Project **Leases**

Topic **Comment Letter Summary**

Introduction

1. In March 2009, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) published the discussion paper, *Leases: Preliminary Views*. The comment period ended July 17, 2009. A total of 290 comment letters were received as of August 11, 2009, as summarized below:

Respondent Type	Number	Percentage
Preparer	136	47%
Industry Organization	51	18%
Professional Organization	37	13%
Standard Setter	16	5%
Individual	11	4%
Academic	9	3%
Accounting Firm	9	3%
Governmental Agency	7	2%
User	5	2%
Other	5	2%
Regulator	4	1%
Total	290	100%

Geographic Region	Number	Percentage
Europe	126	44%
North America	86	30%
International Organization	37	13%
Asia-Pacific	33	11%
Africa/Middle East	4	1%
South America	4	1%
Total	290	100%

Overview

2. Approximately half of the respondents supported the overall principles and objectives set out in the discussion paper, while approximately one-third of the respondents did not support the boards' preliminary views. The reasons cited by those respondents are summarized in paragraphs 5-12.

3. The remaining respondents did not express their views on the overall principles of the discussion paper. Approximately half of those respondents only commented on Chapter 10 of the discussion paper, *Lessor Accounting*, and primarily addressed the question of whether investment properties should be included in the scope of a new lease standard.

4. A summary of responses is provided in paragraphs 5-117. The staff will provide more detail on the responses as individual topics are discussed at future meetings.

Right-of-use Model

5. The respondents who supported the principles of the discussion paper acknowledge the problems with existing lease accounting standards and support the boards' effort to improve lease guidance with a principles-based approach. Those respondents stated that the requirement to distinguish between operating and capital (finance) leases is arbitrary, artificial, and creates accounting complexity. In their view, the right-of-use model would eliminate existing structuring opportunities and would result in accounting for lease arrangements based on the substance, rather than the form, of the transaction.

6. Respondents who are users of financial statements unanimously agreed with the right-of-use model.

> We have long viewed the accounting distinction between operating and finance leases as substantially artificial because, in both cases, the lessee contracts for the use of an asset, entering into a debt-like obligation to make periodic rental payments. As a result, we historically have adjusted the reported amounts to eliminate the operating or financing distinction by capitalizing lease obligations accounted for as operating leases. (CL #199)

7. However, the majority of the respondents who supported the right-of-use model in principle generally expressed concerns over the complexity of the model. They said that the implementation and ongoing compliance would be costly and would require significant effort. In particular, they are concerned about the complexity of the proposed accounting for lease options and contingent payments. Some of those respondents questioned whether the costs of the proposed model would outweigh the benefits.

8. The majority of the respondents who did not support the principles in the discussion paper are preparers and industry organizations. Those respondents stated that the right-of-use model is not applicable to all leases because lease arrangements are very diverse and their economic substance can range from a rental of an asset to a financed purchase. They stated that the existing lease accounting model properly reflects these economic differences by distinguishing between operating and capital (finance) leases. Additionally, those respondents noted that the proposed model is too complex and that its benefits would not outweigh its costs. The majority of those respondents recommended improving and retaining the existing guidance.

9. The respondents who recommended that the boards retain the existing guidance argue that the current guidance is well understood by both preparers and users, and the problems with lease accounting are implementation issues. The majority of those respondents recommended improving the existing guidance through enhanced disclosure requirements.

> We believe the costs and complexities of recognizing all leases far outweigh any benefit financial statement readers may experience. We feel that [with] minor adjustments to the current standard,

> including additional disclosure requirements and financial metrics differentiating capital from operating leases, all required information could be made available to financial statement readers and similar transactions would be treated uniformly for all entities. (CL #127)

10. Respondents who did not support the right-of-use model expressed a number of additional concerns. Specifically, some said that the proposed model is not consistent with the definitions of assets and liabilities in the conceptual frameworks, particularly as it relates to the recognition of lease options and contingent rentals (see paragraphs 59-90). Others were concerned that the significant amount of judgment required to apply the proposed model would provide opportunities for manipulation and make the financial statements less reliable.

11. A number of respondents said that the proposed model could have significant unintended consequences, including:

    (a) A negative impact on the leasing industry. The complexity of the proposed requirements may prevent an entity from entering into leasing transactions, even in circumstances when leasing may be beneficial to the entity.

    (b) A requirement for some financial institutions to hold more regulatory capital.

