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Organización Internacional de Comisiones de Valores
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September 8, 2009

Discussion Paper: Preliminary Views on Leases
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: Discussion Paper: Preliminary Views on Leases

Dear IASB Members:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (Standing Committee No. 1) thanks you for the opportunity to provide our comments regarding the International Accounting Standards Board (IASB or the Board) Discussion Paper, *Leases* (the Discussion Paper or the Paper), which was part of a joint project by the IASB and the US Financial Accounting Standards Board (the Boards).

IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting standards, including rigorous application and enforcement. Members of Standing Committee No. 1 (SC1) seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect a general consensus among the members of SC1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

General Observations

The current lease accounting models have been increasingly criticized as complex, rules-based models which may not always represent the economic substance of the underlying transactions. Accordingly, we support the Boards' decision to consider lease accounting and pursuing the idea of recognizing on the balance sheet an entity's rights and obligations that arise from a lease. A

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lease is a bundle of rights and obligations that affect future cash flows of the entity regardless of their duration. As such their effects should be transparent to investors to the extent they are material. Of course, recognition and measurement questions arise in considering how best to communicate these rights and obligations to a financial statement user and we look forward to more discussion by the Boards.

There are a number of instances where the Boards have come to different conclusions and, in some of those instances, the reasons for the differences are not clear (e.g., reassessment of the borrower's incremental borrowing rate). With the exception of the scope of the project which we discuss in our response to Question 1, we believe it is possible and reasonable to expect that any final standard on lease accounting will be converged. We encourage the Boards to continue to discuss areas of differences to find consensus.

The Boards' tentative decisions require that lease obligations be recognized and measured as a single unit of account. Accordingly, complex leases with renewal and purchase options, residual value guarantees and contingent rental payments must be considered in the initial and subsequent measurement of the lease obligation. The Boards should determine, for the measurement of each of the elements of a lease arrangement, whether:

- to require a probability-weighted approach or
- to develop a set of criteria to determine when a probability or a best-estimate approach should be used.

In addition to these general observations, we also considered each of the individual questions posed in the Discussion Paper and have included our thoughts in the attachment.

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We appreciate your thoughtful consideration of the comments raised in this letter. If you have any questions or need additional information on the recommendations and comments that we have provided, please do not hesitate to contact me at 202-551-5300.

Sincerely,

Julie A. Erhardt
Chair
IOSCO Standing Committee No. 1

Attachment

Questions for respondents

Chapter 2: Scope of lease accounting standard

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.

We believe that any joint standard on lease accounting should have the same scope and include all rights to use assets including investment properties. However, we recognize that it may be more practical to address some rights to use assets in other projects such as the Extractive Activities project.

We also believe that it is critical for any standard on lease accounting to provide guidance on how to identify and separate from the lease any service arrangements that happen to be embedded in the lease contract (e.g., janitorial services included in the lease of an office building). In our experience, lease arrangements often include service components, some of which are significant.

2. Should the proposed new standard exclude non-core asset leases or short-term leases? Please explain why.

Please explain how you would define those leases to be excluded from the scope of the proposed new standard.

We do not believe that non-core leases and short-term leases should be excluded from the proposed standard and believe that any such exclusion would be an attempt to incorporate specific materiality guidance into the standard. We believe that preparers are in the best position to evaluate whether their lease arrangements are material.

Chapter 3: Approach to lessee accounting

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.

We generally agree with the Boards' analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract. However, we believe that clarification of the accounting for return costs and costs to maintain a leased item in a specified condition (which some refer to as "make-good costs") discussed in paragraph 3.9 of the paper is necessary. We understand that the Boards' believe such costs are obligations and should be recognized separately from the lease obligation in accordance with either IAS 37 *Provisions, Contingent*

Liabilities and Contingent Assets or FASB Statement No. 5 *Accounting for Contingencies*, as appropriate. Accordingly, two separate liabilities may be recognized at the inception of a lease. We support this accounting. We also believe that the Boards should more clearly explain that separate recognition of return costs and make-good costs apart from the obligation to pay rentals is consistent with the Boards' proposal to recognize a single asset and a single liability for lease arrangements because the single liability only relates to the obligation to pay rentals to the lessor.

4. The boards tentatively decided to adopt an approach to lessee accounting that would require the lessee to recognise:

(a) an asset representing its right to use the leased item for the lease term (the right-of-use asset)

(b) a liability for its obligation to pay rentals.

