lease contract or a service contract.

## Question 5

*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?*

## Comments

CGA-Canada is in general agreement with the scope exclusion in the proposed IFRS. However, we believe that more implementation guidance is required on how the lessor would apply the proposals in the case of a long-term lease of land because land value does not depreciate with the passage of time. We also note that the proposals now reverse the earlier position of the IASB where, in some cases, the lessee in a

long-term lease of land is economically in equivalent position as if the lessee had purchased the land. We are unsure of the reasons for reversal of the original position which was articulated while amending IAS 17.

### **Question 6**

*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.*

*(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?*

### **Comments**

CGA-Canada prefers the IASB approach to the FASB approach in the case of a lessor that applies the derecognition approach and when the service component and the lease component are not distinct in the contract. We appreciate that the IASB proposal will result in change of practice for the lessor following derecognition approach. However, from the perspective of the users of financial statements, it is more important not to accelerate recognition of income from service component, as per the rationale for IASB proposal, than to reconcile payables of lessee and receivables of the lessor, as per the rationale for FASB proposal.

### **Question 7**

*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?*

### **Comments**

CGA-Canada agrees that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised and that a contract should be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised. We believe that the alternative to this position (treating the purchase option as a term of the lease that should be accounted for as if it were an option to extend the lease term) will unduly complicate accounting without commensurate benefits.

### **Question 8**

*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?*

### **Comments**

CGA-Canada contends that the proposal to 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 is not conceptually sound. We agree with the alternative view that the proposal will overstate the leverage and understate the asset turnover ratio for the lessee. We believe that, *de facto*, the proposals suggest an arbitrary and highly subjective valuation method for options to extend or terminate a lease. For example, in case of an option to terminate a lease, if the “more likely than not” term is shorter than the contract term, it will result in a right-of-use asset being measured at a lower value by the lessee than it would have been otherwise valued in absence of such option. This position implies negative value for the early termination option because it suggests that an option can have a value less than zero.

CGA-Canada believes that the disclosure approach articulated in BC120 (b) is a reasonable alternative to the proposals and it is better to rely on the judgment of users for interpreting the available information than the judgment of preparers to convey this information on the basis of an arbitrary method of valuing lease term options.

### **Question 9**

*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?*

### **Comments**

CGA-Canada does not endorse inclusion of contingent rentals, expected payments under term option penalties, and residual value guarantees that are specified in the lease for the purpose of measuring assets and liabilities arising from a lease. We are concerned that under the proposals, the liabilities of a lessee and the assets of the lessor may be misstated. We believe that the proposals are in conflict with the existing requirements under paragraphs 27 and 31 of IAS 37 which require that a contingent liability or an asset will not be recognized. We note that the principal rationale behind inclusion of these payments is to

preclude any structuring opportunities for a lessee (BC 123(b)). We support the alternative view (AV8) that it is possible to avoid structuring opportunities by establishing principles for identifying where optional lease periods and contingent rental arrangements lack economic substance and represent disguised minimum rental payments, and through appropriate disclosure.

### **Question 10**

*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?*

#### **Comments**

CGA-Canada agrees that subsequent remeasurement is required for assets and liabilities arising from a leasing transaction when facts and circumstances indicate significant change. We believe that such remeasurement is required for providing relevant and decision-useful information in a timely manner. However, we note that the proposals do not provide guidance on what constitutes “significant change” and whether, for this purpose, the materiality considerations should be factored in. We suggest clarification on this issue.

### **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?*

#### **Comments**

CGA-Canada notes that the proposals differ from the current requirements under IAS 17 and will likely end off balance sheet financing practices through structured sale and leaseback transaction. We strongly support the proposals and also suggest clarifying paragraph 69(a) by indicating that, if the consideration for a purchase or sale or the lease payments specified by the leaseback is not at fair value, the transferor should adjust the measurement of the right-of-use asset as well as corresponding lease liabilities.

### **Question 12**

*(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 (paragraph 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?*