12. Several respondents stated that it would be impossible to completely eliminate structuring opportunities under any accounting model. These respondents said that the proposed model would simply encourage the entities to structure contracts as service arrangements rather than as leases.

Lessor Accounting

13. Nearly all of the respondents who commented on the boards' decision to defer consideration of lessor accounting disagree with that decision. Those respondents stated that a leasing transaction involves two parties—lessor and lessee—and should be considered from both perspectives simultaneously to develop consistent and symmetrical accounting. They noted that most lessee and lessor accounting issues are interrelated. Consequently, evaluating only one side

of a lease arrangement may not provide enough information to develop an improved standard.

14. In the view of some respondents, the insights gained in considering lessor accounting issues may have resulted in different preliminary views on lessee accounting.

15. A number of respondents expressed concern that consideration of lessor accounting at a later date could result in revisions to lessee accounting. This would effectively require two changes to lessee accounting, which would result in significant costs and effort. Those respondents stated that they would prefer the boards defer completion of the project to develop lessor guidance at the same time as lessee guidance.

16. Several respondents also stated that it is difficult to evaluate the right-of-use model without considering lessor accounting. A number of respondents urged the boards to issue a separate discussion paper on lessor accounting before issuing an exposure draft on leases.

> …by not sufficiently communicating on lessor accounting issues and failing to consult stakeholders in the form of a discussion paper, it is highly questionable whether the due process that would be expected from the IASB has been appropriately followed and whether any lessor accounting model that may be included in an exposure draft phase would be conceptually correct or practicable. (CL #29)

17. Several respondents who commented on the boards' decision to defer consideration of lessor accounting agreed with that decision. They stated that the most pressing issues in lease accounting relate to lessee accounting; primarily the opportunities to structure a lease to obtain off-balance-sheet financing. Those respondents urged the boards to continue with their plan to address lessee accounting issues in the near term and consider lessor accounting at a later date.

18. Users' views on this issue are mixed. Two user respondents (CL #199 and CL #288) encouraged the boards to address lessee and lessor accounting concurrently. However, one of those respondents (CL #199) stated that if doing so would defer issuance of a final standard on lessee accounting, a standard on lessor accounting should be issued as soon as possible after a new standard on

lessee accounting. Another user (CL #252) expressed disappointment at the boards' decision to defer consideration of lessor accounting. However, this respondent said that the benefits of an improved lessee accounting standard would justify the decision to defer development of a lessor accounting standard.

19. The discussion paper describes two possible approaches to lessor accounting: (a) derecognition of the leased item by the lessor or (b) recognition of a performance obligation by the lessor. More respondents supported the derecognition approach. A summary of the responses on this issue is provided in paragraphs 103-104.

Scope of Lease Accounting Standard

Proposed Scope

20. The majority of respondents who commented on the proposed scope agreed with the boards' decision to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards. Those respondents stated that basing the scope of the new standard on the existing scope would make a new standard easier to understand and implement.

21. However, some of those respondents pointed out that the scope of IAS 17, *Leases*, and the scope of FASB Statement No. 13, *Accounting for Leases,* differ (the scope of IAS 17 includes intangibles, while the scope of Statement 13 does not) and urged the boards to develop a converged scope for the proposed lease accounting standard. Some recommended that the scope of the new guidance should include arrangements that grant an entity a right to use both tangible and intangible assets.

22. Additionally, several respondents recommended that the scope should be broadened to include some intangibles that are currently excluded from the scope of IAS 17, such as mineral rights and licensing arrangements.

23. Those respondents who disagreed with the proposed scope stated that a fundamental review of lease accounting should include a reconsideration of scope. Those respondents urged the boards to reconsider what constitutes a lease

and what distinguishes it from other contracts, such as service arrangements and other executory contracts. A number of respondents suggested that an even broader discussion of accounting for contractual rights and executory contracts is needed. Those respondents stated that unless the boundary between a lease contract and a contract for services is better defined, opportunities to obtain off-balance-sheet financing will remain because entities will attempt to structure leases as contracts for services.

24. A number of respondents noted that the new standard would make the distinction between a lease and a service contract particularly important and requested that the boards clarify and improve IFRIC 4, *Determining whether an Arrangement contains a Lease,* and EITF Issue No. 01-8 "Determining Whether an Arrangement Contains a Lease."