Appendix C describes some possible accounting approaches that were rejected by the boards.

Do you support the proposed approach? If you support an alternative approach, please describe the approach and explain why you support it.

We generally support the Board's proposed approach and encourage the Boards to carefully consider disclosures that would be helpful to understand the nature and significant terms of the various components incorporated into the liability to pay rentals.

5. The boards tentatively decided not to adopt a components approach to lease contracts. Instead, the boards tentatively decided to adopt an approach whereby the lessee recognises:

(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?

See our response to Question #3.

Chapter 4: Initial measurement

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.

The Boards have tentatively decided that a lessee should measure its lease obligations using its incremental borrowing rate since the resulting measure approximates fair value and the interest rate implicit in the lease may be difficult to determine. It is not clear to us whether a lessee's incremental borrowing rate will approximate fair value since a lessee may enter into a lease contract at a rate in excess of its incremental borrowing rate for the benefit of a very limited or very short-term right to use the asset. The Boards should consider this point when reaching their final conclusion.

7. Do you agree with the boards' tentative decision to initially measure the lessee's right-of-use asset at cost?

If you disagree, please explain why and describe how you would initially measure the lessee's right-of-use asset.

We agree based on what the Board has considered in developing the Discussion Paper.

Chapter 5: Subsequent measurement

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.

Do you agree with this proposed approach?

If you disagree with the boards' proposed approach, please describe the approach to subsequent measurement you would favour and why.

We agree based on what the Board has considered in developing the Discussion Paper.

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.

In general, we are uncomfortable with optional accounting because it may impact comparability among a company's arrangements and against its peers.

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.

The Boards' tentative conclusions require that a lease obligation be initially and subsequently measured at an amount that doesn't represent fair value. In light of these tentative decisions, it is unclear why the IASB believes that the incremental borrowing rate should be reassessed and what information reassessment provides to financial statement users. We believe that remeasurement of a lease obligation due to changes in the incremental borrowing rate will not produce significant benefits that justify the additional cost and complexity to preparers and is not consistent with an amortized cost approach or the Financial Instruments project. Also, as mentioned in our general observations above, we believe it is important for the Boards to reach a consensus on the required accounting in any joint project.

11. In developing their preliminary views the boards decided to specify the required accounting for the obligation to pay rentals. An alternative approach would have been for the boards to require lessees to account for the obligation to pay rentals in accordance with existing guidance for financial liabilities.

Do you agree with the proposed approach taken by the boards?

If you disagree, please explain why.

As the Boards observe, a lease obligation meets the definition of a financial liability under U.S. GAAP and IFRS. However, given that the Boards have tentatively decided to account for lease arrangements as a single unit of account which incorporates, among other things, renewal and purchase options, we agree with the Board's decision to provide guidance on the subsequent accounting for lease obligations.

12. Some board members think that for some leases the decrease in value of the right-of-use asset should be described as rental expense rather than amortisation or depreciation in the income statement.

Would you support this approach? If so, for which leases? Please explain your reasons.

The Board has described the asset as a right to use asset which is an intangible asset. Accordingly, it seems that the decrease in the value of the asset can only be characterized as amortization. We believe that additional transparency into the nature and consumption of the right to use can be achieved through presentation and disclosure. See our response to Question #23 below.

Chapter 6: Leases with options

13. The boards tentatively decided that the lessee should recognise an obligation to pay rentals for a specified lease term, ie 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.

See our overall comment related to probability-weighted and best-estimate approaches to recognition and measurement.

If the final standard requires a best estimate approach for recognizing the lease term, we believe that the factors used to assess the lease term should be included within the standard and include the nature of the business factors to be considered. We also believe that lessee intent should be included as a factor to consider since it will by definition significantly impact the most likely lease term. Any final standard should also require disclosure in the notes to the financial statements of the factors used in the assessment.

14. The boards tentatively decided to require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances. Changes in the obligation to pay rentals arising from a reassessment of the lease term should be recognised as an adjustment to the carrying amount of the right-of-use asset.

Do you support the proposed approach?

We support the proposed approach only when new facts or circumstances arise that may impact the lease term.

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

Would requiring reassessment of the lease term provide users of financial statements with more relevant information? Please explain why.

