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Hans Hoogervorst

Chairman

International Accounting Standards Board

Dear Mr. Hoogervorst

Japan Leasing Association (JLA) viewed as acceptable some of the tentative decisions made by the IASB and the FASB (the Boards) after the Boards received more than 780 comment letters and conducted outreach activities. Especially, JLA highly appreciated the tentative decision by the Boards in April 2011 that there should be two types of leases and a lessee would recognize total lease expense for other than finance leases on a straight-line basis.

However, this tentative decision was repealed in May 2011 and was changed in accordance with the proposal in the Exposure Draft *Lease* (ED), which has confused and astonished JLA. In addition, JLA is strongly concerned that constituents could have some doubts about the re-deliberation by the Boards.

Therefore, JLA would like to submit this comment letter on the tentative decisions to the IASB, considering the issue pointed out above and other ones. JLA strongly encourages the Boards to take JLA's comment into account, although the work plan on the lease project is expiring.

Yours faithfully,

Makoto Inoue

Chairman

Japan Leasing Association

Comments on the Tentative Decisions on the Lease Project

Accounting Approach

1. The Boards should repeal the tentative decision in May 2011 that a lessee should apply a single accounting approach for all leases. The Boards should also restore the tentative decision made before May 2011 that there should be two types of lease (i.e. finance leases and other-than-finance leases) and there should be two approaches to both lessee accounting and lessor accounting.

2. The Boards should allow a lessee to account for other-than-finance leases, using one of the "no discounting of liability or right of use (ROU) asset approach" and the current operating lease accounting. The detailed proposals from JLA are written below.

Lessee Accounting

3. As stated below, JLA has commented on the ED that proposed to apply a single model to lessee accounting, because JLA believed that several accounting models should be appropriately applied to various types of leases.
   (a) a lease with non-distinct services, a lease in which an asset is leased to multiple lessees one after another for the useful life of the asset and each lease term is non-cancelable…..either the right of use model (ROU model) or a simplified ROU model (i.e. no discounting of liability or ROU asset approach)
   (b) a lease in which an asset is leased to multiple lessees one after another for the useful life of the asset and each lease term is cancelable at any time (at will lease or rental transaction), and a property lease…...the current operating lease accounting.

   JLA proposed to apply the ROU model to all the other leases that meet neither (a) nor (b). JLA also proposed to apply the current operating lease accounting to short term leases and immaterial leases.

4. In April 2011, the Boards tentatively decided that a lessee would classify leases either "finance leases" or "other-than-finance leases", using a guidance similar to that in IAS 17 *Leases* instead of using a single accounting model. JLA, which has been proposing that there should be various types of leases, is supportive of that tentative decision. This would be the most practical solution to appropriately account for various types of leases. However, JLA notes that there should be two approaches for "other-than-finance leases" as follows.

5. At first, there are some other-than-finance leases for which the current operating lease accounting is

appropriate. It is the most practical to account for a lease cancelable at any time (at will lease) and a property lease in accordance with the current operating lease accounting regardless of whether those leases are classified as short term leases or not. If a lessee is required to recognize ROU assets and liabilities to make lease payments that do not meet the definitions of asset and liability under a lease cancelable at any time, a property lease, and the other lease, the Boards should clarify the rationale to require lessees to do so and any differences between lease contracts and off-balance service contracts. If the Boards have difficulty in clarifying the rationale, the Boards should re-consider the proposed definition of a lease and the accounting requirement to recognize assets and liabilities arising from leases.