> Although we believe the principles underlying these interpretations are still appropriate, we observe that it is often difficult under these interpretations to differentiate between a lease and a service contract. (CL #120)

Scope Exclusions

25. The boards asked constituents whether the proposed new standard should exclude leases of non-core assets or short-term leases.

26. The majority of respondents who commented on excluding short-term leases from the scope of the new standard are in favor of the exclusion. Those respondents stated that the complexity and costs of recognizing assets and liabilities for short-term leases would outweigh the benefits. Additionally, those respondents said that the information on short-term leases is not useful to users since those leases do not have a significant impact on the entity's financial statements.

27. Respondents who recommended a scope exclusion for short-term leases suggested that lessees should be required to consider the most likely lease term to determine whether a lease qualifies for the exception. They argue that this would prevent structuring of lease transactions based on the scope exclusion.

28. The majority of respondents who recommended excluding short-term leases from the scope of the new standard suggested excluding leases with terms of less than one year.

29. The majority of respondents who commented on the possible exclusion of leases of non-core assets from the scope of the new standard are against this exclusion. The respondents who supported a scope exclusion for leases of non-core assets cite cost-benefit considerations and relevance.

30. Respondents who did not support scope exclusions for either leases of non-core assets or short-term leases noted that:

    (a) All leases give rise to assets and liabilities. Consequently, there is no conceptual justification to exclude some leases from the scope of the new standard.

    (b) Excluding short-term leases and non-core asset leases from the scope of the new standard would create complexity and provide opportunities for structuring lease transactions.

    (c) Defining non-core assets would be difficult. Any definition would be subject to interpretation, which would decrease the comparability of financial statements.

    (d) Both short-term leases and non-core asset leases could be significant to the entity’s financial statements. The only valid reason to exclude a lease from the scope of the new guidance would be due to materiality.

Approach to Lessee Accounting

Boards’ Analysis of a Simple Lease Contract

31. Approximately half of the respondents agreed in principle with the boards’ analysis of the rights and obligations and assets and liabilities arising in a simple lease contract. Those respondents noted that the proposed model reflects the economic substance of a lease transaction and provides more relevant information than the information currently presented.

32. Some respondents agreed with the boards' analysis of the rights and obligations arising in a lease contract except for those leases that represent in-substance purchases. Those respondents said that leases that are in-substance purchases should be accounted for similarly to other purchases of assets, including recognition of the leased asset in the lessee's financial statements.

33. Several respondents who disagreed with the boards' analysis said that the distinction between capital and operating leases should be retained because it reflects genuine economic differences between different types of lease arrangements.

34. Several respondents stated that while they agree with the boards' analysis of the rights and obligations for simple leases, they do not agree with some aspects of that analysis for more complex leases. Specifically, those respondents disagree with the boards' decision to recognize assets and liabilities related to lease options and contingent rental payments (see paragraphs 59-90).

Components Approach

35. Rather than recognizing and measuring the components of a lease separately (a components approach), the boards have tentatively decided to adopt a single asset and liability approach in which the lessees recognize:

    (a) A single right-of-use asset that includes rights acquired under options.

    (b) A single obligation to pay rentals that includes obligations that arise under contingent rental arrangements and residual value guarantees.

36. More than half of respondents who commented on this issue support the boards' decision not to adopt a components approach to lessee accounting. Those respondents stated that the components approach is too complex and costly. Additionally, they noted that the proposed single asset and liability approach better reflects the inter-related nature of lease components such as options, contingent rentals, and the non-cancellable contractual period.

37. Some respondents did not support a components approach or the boards' proposed approach. They disagree with the boards' approach regarding

accounting for options and contingent rentals. They noted that a liability dependent on a *future* event constitutes a contingent liability and should be accounted for in accordance with IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, and FASB Statement No. 5, *Accounting for Contingencies*. Additionally, those respondents were concerned that the significant estimates required to apply the proposed approach would decrease reliability and consistency in the financial statements.

38. Several respondents supported a components approach to lessee accounting. Those respondents said that adopting a single asset and liability approach would be inconsistent with other guidance for similar multi-element contracts such as contracts that include embedded derivatives. Furthermore, they added that a components approach would reflect the substance of a lease arrangement more clearly.

