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14 July 2009

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir or Madame

Re: Comments on Discussion Paper *Leases—Preliminary Views*

We appreciate the efforts by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) on the Lease project and welcome the opportunity to provide comments on the Discussion Paper (the DP) *Leases—Preliminary Views*. The views mentioned below are those of the Lease Accounting Technical Committee, which has been set up in the Accounting Standards Board of Japan (ASBJ). This technical committee is composed of financial statement users, preparers, and auditors who are market constituents, as well as academics and board members and staffs of the ASBJ.

General comments

Applicability of the proposed lessee accounting model

We note, in paragraph 3.26 of the DP, the Boards tentatively decided, as a preliminary view, to develop a new approach that would treat all lease contracts as acquisition of a right to use leased item for the lease term. Question 4 of the DP asks whether we support the proposed approach.

We appreciate the boards' efforts to overcome issues arising from some lease contracts that are accounted off-balance sheet in some lease accounting models. However, we believe there are a number of issues[1] to be addressed so that lessees can account for all lease contracts in accordance with the DP's preliminary views. For example, we believe that it is appropriate to recognise lease payments as an expense for lease contracts that can be terminated anytime at the lessee's discretion[2].

For instance, consider the short-term leases described after paragraph 2.15. The right-of-use model might require recognition and measurement of right-of-use asset (an asset) and obligation to pay rentals (a liability) even for the use of pay-by-the-hour vehicles or parking spaces or apartment hotels. However, it is evident that recognition and measurement of assets and liabilities in every such lease contract is excessively complex and cost-ineffective for prepares

[1] These issues are discussed in our response to individual questions.
[2] See paragraphs 10 – 14.

of financial statements.

The boards note that some short-term leases and/or leases of non-core assets may be immaterial to the lessee (paragraph 2.15). However, in order to determine whether leases are immaterial, it is necessary to recognise and measure all right-of-use assets and obligations to pay rentals, and thus the burden to preparers will not be reduced.

Accordingly, we agree with the proposed lessee accounting model only if all issues that we suggested in this comment are resolved. In addition, we urge the IASB to issue a new lease accounting standard after resolving these issues.

Clarification of lessor accounting model

The DP mainly focuses on lessee accounting and does not set out preliminary views on lessor accounting. However, as stated in paragraph 1.22 of the DP, issuing a new accounting standard that specifies only lessee accounting without fully articulating lessor accounting could result in material flaw in light of developing new accounting model for whole lease transactions, which, we concern, would potentially undermine the reliability of the IFRSs as a whole in an anticipated future period.

Accordingly, we strongly suggest at least the board issue exposure draft[3] of a new lease accounting standard that encompasses both lessee and lessor accounting in a comprehensive manner after giving full consideration to the lessor accounting treatments.

Please refer to the attachment to this letter which sets out our responses to individual questions placed at the end of each chapter in the DP. We would be pleased, if our comments contribute to the IASB's future deliberations in this project.

Sincerely yours,

S. Sakase

Shigeo Sakase

Chairman, Lease Accounting Technical Committee
Vice Chairman, Accounting Standards Board of Japan

[3] If possible, it is desirable to issue preliminary views on lessor accounting and seek public comments from broad constituents before issuing the exposure draft.

Appendix

Response to the specific questions in the DP

Question 1
The boards tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards. Do you agree with this proposed approach? If you disagree with the proposed approach, please describe how you would define the scope of the proposed new standard.

1. The boards' preliminary view is that the scope of the proposed new standard should be based on the scope of the existing standards (paragraph 2.9). However, we disagree with the boards' tentative decision not to exclude leases that are in substance purchases from the scope of a new lease accounting standard (paragraph 2.12) for the following reasons.

2. As stated in paragraph 3.2, the DP requires lessees to apply *right-of-use* model. Under this model, a lessee recognises an asset not because the lessee obtains the leased item, but because the lessee obtains the right to use the leased item over the lease term (paragraph 3.17). However, a leased item that is in-substance purchase is literally a 'purchase in substance' (i.e. lessee obtains title of the leased item), which is clearly different from the right to use the leased item. Requiring the same accounting for two transactions that have different characteristics is inconsistent with the substance-over-form principle described in paragraph 35 of the *Framework for the Preparation and Presentation of Financial Statements*.

3. In addition, paragraph 2.12(a) states that the accounting proposed in the DP for lessees should result in accounting that is similar to that required for assets that are purchased. However, the accounting for the right-of-use assets and that for purchase will differ in their initial and subsequent measurements and depreciation periods. In other words, as far as the recognition and measurement requirements for the right-of-use assets are different from those specified in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*, these accounting will never be the same.