We believe that reassessment of the lease term provides users with more relevant information because it results in the lease obligation being recognized at an amount most likely to be paid to the lessor as of the reporting date. We also support the tentative conclusion to require reassessment when new facts arise or circumstances change rather than at each reporting period. We believe that this approach achieves an appropriate cost-benefit balance.

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.

We agree based on what the Board has considered in developing the Discussion Paper.

Chapter 7: Contingent rentals and residual value guarantees

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?

We support the proposed approach based on what the Board has considered in developing the Discussion Paper.

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.

Please see our general observations for our views on the importance of a converged approach by the Boards and the approach we believe is appropriate for measuring all components of a lease liability, including contingent rentals.

18. The FASB tentatively decided that if lease rentals are contingent on changes in an index or rate, such as the consumer price index or the prime interest rate, the lessee should measure the obligation to pay rentals using the index or rate existing at the inception of the lease.

Do you support the proposed approach? Please explain your reasons.

We support the proposed approach. We believe that a requirement to forecast indices or rates will be complicated and difficult to do and we question whether the benefits will outweigh the costs for lease contracts.

19. The boards tentatively decided to require remeasurement of the lessee's obligation to pay rentals for changes in estimated contingent rental payments.

Do you support the proposed approach? If not, please explain why.

We support the proposed approach and believe that all reassessments required by a proposed standard should be as of each reporting date on the basis of any new facts or circumstances. In general, we believe that reassessments are important and provide users with important information about expected cash outflows expected under the lease terms.

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.

We believe that the proposed model is a cost-based model. Accordingly, we believe that any change to the lease obligation should be recorded as an adjustment to the carrying amount of the asset. We support the Boards' plans to discuss an impairment model for right-to-use assets.

21. The boards tentatively decided that the recognition and measurement requirements for contingent rentals and residual value guarantees should be the same. In particular, the boards tentatively decided not to require residual value guarantees to be separated from the lease contract and accounted for as derivatives.

Do you agree with the proposed approach? If not, what alternative approach would you recommend and why?

We agree with the proposed approach and note that it is consistent with the Boards' decision to recognize the right to use and lease obligation as single units of accounting.

Chapter 8: Presentation

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?

We believe that either approach considered has merit and encourage the Boards to choose one. If the lease obligation is not separately shown in the statement of financial position, we believe that note disclosure of the amounts that relate to lease obligations would be helpful since the measurement attribute of lease obligations is different than most financial liabilities. We also believe that users would value disclosure of future payments to be made under the lease similar to the disclosures currently required by paragraph 35(a) of IAS 17 and paragraph 16(b)(1) of SFAS 13.

23. This chapter describes three approaches to presentation of the right-of-use asset in the statement of financial position.

How should the right-of-use asset be presented in the statement of financial position? Please explain your reasons.

We support the tentative conclusion to present the right-of-use asset in the statement of financial position based on the nature of the leased item. We believe that this approach balances the need to understand the significance and nature of a company's leases.

What additional disclosures (if any) do you think are necessary under each of the approaches?

We believe that significant terms related to the right-to-use asset should be disclosed including the existence and terms of renewal and purchase options, value guarantees, and contingent rents.

We also believe that it is important for the Boards to consider and provide guidance on the presentation of lease payments in the Statement of Cash Flows. Based on the preliminary view to eliminate the off-balance sheet treatment for operating leases, it appears that operating cash flows will decrease and financing cash flows will increase because payments made on such leases will now have a financing component to them.

Chapter 9: Other lessee issues

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

None noted.

Chapter 10: Lessor accounting

Since the focus of the Discussion Paper is on lessee accounting and doesn't include any preliminary views on lessor accounting, we would like to offer the Boards some overall observations related to lessor accounting. First, we recognize that lessor accounting is within the scope of the project on the Boards' agenda. We encourage the Boards to continue to assess how any decisions on lessee accounting will interact with lessor accounting and the best way to make sure that the lessee and lessor models work seamlessly when all deliberations are complete. In connection with this work, we believe that it is appropriate to consider whether there is a basis for full or partial derecognition by the lessor of a leased item since the future economic benefit of the leased asset will be realized through the lease receivable recorded by the lessor, not the leased asset. We also encourage the Boards to consider the conceptual merits of recognizing a performance obligation since the right to use the asset has been transferred to the lessee and no probable future economic sacrifice seems to remain for the lessor.