> …separate recognition and measurement of options and other arrangements [are] critical for providing users of financial statements with decision-useful information. (CL #64)

Initial Measurement

Obligation to Pay Rentals

39. Nearly all respondents agreed with the boards' tentative decision to measure the lessee's obligation to pay rentals at the present value of the lease payments. However, respondents were divided on whether the lease payments should be discounted using the lessee's incremental borrowing rate or the interest rate implicit in the lease.

40. Those who agreed with the boards' approach stated that the implicit rate in a lease arrangement is difficult to determine. Consequently, the proposed approach would be simpler to apply. In many cases, they noted that the incremental borrowing rate would be a reasonable approximation of the implicit rate. Some of those respondents asked the boards to provide guidance on determining the incremental borrowing rate.

41. Those respondents who did not support the boards' approach argue that the implicit rate should be used when determinable. Those respondents noted that discounting the lease payments using the implicit rate is the conceptually correct approach. Consequently, in their view, the incremental borrowing rate should only be used when the implicit rate is not available.

Right-of-use Asset

42. Nearly all respondents supported initially measuring the lessee's right-of-use asset at cost because it is consistent with the measurement of other non-financial assets.

43. Several respondents said that the right-of-use asset should initially be measured at fair value. Those respondents stated that measuring the right-of-use asset at fair value would provide a more relevant assessment of the economic benefit from the use of the asset.

Subsequent Measurement

Amortized Cost Approach

44. The majority of respondents supported the boards' preliminary view to adopt an amortized cost-based approach (non-linked approach) to subsequent measurement of both the obligation to pay rentals and the right-of-use asset. Those respondents said that an amortized cost-based approach is consistent with current guidance for non-derivative financial liabilities and non-financial assets. Additionally, those who supported this approach note that comparability among reporting entities would be increased.

45. Some respondents who did not support the proposed approach prefer a *linked* approach. Under a linked approach, leases that are currently classified as capital leases would be accounted for as purchases. Leases currently classified as operating leases would be subject to mortgage-based amortization for both the obligation to pay rentals and the right-of-use asset.

46. Those who supported a linked approach said that it better reflects the economics of most lease contracts because costs are evenly distributed over the lease term. In addition, the linked approach recognizes that the right-of-use asset and the obligation to pay rentals are linked throughout the term of the lease.

Option to Fair Value the Obligation to Pay Rentals

47. The boards asked respondents whether the lessee should be permitted to subsequently measure the obligation to pay rentals at fair value.

48. The majority of respondents did not support the option to subsequently measure the obligation to pay rentals at fair value. They were concerned that a fair value option would reduce comparability in the financial statements.

49. Several respondents supported a fair value option, stating that a lease liability should be treated in accordance with existing guidance for other financial liabilities. Those respondents said that a fair value option would provide more relevant information than an amortized cost-based measurement.

Reassessment of Interest Rate

50. Nearly all respondents said that the lessee should not be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate.

51. Those respondents stated that requiring reassessment of the incremental borrowing rate would:

    (a) Significantly increase complexity for preparers

    (b) Reduce consistency and comparability

    (c) Be inconsistent with the treatment of other non-derivative financial liabilities.

52. Several respondents supported reassessment of the incremental borrowing rate. Those respondents said that the incremental borrowing rate used to discount the lessee's liability should reflect current economic conditions. They added that an adjustment should only be required when there is a material change in the cash flows of a leasing arrangement.

Obligation to Pay Rentals

53. The boards' tentatively decided to specify the required accounting for the obligation to pay rentals in the proposed lease guidance. An alternative approach would be to require the lessee to account for the obligation to pay rentals in accordance with existing guidance for financial liabilities.

54. The majority of respondents supported the boards' tentative decision to specify the required accounting for the obligation to pay rentals. Those who supported the boards' approach stated that providing guidance in one comprehensive standard would make the standard easier to apply.

55. Other respondents agreed with the boards' proposed method to specify accounting for the obligation to pay rentals, except for when accounting for in-substance purchase arrangements. Those respondents said that in-substance purchase arrangements are substantively different from a simple lease arrangement. As such, they argued that liabilities arising from in-substance purchase arrangements should be accounted for in accordance with existing financial instruments standards.

56. Several respondents did not support the proposed approach. Rather, they stated that accounting for the obligation to pay rentals in accordance with existing financial instruments standards would increase comparability and reduce complexity.

Rental Expense vs. Amortization

57. Nearly all respondents agreed with the boards' tentative decision to describe decreases in the right-of-use asset as amortization or depreciation rather than as rental expense.