6. At second, there are some other-than-finance leases for which a lessee should recognize ROU assets and liabilities from those leases and the lessee should recognize lease expense on a straight-line basis. The Boards should allow a lessee to recognize lease expense arising from those leases on a straight-line basis because the lease payments for those leases are arising from operating activities rather than from finance activities. However, JLA is supportive of neither the linked approach nor the annuity approach, because JLA regards those approaches as unreasonable and practically complex. JLA encourages the Boards to re-consider the "no discounting of liability or ROU asset approach", which is described in IASB Agenda reference 1H/FASB Agenda reference162. JLA believes that it would be the simplest and most practical for a lessee to initially recognize both ROU assets and liabilities to pay lease payments at undiscounted amount of lease payments (i.e. amount of total lease payments), and to subsequently amortize the ROU assets and liabilities over the lease term on a straight-line basis (the depreciation expense would be equal to the amount the lessee pays to the lessor in each period if the lease payments are evenly made.). Many of constituents (mainly, preparers of financial statements) are supportive of the straight-line expense recognition pattern for other-than-finance leases to reflect economic nature of those leases, and JLA believes that "no discounting of liability or ROU asset approach" would be the best solution from the standpoint of practice.

7. If the Boards propose to apply a single model to lessee accounting for all the leases, the lease project would cause confusion again because the majority of constituents would raise their concerns again as same as ones to the ED.

Lessor Accounting

8. The ED proposed to apply the hybrid model in which a lessor use either the performance obligation approach or de-recognition approach, while JLA proposed as follows in order to appropriately account for various types of leases similarly to JLA's proposal for lessee accounting.

(a) a lease with non-distinct services……the performance obligation approach or a simplified performance obligation approach (i.e. no discounting of lease liability or right to receive lease payments approach)

(b) a lease in which an asset is leased to multiple lessees one after another for the useful life of the asset……recognizing neither lease receivables and lease liabilities arising from leases and recognizing lease income in profit (i.e. the current operating lease accounting).

JLA was supportive of applying the de-recognition approach to all the other leases that meet neither (a) nor (b). JLA is also supportive of applying the current operating lease accounting to short term leases.

9. JLA is supportive of the tentative decision in April 2011 that a lessor would use a guidance similar to that in IAS 17 *Leases* to determine whether a lease is a finance lease or other-than-finance lease. This is why JLA has been suggesting that there are various leases.

10. In spite of the tentative decision in April 2011, the Boards discussed whether there should be one or two approaches to lessor accounting in May 2011, only not to have reached any tentative decision even in June 2011.

11. As stated in paragraph 9, JLA is supportive of the two approaches to lessor accounting. For other-than-finance leases, it is rational for a lessee to recognize assets and liabilities for non-cancelable lease term, while a lessor, especially a lessor engaged in leases cancelable at any time (at will lease or rental transaction), and property leases, intends to generate a return by leasing one underlying asset to multiple lessees one after another for the useful life of the asset. This type of lessor is usually required to maintain/repair the leased asset for the useful life of the asset, and takes no risks associated with the credit for lessees but risks associated with the underlying asset such as maintaining/repairing the underlying asset and inventory risks. Therefore, this type of lessor should depreciate the underlying asset and recognize lease payments to be received in profit in order to better reflect the economic nature of those leases. JLA's proposal is that a lessor should account for other-than-finance leases in accordance with the current operating lease accounting.

12. For finance leases, JLA is wondering whether there is any need to revise the current finance lease accounting for lessor. It is the de-recognition approach that is consistent with the ROU model for lessee accounting. However, if the Boards retain two approaches to lessor accounting, there would be no problem in applying the current finance lease accounting to finance leases. Furthermore, concerns related to accounting for residual assets would be resolved by requiring a lessor to measure the present value of lease payments including the estimated residual value of underlying asset as

required in the current standard.

13. If the Boards propose to apply the de-recognition approach rather than the current finance lease accounting, JLA believes that the full de-recognition approach would be practically easier to apply, compared to the partial de-recognition approach.

Factors to Evaluate Significant Economic Incentive

14. JLA believes that the definition of a lease term in IAS 17 *Leases* should be retained and any lease term should include only options to be exercised reasonably certain. Any guidance to determine whether a lessee has a significant economic incentive to exercise an option should be the one to determine whether it is reasonably certain for a lessee to exercise an option. Including uncertain options in a lease term would cause a new concern that depreciation on ROU assets recognized by a lessee or lease receivables recognized by a lessor could be intentionally distorted, financial statements being less comparable.

