



17 July 2009

International Accounting Standards Board  
1<sup>st</sup> Floor 30 Cannon Street  
London EC4M 6XH  
United Kingdom

*(By online submission)*

Dear Sirs:

## **RESPONSE TO DISCUSSION PAPER – PRELIMINARY VIEWS ON LEASES**

The Accounting Standards Council (ASC) appreciates the opportunity to comment on the Discussion Paper – *Preliminary Views on Leases* issued by the International Accounting Standards Board (IASB) in March 2009.

2 We note that the existing accounting model of leases has its criticisms of being complicated and not facilitating comparability for users of financial statements. Critics have also suggested that the existing accounting model of leases provides opportunities to structure transactions so as to achieve a particular lease classification. We support the IASB's efforts to address lease accounting and are pleased that this project has been undertaken as a convergence project with the FASB. We would like to provide our comments as set out below:

### **Recording by Lessors and Lessees**

3 Although we understand why the IASB and FASB have tentatively decided to defer the consideration of lessor accounting and to concentrate on developing an improved lessee accounting model, we are of the view that it may not be appropriate to merely focus on the change in the accounting treatment for lessees in isolation as most of the topics are inter-linked. Based on the existing treatment for operating leases, only one entity (lessor) records the asset. Under the new proposal that deals mainly with lessee accounting only, we may have a situation whereby the lessee records a payable to the lessor, but the lessor does not record a receivable on its books (this is on the assumption that the final standard does not consider lessor accounting concurrently) and hence resulting in an accounting mismatch. We should avoid a situation whereby the accounting for lessees has to be amended when the requirements for lessor accounting are finalized and this, in our view, seems likely as some principles on lessee accounting could possibly lead to a substantially different view had the issues been addressed and analysed from both the lessee and lessor's perspectives. We urge the boards to consider lessor accounting in tandem with this DP.

## Convergence

4 We also note that there are several areas where there is an inconsistent accounting treatment in leases between IASB and FASB. Ideally, a common position should be adopted especially in subjective areas. As far as possible, the changes should also not introduce undue volatility to profit or loss or balance sheet items.

## Tax Issues

5 The proposed accounting treatment of leases would most likely have an impact on the way tax authorities across jurisdictions deal with tax matters relating to leases. Most countries, including Singapore, treat aircraft leases differently for tax purposes depending on their accounting classification. For example, the tax authorities in Singapore allow lessees to make capital tax claims for finance leases over a specified period (i.e. lessee is allowed to treat the leased asset as its owned asset) and tax deductions for operating lease for its lease rentals over the lease term (i.e. the lessor claims the capital tax allowance in the case of operating leases). With the elimination of finance and operating leases, it may be unclear as to which party could claim for the different types of tax rebates and over how long (e.g. based on the “most likely” lease term which may fluctuate every year with a requirement to reassess the lease term yearly). This could have a great impact on the existing domestic tax law and both lessees and lessors may find their tax position change substantially in relation to the leased asset. We are aware and understand that the IASB would not be able to address tax issues pertaining to each and every jurisdiction, however, we hope to highlight these pertinent consequential issues that extend beyond the changes required to be made on the balance sheet, and ask that the IASB allow ample time for the national standard setters to consult with interested parties on the effect of these changes..

## Impairment Issues

6 We noted that the boards have not yet reached a preliminary view on how to determine impairment of a right-of-use asset. We feel that most, if not all, of the impairment issues pertaining to right-of-use assets should be treated in accordance with the existing requirements under IAS 36 on Impairment of Assets.

Our comments on the specific questions to the discussion paper are as follows:

### *Question 1:*

*The boards tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards. Do you agree with this proposed approach? If you disagree with the proposed approach, please describe how you would define the scope of the proposed new standard.*

7 We agree with the boards’ decision to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards. However, we would like to seek clearer guidance in this area. The DP stated that the scope of IAS 17 covers all lease contracts, “including leases of some intangible assets”. We have assumed that since franchises are currently accounted for under IAS 38 Intangible Asset, it is not the

intention that franchises will be considered as leases and accounted for as a “right-of-use” under the proposed standard. If such is not the intention, then it would be necessary for the board to provide clearer guidance on the scope of this standard and whether the proposed “right-of-use” concept in this DP would extend to franchises.