58. Those respondents stated that reporting a decrease in the value of a right-of-use asset as depreciation or amortization is consistent with accounting for other non-financial assets. Moreover, reflecting a decrease in the value of some right-of-use assets as rental expense would require lease classification guidance similar to what is required in the existing standards.

Leases with Options

Most Likely Lease Term

59. The boards tentatively decided to require lessees to recognize an obligation to pay rentals based on the most likely lease term. Respondent views on this approach were mixed.

60. Supporters of the proposed approach said that it represents a practical solution to the problems associated with determining the lease term and is easier for preparers to apply than the alternative approaches considered by the boards. In their view, a probability-weighted approach to determining the lease term would add unnecessary complexity. They added that the proposed approach would provide more relevant information to users of financial statements than the probability-weighted approach because it would reflect an actual possible outcome.

61. Respondents who opposed the proposed approach stated that basing the obligation to pay rentals on the most likely lease term results in the recognition of a liability that does not meet the definition of a liability in the boards' frameworks. They noted that until an option to extend a lease is exercised, the lessee does not have a present obligation to pay rentals in the optional period. In addition, many respondents argued that determining the most likely lease term would be highly subjective and thus would increase complexity and decrease comparability.

62. Some of those who opposed the proposed approach suggested that the lessee should recognize its obligation based on the minimum contractual lease term with the existence of any options being disclosed. They noted that this approach reflects the contractual position of the lessee and that the minimum lease payments already include a premium for the option. Some supported including rentals during optional periods in the recognized liability if exercise of an option to extend the lease is considered reasonably certain.

Reassessment of Lease Term

63. More than half of respondents supported reassessing the lease term at each reporting date with changes to the obligation to pay rentals arising from reassessment recognized as an adjustment to the carrying amount of the right-of-use asset. Respondents who supported this approach noted that requiring reassessment of the lease term provides more useful and relevant information because it reflects the lessee's current obligations. A few respondents suggested requiring detailed disclosure of the facts or circumstances that management considered in its reassessment.

64. However, some respondents questioned whether the costs associated with reassessment would outweigh the benefits. They stated that although the reassessment may provide users with relevant information, it represents a significant burden to lessees, particularly when a lessee has a large number of leases. Therefore, they suggested that reassessment should be performed only after a specified trigger event, for example, a change in economic conditions or lessee intentions. They noted that reassessment based on a triggering event is similar to the approach in FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.*

65. Some respondents opposed reassessment because, in their view, the reported obligation should only reflect the lessee's minimum contractual payments. They said that users would not benefit from continuously changing assets and liabilities. Some respondents suggested requiring detailed disclosure of the relevant facts or circumstances in lieu of adjusting the amounts on the balance sheet.

Purchase Options

66. The discussion paper proposes that the treatment of purchase options in lease contracts should be the same as the treatment of options to extend or terminate the lease.

67. Most respondents supported this proposal. However, they reiterated many of their concerns about the complexity of the proposed accounting for options to extend or terminate the lease.

> Requiring purchase options to be accounted for separately from options to extend or terminate a lease introduces a distinction between economically similar arrangements which would add unnecessary complexity to lessee accounting and may provide opportunities for structuring arrangements to achieve desired accounting. (CL #139)

68. Several respondents stated that only bargain purchase options should be included in the obligation. Some noted that purchase options should be considered only in the event of exercise or when contractual or economic penalties make exercise reasonably certain.

69. Some respondents argued that purchase options should be excluded from the obligation to pay rentals and should be dealt with through increased disclosures.

Contingent rentals and residual value guarantees

Recognition of Contingent Rentals

70. The discussion paper proposes that the lessee's obligation to pay rentals includes amounts payable under contingent rental arrangements.

71. More than half of respondents disagreed with this proposal. They stated that contingent rentals do not meet the definition of a liability because those rentals are dependent on a future event that may or may not occur.

> The contingent rents themselves do not meet the definition of a liability at inception because they do not meet the "past event" requirement to be recorded as a liability. Thus it would not be correct recording a liability for an obligation which is not present due to the absence of a past event. (CL #141)

72. Some respondents questioned the benefits of recognizing and estimating future contingent payments. Because contingent rentals may be difficult to predict and estimates may change significantly from period to period, including them in the recognized liability could increase volatility and reduce comparability in the financial statements.