### **Comments**

- (a) CGA-Canada notes that the proposals differ from the current IAS 17 requirements and may entail change in practice for some entities and increase line items in their financial statements. We support the proposals as the new presentation requirements will enhance comparability as well as the usefulness of the financial statements prepared by lessees. However, we also note the conundrum related to right-of-use asset which satisfies the definition of an intangible asset under IAS 38 but, under the proposals, will be presented along with other tangible assets. We believe that resolution of this anomaly is necessary for aligning the proposals with the conceptual framework of the IFRSs.
- (b) CGA-Canada agrees with the Boards' rationale articulated in BC 148-149 regarding presentation proposals for the lessors so far as it relates to underlying assets, rights to receive lease payments, and lease liabilities gross in the statement of financial position, totalling to a net lease asset or a net lease liability. We believe that the proposals will mitigate concerns regarding "double counting" of underlying assets under the performance obligation approach.
- (c) CGA-Canada is in agreement with the proposed presentation scheme for lessors under derecognition approach. We agree that the right to receive lease payments and the residual asset have both different risk profile and measurement approach than other financial assets and other property, plant and equipment, respectively.
- (d) CGA-Canada agrees that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position and concurs with the boards' rationale that the head lease and the sublease are separate transactions and that subleases should be measured and presented in the same manner as other leases. However, we suggest clarifying the treatment when the intermediate lessor is acting only as an agent.

### **Question 13**

*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?*

### **Comments**

CGA-Canada agrees that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss because of their distinctive attributes, and that their separate presentation will provide more useful information. We also believe that under the derecognition

approach, even if the lessor's business model employs leases for the purpose of providing finance, the lessor should present lease income and lease expense on separate line items, and not on a single line item as proposed in paragraph 61(b). We believe that information about the lessor's business model should be conveyed by appropriate disclosures in the notes to the financial statements, and not by netting the line items in the financial statements.

#### **Question 14**

*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?*

#### **Comments**

CGA-Canada agrees that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows. However, we suggest that under the performance obligation approach, it should be further clarified that if the lessor follows the indirect method of preparing the statement of cash flows, the changes in the right to receive lease payments as well as changes in lease liabilities should be presented separately from the changes in other operating receivables and other liabilities.

#### **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?*

#### **Comments**

CGA-Canada notes that the proposed disclosure requirements are similar to, and extend, the current requirements under IAS 17. We believe that the proposed requirements will satisfy the overall disclosure requirements and particularly welcome the requirement for entities to use their judgement to assess whether the disclosures meet the overall objectives, and whether to supplement the required disclosures, for this purpose. We also welcome the proposal for new disclosure requirement in respect of sale and leaseback transactions.

#### **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?*

*(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?*

**Comments**

- (a) CGA-Canada supports the proposal that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach. We particularly welcome relief granted to short-term and simple finance leases. We believe that this approach balances the need to provide the users with relevant information and the need to limit the cost of providing such information.
- (b) CGA-Canada does not support full retrospective application of lease accounting application on the consideration of costs and benefits.
- (c) CGA-Canada suggests providing specific guidance on treatment of sale and leaseback transactions when the proposals are initially applied.

**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?*

**Comments**

CGA-Canada appreciates the complexities associated with accounting for leases and also recognises the inadequacy of the current requirements of IAS 17. We expect that the proposals will enhance transparency in lease accounting, facilitate the analysis, and diminish the asymmetry of information between the preparers and the users of financial statements. We also believe that, although there are costs associated with the proposed transition to the new model, the resulting benefits will outweigh these costs.

**Question 18**

*Do you have any other comments on the proposals?*

**Comments**

CGA-Canada notes that the proposals distinguish between the “right-of-use” and “economic resource” associated with the underlying asset in a lease. We are unsure if this distinction is compatible with the current or to-be-developed conceptual framework for the IFRSs. We also note that application guidance B5 requires that 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. We further note that “Performance Obligation” is a defined term under the proposals for *Revenue from Contracts with Customers*, but not under the current proposals for “Leases”. This ambiguity may create confusion regarding its exact connotation under the proposals. We suggest clarifying and defining this term under the proposed standard. We also note that the proposals, unlike IAS 17, do not provide any guidance on lease incentives, renegotiation of leases, and derecognition of lease assets and liabilities. We suggest providing guidance on these issues.

CGA-Canada applauds this major initiative by the boards to improve lease accounting standard which we consider critically important. We do not see merit in the argument that the proposals will result in front-loading of leasing costs for lessees. On the contrary, we believe that the proposals will align the lessee accounting with the economic substance of lease transactions, which is not necessarily the present case. We also believe that dual model accounting for lessors is obligatory if the intent is to accommodate the range of possibilities in which the leasing transactions can be structured.

Should you wish to discuss the contents of this comment paper or require further elaboration on any of the items presented herein, please do not hesitate to contact Kamalesh Gosalia at [kgosalia@cga-canada.org](mailto:kgosalia@cga-canada.org) or alternatively the undersigned at [rlefevre@cga-canada.org](mailto:rlefevre@cga-canada.org).

Sincerely,

[Original signed by:]

Rock Lefebvre, MBA, CFE, FCIS, FCGA  
Vice-President, Research & Standards