15. The Boards tentatively decided that a lessee and a lessor initially consider all the factors such as "contract-based", "asset-based", "market-based", and "entity-based" factors to evaluate a lessee's significant economic incentive to exercise options to extend or terminate a lease and an option to purchase the underlying asset.

16. However, there are some cases where it is difficult to evaluate whether an economic incentive is significant or not when considering an "entity-based" factor. For example, it is not always clear whether a lessee will exercise an option to extend a lease, even though the lessee exercised a similar option in the past.

    It seems that a lessee and a lessor could not estimate a lease term without considering an "entity-based" factor if required to estimate a lease term based on an uncertain threshold such as "the longest possible term that is more likely than not to occur" as proposed in the ED. However, the Boards tentatively decided to define a lease term as a non-cancelable period together with any options to extend or terminate the lease when there is "a significant economic incentive". In addition, "contract-based", "asset-based", and "market-based" factors include indicators to objectively evaluate a lessee's significant economic incentive. Therefore, only "contract-based", "asset-based", and "market-based" factors should be considered to determine whether a lessee has a significant economic incentive to exercise an option. Considering an uncertain factor such as an "entity-based" factor would lead to a lease term including optional periods that are uncertain. This would cause a concern similar to the one about the ED.

17. Consequently, an “entity-based” factor should not be considered in evaluating a lessee’s significant economic incentive.

Short Term Lease and Immaterial Lease

18. The definition of a short term lease should be “a lease that has a lease term of twelve months or less” in accordance with the definition of a lease term tentatively decided in February 2011. That definition of a lease term would resolve concerns related to understating assets and liabilities.

19. If the Boards’ intention is to determine whether a lease is a short term lease only based on the explicit contractual terms, it might be easy to do so. However, this would require a lessee and a lessor to estimate a lease term, considering any explicit contractual options to renew the lease when determining whether a lease is a short term lease, even if it is uncertain for a lessee to exercise those renewal options.

    If the Boards’ intention is as written above, the proposed accounting for short term leases would be applied to few leases because lease contracts usually include renewal options. Therefore, a lessee would be required to apply the burdensome accounting model (i.e. the ROU model) to leases that are in-substance short term leases. In spite that the Boards tentatively decided to apply a cost-relief accounting approach (i.e. the current operating lease accounting) to short term leases in March and June in 2011, the Boards’ objective to mitigate costs incurred by preparers of financial statements would not be achieved. Consequently, JLA cannot accept the tentative decision for the definition of a short term lease.

20. In paragraph 40-42 in IASB Agenda reference 5A/FASB Agenda reference 140 (The staff paper in March 2011), the staff analyzes a lease contract with a non-cancellable lease term of 364 days and includes 1-year renewal options at market rates for the next 9 years without a lessee’s significant economic incentive. This example is too extreme. For the purpose of preventing this extreme example from being accounted for as a short term lease, the Boards should not apply the ROU model to a lease with 1-year renewal options that is in-substance a short term lease.

21. In June 2011, the Boards discussed how to account for immaterial leases (i.e. the approach C in IASB Agenda reference 2C/FASB Agenda reference183) to provide some relief to lessees from the cost burdens of applying a single approach to lessee accounting. As proposed in paragraph 4-6, JLA proposes to apply several accounting approaches to lessee accounting. Furthermore, JLA proposes that the Boards provide an application guidance to evaluate immaterial leases. If a lease is classified as an immaterial lease under the application guidance, the Boards should allow that lease to be accounted for under the current operating lease accounting regardless of whether that lease is a short

term lease nor not.

Re-expose the Proposals by the Boards

22. The tentative decisions made by the Boards after the ED are considerably different from the proposals in the ED. Some of the tentative decisions after the ED seem to be acceptable because those reflect feedback from constituents. However, any final standard could be the one that has significant changes from the ED.

23. Given a number of comment letters to the ED, the outreach activities would not be a substitute for due process. Consequently, JLA strongly requires the Boards to comprehensively re-expose the proposals on lease accounting, which would be the process constituents regard as proper.