73. Some respondents provided alternative suggestions for dealing with contingent rentals including the following:

    (a) Expense contingent rentals as incurred

    (b) Only include contingent rentals that meet the definition of a liability (for example, upon a triggering event or using a probability threshold such as reasonably certain, probable, etc.)

    (c) Include or exclude contingent rentals in the liability depending on the nature of the contingency. Contingent rentals in which the lessee has effective control over the outcome (for example, usage-based contingent rentals) would not be included in the liability; contingent rentals in which the lessee has no effective control over the outcome (for example, index-based contingent rentals) would be included in the liability.

74. Some respondents agreed with the proposed treatment of contingent rentals. They argued that contingent rental payments are a portion of the total cost of acquiring the right-of-use asset and noted that the proposal is consistent with the required accounting for financial liabilities. In addition, they noted that excluding contingent rentals would provide opportunities to structure a lease so as to minimize the recognized obligation.

Measurement of Contingent Rentals

75. The discussion paper sets out two different approaches to measuring contingent rentals. The IASB proposes that the lessee's obligation to pay rentals should include a probability-weighted estimate of contingent rentals payable. However, the FASB suggests measuring contingent rentals based on the most likely rental payment.

76. More respondents supported measuring contingent rentals based on the most likely rental payment because it is simpler and less costly than the probability-weighted approach. Moreover, the most likely rental payment approach is consistent with the proposed approach to lease term options.

77. Those respondents who supported the probability-weighted approach stated that it better reflects the uncertainty inherent in any estimation of contingent rental payments. Some noted that the approach is consistent with measurement of other non-financial liabilities under International Financial Reporting Standards (IFRSs) such as provisions and future taxes.

78. Many respondents disagreed with both approaches either because they disagree with recognizing contingent rentals as a liability or because they think both approaches result in inappropriately subjective and volatile estimates.

79. In the discussion paper, the FASB proposes measuring contingent rentals that are linked to an index or rate using the index or rate existing at the inception of the lease. The majority of respondents agreed with this approach because it is simple to apply. They noted that it may be very difficult to estimate future changes in indices or rates over a long period of time. However, some respondents did not agree with using the index or rate existing at the inception of the lease if there is market-based information on expectations of the movement in the index or rate.

Remeasurement of Contingent Rentals

80. The discussion paper proposes remeasurement of the lessee’s obligation to pay rentals for changes in estimated contingent rental payments.

81. Nearly half of the respondents agreed with remeasurement because remeasuring the liability would reflect the most up to date information. They argue that failing to remeasure the obligation may result in information that is outdated, irrelevant, or misleading. Several respondents who supported remeasurement noted that the proposed approach is consistent with the boards’ tentative decision to require reassessment of the lease term.

82. However, other respondents commented that the requirement to remeasure the obligation for changes in estimated contingent rental payments at each reporting date may be onerous for preparers. Some respondents said that the estimates and assumptions made at the inception of the lease should be retained for the life of the lease unless a triggering event occurs.

83. A few respondents recommended that the boards consider which indicators represent triggers for remeasurement, provide examples to assist preparers in its application, and clarify how changes should be presented and disclosed in the financial statements.

> …remeasurement of the lessee's obligation to pay rentals for changes in estimated contingent rental payments should be required only when an indicator shows clearly that there has been a significant change to the original assumptions used and that change will have a material impact on the financial statements. (CL #120)

Recognizing Changes Arising from Remeasurement of Contingent Rentals

84. The discussion paper describes two ways in which changes in the obligation to pay rentals arising from remeasurement of contingent rentals could be recognized. Under the first approach, changes in the obligation would be recognized in profit or loss; under the second approach, changes would be recognized as an adjustment to the carrying amount of the right-of-use asset.

85. More respondents supported recognizing any change in the liability as an adjustment to the carrying amount of the right-of-use asset rather than support recognizing any change in profit or loss. Those who support recognizing the change as an adjustment to the carrying amount of the right-of-use asset noted that it reflects the linkage between the right-of-use asset and the obligation to pay rentals. They also stated that it is consistent with the proposed treatment for changes arising from a reassessment of the lease term. A number of respondents noted that recognizing the change in profit or loss is inconsistent with IAS 16, *Property, Plant and Equipment*, IFRIC 1, *Changes in Existing Decommissioning, Restoration and Similar Liabilities*, and FASB Statement No. 143, *Accounting for Asset Retirement Obligations*.