*Question 3:*

*Do you agree with the boards’ analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract? If you disagree, please explain why.*

8 We agree with the boards’ analysis. However, we would like to highlight that in practice, there may be different interpretations of what constitutes “right-of-use” as well as *when* to recognize the asset and liability in the books (e.g. at inception date when contract is signed or commencement date when the leased assets are delivered). As the DP has pointed out, the rights and obligations arising under non-financial executory contracts are typically not recognized in the financial statements. Some may argue that prior to the delivery of the leased item the contract is an executory contract and hence, no assets and liabilities need to be reflected in the books even though the lessee may have obtained rights and obligations that meet the definitions of assets and liabilities prior to delivery (i.e. when the lease contract is signed). We think that it is important to establish economic substance over form so as to reflect a true view of the financial position of the entity. We suggest that the boards provide further guidance on the definition of the “right-of-use” as well as the timing of initial recognition, and to provide more illustrative examples if necessary for clarity.

*Question 5:*

*The boards tentatively decided not to adopt a components approach to lease contracts. Instead, the boards tentatively decide to adopt an approach whereby the lessee recognizes: (a) a single right-of-use asset that includes rights acquired under options; (b) a single obligation to pay rentals that includes obligations arising under contingent rental arrangements and residual value guarantees. Do you support this proposed approach? If not, why?*

9 We support the Board’s proposal of requiring lessees to recognize a single right-of-use asset that includes rights acquired under options. We also note that components of a lease contract are often interrelated and that it may be possible for companies to structure leases to reduce the amount recognized for the lessee’s obligations to pay rentals, compromising comparability as a result. A single right-of-use asset that includes rights acquired under options would clearly reflect the effect that the options could have on the lessee’s assets and liabilities and provides useful and relevant information to users. However, we would like to suggest that the amounts relating to the right-to-use the leased item for the lease term and the rights under options be disclosed separately in the notes to the accounts. We believe that such information is useful and relevant to the decision making of the users of the financial statements.

*Question 6:*

*Do you agree with the boards’ tentative decision to measure the lessee’s obligation to pay rentals at the present value of the lease payments discounted using the lessee’s incremental*

*borrowing rate? If you disagree, please explain why and describe how you would initially measure the lessee's obligation to pay rentals.*

10 We think that using the incremental borrowing rate to measure the lessee's obligation to pay rentals is easier to apply and would result in a reasonable approximation of fair value. However, we believe that using the implicit rate would be more relevant and objective as it is directly related to the lease, rather than on similar lease and/or the general economic situation. We suggest that, instead of removing the option of using implicit rate to measure the lessee's obligation, the IASB should consider retaining the current approach in the existing standard – that is to require lessees to discount the lease payments using the interest rate implicit in the lease if it is practicable to determine that rate. If it is not practicable to determine that rate, the lessee's incremental borrowing rate is used.

*Question 8*

*The boards tentatively decided to adopt an amortised cost-based approach to subsequent measurement of both the obligation to pay rentals and the right-of-use asset.*

11 We agree with the boards' tentative decision to measure the lessee's right-of-use asset at cost on initial recognition, this being the general measurement approach required in IFRS. However, we would like to suggest that the boards consider allowing the option to use the revaluation model, as is currently allowed for finance lease in the existing IAS 17 for subsequent measurement. We are of the view that if fair value can be measured reliably, an entity should be allowed to carry the right-of-use asset at a revalued amount (which is the fair value of the items at the date of the revaluation less any subsequent accumulated depreciation and accumulated impairment losses) and not be restricted to an amortised cost-based approach for subsequent measurement. This is consistent with the requirements under IAS 16 which finance leases are currently required to comply with and is an important issue for jurisdictions where leasehold land and properties are the norm. Having said this, we think that the revaluation option may not be appropriate for leases where there is no realizable value during or at the end of the lease term. The boards may wish to consider restricting this revaluation option to specific type of leases where the value is realizable, such as those for leasehold property.

