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May 17, 2010

Sir David Tweedie
Chairman
International Accounting Standards Board

Dear Sir David,

The Japan Leasing Association (JLA) has already submitted its comments to the project on lease accounting by International Accounting Standards Board and Financial Accounting Standards Board (the boards).

Taking into consideration that the publication of the exposure draft for the new lease accounting standard is forthcoming, JLA has decided to submit its comment again on "Lessor accounting model", "Purchases/sales of the underlying asset", and "Recognition on lease terms", which are the topics JLA would like to especially insist on, before the exposure draft is published.

We strongly hope that the boards will consider and adopt our proposal to the forthcoming exposure draft in a constructive manner.

Yours faithfully,

Takao Sunami
Chairman, Japan Leasing Association

JLA comments on the Project on Lease Accounting

Focused on "Lessor accounting model", "Purchases/sales of underlying asset", "Recognition on lease terms"

1. De-recognition approach should be adopted as lessor accounting model

1.1 "The performance obligation approach", which International Accounting Standards Board and Financial Accounting Standards Board (the boards) have tentatively decided to adopt for lessor accounting, is based on the view that the lessor is committed to allowing the lessee to use the leased asset over the lease term. However, the right-of-use model adopted by the boards is supported by the logic that the lessor has completed the performance obligation upon the delivery of the leased asset. Accordingly, it is clear that there is an inconsistency between the lessor accounting model and the lessee accounting model adopted by the boards.

1.2 "The de-recognition approach", in which the lessor has transferred a portion or all of the leased asset to the lessee in exchange for a right to receive payments over the lease term, is consistent with the right of use model. Accordingly, Japan Leasing Association (JLA) believes that the de-recognition approach, which is consistent with the lessee accounting model, should be adopted for lessor accounting model in principal.

1.3 However, JLA recognizes that it is difficult for the de-recognition approach to be applied to all the leases from the viewpoint of the practice. It is inappropriate and difficult for a single accounting model to be applied to various leases, as JLA has already proposed. Therefore, the accounting for current operating leases should be applied to leases cancelable at any time, leases of an asset intended to be leased to an unspecified number of entities or persons, and leases of real estate and other similar property, instead of the de-recognition approach for lessor accounting and the right-of-use model for lessee accounting. The proposal by JLA would resolve most of the concerns that the boards have relating to application of the de-recognition approach to lessor accounting.

2. "Leases in which the title of leased asset is not transferred to the lessee" should not be treated as purchases/sales of the underlying asset

2.1 In February 2010, the boards have tentatively decided to exclude contracts that are purchases/sales of the underlying asset from the scope of the new lease accounting standard, because such contracts are not lease contracts. The boards have also tentatively decided that the contracts which transfer control of the underlying asset at the end of the contract or all but a trivial amount of the risks and benefits associated with the underlying asset are purchases/sales of the underlying asset. According to the tentative decisions by the boards, control of the underlying asset is generally transferred/obtained in the following situations.

a. Contracts in which the title of the underlying asset transfers to the lessee automatically
b. Contracts that include a bargain purchase option, if it is reasonably certain that the option will be exercised
c. Contracts in which the return that the lessor receives is fixed
d. Contracts in which it is reasonably certain that the contract will cover the expected useful life of the asset, and in which any risks or benefits associated with the underlying asset retained by the lessor at the end of the contract are not expected to be more than trivial

2.2 According to the criteria above, finance leases under the current lease accounting standard would be likely to be regarded as the contracts which transfer control of the underlying asset at the end of the contract, or the contracts which transfer all but a trivial amount of the risks and benefits associated with the underlying asset at the end of the contract. Therefore, JLA believes that this fact proves it impossible to develop a single accounting model, abolishing the requirement to classify leases as finance leases or operating leases, although the project on lease accounting originally aimed at developing a single accounting model.

2.3 JLA believes that the contracts which are purchases/sales of the underlying asset should be limited to leases defined in a. and b. of 2.1 above, and "leases in which the title of the leased asset is not transferred to lessee" should not be treated as "purchases/sales of the underlying asset" in accordance with leases in which the title of the leased asset transfers to the lessee. If a lease contract does not transfer the title of leased asset to the lessee, the leased asset will be returned to the lessor without fail. Subsequently, the lessor will sell or lease the returned asset to the third party in order to collect the residual value of the asset. On the other hand, the lessor will have the responsibility to properly dispose of the asset in accordance with environmental-protection-related laws and regulations, if the lessor is unlikely to sell or lease the returned asset to the third party. Therefore, JLA believes that "leases in which the title of the leased asset is not transferred to the lessee" are totally different from the contracts which are purchases/sales of the underlying asset. The analysis by the staff that a right of use asset is inherently different from a owned asset also makes the difference clearer as follows. Furthermore, it would lead to not providing useful information to users of financial statements that the leases which do not transfer the title of leased asset are regarded as purchases/sales of the underlying asset, and are excluded from the scope of the new accounting standard. This is why JLA believes that the leases which do not transfer the title of leased asset should not be treated as purchases/sales of the underlying asset.

<IASB agenda reference 9A/ FASB memo reference 74, "Lessee accounting – Presentation">

27. The staff also recommend that an entity should be required to present separately a right-of-use asset from other assets on the SFP because that presentation provides users of financial statements with information that is important to understand that a right-of-use asset is inherently different from an owned asset. For example, an entity may have greater financial flexibility with the right-of-use asset (eg the entity can easily choose to replace the right-of-use asset with a new and/or better right-of-use asset at the end of the lease term). On the other hand, a lessee may assume greater risk by acquiring a right-to-use asset (rather than owning an asset outright) because, for example, the lessee may need to replace the right-of-use asset at the end of the lease term but may not be able to secure a favourable rate.

2.4 The boards should return to the original proposal by the boards that leases which are in substance purchases/sales of the underlying asset are not excluded from the scope of the new lease accounting standard, if the boards would choose to adopt the de-recognition approach in place of the performance obligation approach, changing the tentative decision for lessor accounting model. If the board would do so, the boards should clarify the differences between leases which transfer the title of the leased asset to the lessee and the other leases which do not, as the current lease accounting standard clarifies the differences for the two types of leases by setting differentiated depreciation periods or separate presentations.

3. Recognition on lease term should be based on contractual lease term that is non-cancelable

3.1 The boards have proposed the right-of-use model from the standpoint of the view that the right-of-use asset and the obligation to pay rentals respectively meet the definitions of an asset and the definitions of an liability. However, the boards have tentatively decided that the lessee and the lessor should initially recognize their assets and liabilities based on the lease term including the optional periods, without clarifying whether the assets and the obligations during the optional periods would meet the definitions or not.

3.2 Uncertainty such as optional periods should not be taken into consideration, when recognizing the lease term. The lease term initially recognized should be limited to the contractual lease term that is non-cancelable.

3.3 Taking into consideration the needs to eliminate the cases where the lessee intends to exercise renewal options over and over, "the longest possible lease term that is more likely than not to occur" proposed by the boards should be applied to leases in which only the specific lessee is likely to use the leased asset for a long period, and in which renewal options are intentionally included (That is, the lessor is unlikely to lease the asset to an unspecified number of lessees, and is unlikely to receive revenues from an unspecified number of lessees). It would be possible to determine whether the lease contract intentionally included renewal options or not, considering contractual factors, non-contractual financial factors, business factors and lessee specific factors as the boards have proposed.