86. Respondents who supported recognizing changes in the obligation to pay rentals in profit or loss said that this approach would better match the associated economic activity (especially usage-based contingent payments) and that ongoing adjustments to the carrying amount of the right-of-use asset would not provide useful information about the nature of the asset.

87. A few respondents suggested combining the approaches depending on whether changes are related to current periods or future periods; if changes relate to current periods, they should be recognized in profit or loss; if changes relate to expected future benefits, they should be recognized to the right-of-use asset.

Residual Value Guarantees

88. The majority of respondents agreed with aligning the accounting treatment of residual value guarantees with that of contingent rentals because both are conditional on future events. They noted that residual value guarantees are a liability and that the proposed treatment is consistent with the preliminary decision of the boards not to adopt a components approach.

89. However, the minority of respondents disagreed with the proposal. As with other contingent rental payments, some respondents said that residual value guarantees are not obligations until a triggering event takes place in the future. They would support recognizing this obligation when that future event occurs. In addition, a few respondents recommended retaining the existing guidance of recognizing the maximum amounts payable under residual value guarantees.

90. Respondents who opposed the proposed approach also commented that treating contingent rentals and residual value guarantees in the same way would not faithfully represent the transaction. They noted that residual value guarantees are of a very different nature to contingent rentals, because they are linked to the value of the leased item. Some of those respondents favored a components approach in which guarantees should be accounted for separately, consistent with other similar guarantees outside of lease contracts.

Presentation

Obligation to Pay Rentals

91. The discussion paper describes two different approaches to presentation of the lessee’s obligation to pay rentals in the statement of financial position. The

FASB proposes that the obligation to pay rentals be presented separately from other financial liabilities. The IASB does not propose separate presentation.

92. More than half of the respondents agreed with the FASB's preliminary view that the lessee's obligation to pay rentals should be presented separately in the statement of financial position because it represents a unique class of liabilities linked to a corresponding asset. Those respondents said that it is necessary to understand that lease liabilities have different elements of risk compared to other liabilities. For example, the obligation to pay rentals may include amounts payable in an optional period and/or under contingent rental arrangements. Additionally, respondents noted that the significant management estimates required to measure a lease obligation make separate disclosure necessary.

93. Other respondents commented that separate presentation should depend on facts or circumstances and the relative materiality of any lease liabilities.

> We would support lessees having the option to present lease liabilities separately if management believed that this was necessary for users to understand the financial position of the entity. (CL #170)

94. In contrast, some respondents stated that separate presentation would not provide useful information to users. They added that lease obligations should be presented in the same way as other financial liabilities.

95. However, the majority of respondents who agreed with the IASB's preliminary view of not requiring separate presentation suggested that additional footnote disclosures should be required. Those disclosures should be sufficient to allow financial statement users to determine how much of an entity's liabilities relate to lease contracts.

96. Additionally, several respondents noted that regardless of the presentation decision, the boards' conclusions should be consistent with the financial statement presentation project. Some respondents added that to be consistent with decisions reached in the revenue recognition project, the rights and obligations arising in a lease should be presented net.

Right-of-use Asset

97. The majority of respondents agreed with the boards' tentative decision to present the right-of-use asset in the statement of financial position based on the nature of the underlying asset. Those respondents stated that the nature of future economic benefits the entity will receive from the asset during the lease term is consistent with the future economic benefits derived from an equivalent owned asset. This would result in a clear presentation that distinguishes entities that make greater use of leases in their operations and those that make greater use of loans and borrowing to finance their assets.

98. Several of those respondents added that presenting right-of-use assets as intangible assets is misleading because the assets are not the same as other intangible assets such as distribution rights or customer lists. However, if the boards require that the right-of-use asset is to be presented as an intangible asset, the respondents recommend that further disclosure is necessary to explain the nature of the underlying assets.

99. The minority of respondents supported presenting the right-of-use asset in the statement of financial position as an intangible asset. Those respondents stated that the right-of-use asset has many of the same characteristics as intangible assets and, therefore, should be presented as an intangible asset.

Other Lessee Issues

100. In addition to the issues included in the discussion paper, respondents recommended that the boards address the following lessee accounting issues:
   (a) Cash flow statement presentation
   (b) Accounting for in-substance purchases
   (c) Transitional guidance
   (d) Lease incentives.