*Question 9:*

*Should a new lease accounting standard permit a lessee to elect to measure its obligation to pay rentals at fair value? Please explain your reasons.*

12 We do not think that it is appropriate to permit a lessee to elect to measure its obligation to pay rentals at fair value subsequent to its initial recognition. In our view, leases should be accounted for in the same way that similar non-lease financial liabilities (e.g. debt used to purchase property, plant and equipment) are currently accounted for under the IFRS and US GAAP on amortised cost-based approach. Requiring lease liabilities to be measured at fair value would reduce comparability and is inconsistent with the boards' tentative decision to require measurement at cost on initial recognition. Imposing a fair value requirement would also be costly and complex for preparers. We suggest that the boards retain its preliminary views to adopt an amortised cost-based approach to subsequent

measurement of the obligation to pay rentals, and to allow disclosure of fair value amounts in the notes.

*Question 10*

*Should the lessee be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate? Please explain your reasons. If the boards decide to require the obligation to pay rentals to be revised for changes in the incremental borrowing rate, should revision be made at each reporting date or only when there is a change in the estimated cash flows? Please explain your reasons.*

13 We do not agree that the obligation to pay rentals should be revised for changes in the incremental borrowing rate, notwithstanding the fact that we believe that implicit rate should be used in measuring rental obligation in the first place (see comments to Question 6). Even though revising the obligation to pay rental to reflect changes in incremental borrowing rate will result in more relevant and current information, the cost involved in the process would most likely outweigh the potential benefits, especially when there is no change in estimated cash flows. Moreover, we note that lease payments generally do not fluctuate with changes in market conditions and the liability (and hence credit-worthiness) of the lessee should not be subjected to the fluctuations related to market conditions.

*Question 13:*

*The boards tentatively decided that the lessee should recognize an obligation to pay rentals for a specified lease term, i.e. in a 10-year lease with an option to extend for five years, the lessee must decide whether its liability is an obligation to pay 10 or 15 years of rentals. The boards tentatively decided that the lease term should be the most likely lease term. Do you support the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why.*

14 We support the boards' tentative decision on the most likely lease term approach. However, we note that the boards' preliminary view is that the lessee's intentions and past practice would not be considered in determining the lease term. We are aware of the boards' concerns that basing the lease term on lessee's stated intention would be open to abuse. However, we think that the lessee's intentions is an important factor in determining the lease term and we suggest that the boards include this factor in the guidance and if necessary, to require them to substantiate their intentions with evidence such as budgets, forecasts, past actions and industry practice. We would also like to point out that not requiring the consideration of management's intentions and views in this area seems to be inconsistent with other aspects of the DP, such as financial statement presentation issues. Under the DP, the obligation to pay rentals would be classified either as a business liability (operating or investing) or a financing liability depending on management's view of the obligation. We strongly recommend consistency in the use of management's intention to be considered throughout the whole DP.

*Question 15*

*The boards tentatively concluded that purchase options should be accounted for in the same way as options to extend or terminate the lease. Do you agree with the proposed approach?*

*If you disagree with the proposed approach, please describe what alternative approach you would support and why.*

15 We agree that purchase options should be accounted for in the same way as options to extend or terminate the lease. However, as mentioned earlier in our response to Question 5, we believe that the information of such an option (e.g. why and how it has been inputted) should be disclosed in the notes.