Lessor Accounting

101. As discussed in the overview section (paragraphs 13-19), the majority of respondents stated that it is difficult to provide detailed responses to the questions in this chapter of the discussion paper because of the incomplete analysis of lessor accounting issues. However, a summary of the responses received is provided below.

> Lessee and lessor accounting are two sides of the same coin and [it seems] inappropriate to revisit the conceptual basis for one without addressing the other. (CL #12)

Lessor's Receivable

102. Almost all respondents agreed that the lessor's right to receive rentals under a lease meets the definition of an asset. Some respondents noted that if the lessee's obligation to pay rentals meets the definition of a liability, then the lessor's right to receive those rentals must meet the definition of an asset.

> Lessee and lessor accounting should mirror each other. If the requirement to pay rentals under the terms of a lease meets the definition of an obligation, then the right to receive those rentals meets the definition of an asset. (CL #103)

Approach to Lessor Accounting

103. The discussion paper describes two possible approaches for lessor accounting as follows:

    (a) Derecognition Approach – the lessor is viewed as having transferred a portion of the leased item to the lessee in exchange for a right to receive rentals over the lease term.

    (b) Performance Obligation Approach – the lessor is viewed as having granted the lessee the right to use its economic resource (the leased item) in exchange for a right to receive rentals from the lessee.

104. More than half of the respondents agreed with the derecognition approach to lessor accounting because they said it results in more relevant and understandable information to users than the alternative approach. Additionally,

respondents argue that this approach is consistent with that in the revenue recognition project. Respondents added that the alternative approach of the recognition of a performance obligation by the lessor would result in double counting of assets on the statement of financial position.

Income Recognition

105. Respondent views were mixed on whether it is necessary for the boards to explore when it would be appropriate for a lessor to recognize income at the inception of the lease. Some respondents stated that any new standard should be complete and that not exploring when it would be appropriate for a lessor to recognize income at the inception of the lease would be detrimental to the quality and comparability of information.

106. However, other respondents stated that there is no need to explore income recognition specifically within this project because the revenue recognition project should provide the framework for this matter.

107. In either case, respondents stated that it is necessary that any revenue recognition guidance for lessors be consistent with the revenue recognition project.

Investment Properties

108. The majority of respondents stated that investment properties should be within the scope of any proposed new standard on lessor accounting. Those respondents said that the nature of the leased asset should not determine whether an asset is in scope of the leases project.

109. Almost all investment property companies that responded argued that investment properties should be excluded from the scope of any new lessor standard. Those that currently apply the fair value model in IAS 40, *Investment Property*, argued that moving from a position in which investment properties are carried at fair value to a (possibly) cost-based model would not provide better information to financial statement users.

Other Lessor Issues

110. Respondents noted that the boards also should consider the following lessor accounting issues:

    (a) Leveraged lease accounting

    (b) Interaction between lease accounting and tax accounting including tax effects

    (c) Lease incentives

    (d) Intra-group leases

    (e) Initial direct costs incurred by lessors.

Remaining Issues

111. A number of issues were raised by respondents that are not directly related to specific questions on the discussion paper. Those issues are summarized below.

Field Testing/Cost-Benefit Analysis

112. A number of respondents commented that the discussion paper lacks a cost-benefit analysis and recommended field testing any proposals to ensure that no unintended consequences would arise. Some respondents noted that the proposed guidance would result in significant implementation costs, both initial and ongoing. Respondents also expressed concern that the costs to implement this new proposal would exceed the benefits.

113. Additionally, several respondents stated that the proposals should be stress tested against the complex lease arrangements that are seen in practice because they think that structuring may not disappear under the proposed model.

Timetable

114. Given the complexity of the subject matter and the inter-relationships between the leases project and some of the boards' other ongoing projects, many

respondents suggested that the boards should take all necessary time to ensure that all issues are thoroughly examined.

115. A few respondents also commented that the leases project should not be a high priority. Instead the boards' attention should be focused on resolving other, urgent issues arising from the financial crisis, for example the financial instruments project.

Convergence

116. Many respondents stressed the importance of convergence between the IASB and the FASB and encouraged the boards to reach converged decisions on all issues addressed in the discussion paper before issuing an exposure draft. Some respondents noted that a failure to reach a converged answer could result in U.S. generally accepted accounting principle reporters incurring additional costs if they adopt IFRS in the future.

117. Other respondents did not support convergence if the quality of accounting standards might be compromised to achieve convergence.