*Question 16*

*The boards propose that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements. Do you support the proposed approach? If you disagree with the proposed approach, what alternative approach would you recommend and why?*

16 We are supportive of the proposed approach to include in the lessee's obligation to pay rental amounts payable under contingent rental arrangements. We agree that excluding the obligation to pay contingent rental from the measurement of the liability may underestimate the asset of the lessee. For example, for a lease in which rentals are completely contingent on sales from the lease property, the lessee would recognize no asset for the right to use the leased property even though that asset could be valuable. Excluding such an obligation may also lead to a situation whereby the lessee could minimize both the right-of-use asset and obligation to pay rentals at the start of the lease by including a significant element of contingent rentals in the lease contract.

*Question 17*

*The IASB tentatively decided that the measurement of the lessee's obligation to pay rentals should include a probability-weighted estimate of contingent rentals payable. The FASB tentatively decided that a lessee should measure contingent rentals on the basis of the most likely rental payment. A lessee would determine the most likely amount by considering the range of possible outcomes. However, this measure would not necessarily equal the probability-weighted sum of the possible outcomes. Which of these approaches to measuring the lessee's obligation to pay rentals do you support? Please explain your reasons.*

17 We are more inclined towards the FASB's tentative decision to measure contingent rentals on the basis of the most likely rental payment as this approach would be simpler to apply and is more consistent with other aspects of the DP (e.g. recognition of options to extend or terminate a lease). We believe that a most likely approach would be less complex than a probability approach. and have noted in situations where other accounting standards allow 'probability-weighted outcomes' approach, such as impairment assessment in IAS 36, this approach is generally not used in practice.

*Question 20*

*The boards discussed two possible approaches to recognising all changes in the lessee's obligation to pay rentals arising from changes in estimated contingent rental payments: (a) recognise any change in the liability in profit or loss (b) recognise any change in the liability as an adjustment to the carrying amount of the right-of-use asset. Which of these two*

*approaches do you support? Please explain your reasons. If you support neither approach, please describe any alternative approach you would prefer and why*

18 We are of the view that all changes in the lessee's obligation to pay rentals arising from changes in estimated contingent rental payments should be recognized as an adjustment to the carrying amount of the right-of-use asset. This approach would be consistent with treatment of changes in obligation due to the change in expected optional period as covered in Chapter 6 of the DP (i.e. changes in the obligation to pay rentals arising from a reassessment of the lease term should be recognized as an adjustment to the carrying amount of the right-of-use asset). However, should our recommendation in Question 8 be adopted - that is to allow revaluation option in the measurement of the right-of-use asset under IAS 16 - any changes in contingent rentals should be recognized in profit or loss in accordance to the standard.

*Question 22*

*Should the lessee's obligation to pay rentals be presented separately in the statement of financial position? Please explain your reasons. What additional information would separate presentation provide?*

19 We think that the lessee's obligation to pay rentals should be presented separately in the statement of financial position as such obligations differ from the way many other financial liabilities are accounted for. For example, the obligation to pay rental is linked to the right-of-use asset and includes amounts payable in optional periods. Moreover, separate presentation could provide more useful information for users of the financial statements. Consequently, we support separate presentation of the lessee's obligation to pay rentals from other financial liabilities.

*Question 24*

*Are there any lessee issues not described in this discussion paper that should be addressed in this project? Please describe those issues.*

20 We would like to address the issue on the treatment of initial direct costs (to capitalise or expense as incurred) that is not yet resolved by the boards. We feel that such costs should be dealt with in the same manner as how the other standards (e.g. IAS 23, IAS 38 and IAS 16) have prescribed, that is to capitalize and recognize the initial direct costs as part of the carrying amount of the asset only if it is directly attributable to the asset (in this case the right-of-use asset) and if such costs satisfies the recognition criteria of an asset (ie. probability and reliability of measurement). In so doing, the fundamental principles of asset recognition is retained and is consistent with the other IFRSs that deals with similar assets such as intangible assets/property, plant and equipment under IAS 38 and IAS 16 respectively.

Should you require any further clarification, do contact me. Thank you.

Yours faithfully,

Dexter Tan  
Secretary, Accounting Standards Council