4. Paragraph 2.12(b) of the DP states that attempting to define what is meant by an in-substance purchase may be difficult. However, it rests with the boards' responsibility to define such notion, and various due processes for consultations are available accordingly. If a lease that is an in-substance purchase is accounted for differently from other purchased assets, we are afraid that comparability for users of financial statements may be jeopardised.

5. Accordingly, at least assets that arise from either one of the following lease transactions should be excluded from the scope of the new lease accounting standard because such assets are considered as purchased physical assets in substance (rather than right-of-use assets).
   (1) Under lease contract, the title of the leased item is transferred to the lessee at the end of or in the middle of the lease term.
   (2) Under lease contract, the lessee has an option to purchase leased item at the end of or in the middle of the lease term at significant bargain price compared to its nominal price or the price of the leased item on the exercise date, and the option is expected to be exercised with certainty.

Question 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.

6. We believe, similar to some constituents' view as referred in paragraph 2.18, the costs associated with recognising and measuring the rights and obligations arising under short-term lease contracts usually outweigh the benefits.

7. The preliminary views of the DP state excluding short-term leases from the scope of a new standard may fail to meet the needs of users because of the reasons listed in paragraph 2.19. In the meantime, however, the DP explains the factors to consider when determining the lease term (paragraph 6.39) and states that the boards' preliminary view is that the guidance should specify that contractual, non-contractual and business factors be considered in determining the lease term (paragraph 6.41). That is, even if lease term is below certain threshold, lessees have to reasonably determine substantive lease term and thus the statement of paragraph 2.19(b) does not hold true.

8. Accordingly, when deciding whether to provide a scope exclusion for short-term lease contracts, it is necessary to weigh costs and benefits sufficiently in view of the fact that a new lease accounting standard will apply to all lease transactions. Consequently, if the costs outweigh the benefits, short-term lease contracts should be scoped out from the new lease accounting standard.

9. We believe that it is appropriate to expense rentals on shot-term leases that should be excluded from the scope of a new lease accounting standard. Accordingly, we would like to ask the boards to specify such effect in a new lease accounting standard. In addition, it is necessary to define clearly in a new lease accounting standard to determine whether a lease is a short-term lease so as not to allow preparers' arbitrary interpretation.

Question 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.

10. We agree with the boards' proposed approach (i.e. lessees recognise right-of-use assets and obligations to pay rentals) only if all issues that we point out in this comment letter are resolved, including the *treatment of lease contracts that can be terminated any time*, which is discussed below.

Treatment of lease contracts that can be terminated at any time

11. We believe that it is appropriate to expense rentals on leases that can be terminated any time at lessee's discretion even if the right-of-use model is adopted as an approach for

lessee accounting.

12. Under the right-of-use model proposed by the DP, recognition of assets and liabilities could be required for leases that can be terminated any time at lessee's discretion as well as the leases whose lease terms are explicitly stated in lease contracts. However, under such lease contracts that can be terminated any time at lessee's discretion, lessees can evade contractual obligations any time without any additional charge. Accordingly, it is inappropriate to recognise liabilities for the obligations to pay rentals in such lease contracts because such obligations do not meet the definition of liabilities set out in the *Framework* and do not constitute present obligations (whether legal or constructive) as defined in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

13. In addition, under such lease contracts, it is extremely difficult to reasonably estimate when to terminate the lease contract at its inception because lessees normally terminate contracts in consideration of facts and circumstances such as their own performance, demand trends, economic climate, competitors' reactions, and introduction of new products that can potentially substitute leased items.

14. Accordingly, we believe that, for the leases that can be terminated any time at lessee's discretion, it is appropriate to expense rental payments as a lessee uses the leased item.

Question 6
Do you agree with the boards' tentative decision to measure the lessee's obligation to pay rentals at the present value of the lease payments discounted using the lessee's incremental borrowing rate? If you disagree, please explain why and describe how you would initially measure the lessee's obligation to pay rentals.

Discount rate used when measuring obligations to pay rentals

15. The boards tentatively decided to require the use of the lessee's incremental borrowing rate to discount the lease payments because determining the implicit rate is often difficult for lessees and the approach to discount rates used in the existing standards would be more complex for preparers to apply and might reduce comparability for users (paragraph 4.17).

16. However, in certain situations, lessees may have an access to the interest rate implicit in the lease through various means (e.g. requesting several leasing companies (lessors) to submit quotations). In addition, while paragraph 4.16 states that 'in most leases the present value of the lease payments discounted using the lessee's incremental borrowing rate would be a reasonable approximation to fair value,' it is not necessarily true. Furthermore, while the DP states that 'cost equals the present value of the lease payments discounted using the lessee's incremental borrowing rate' (paragraph 4.23), we believe the interest rate implicit in the lease should be more relevant in order to reflect the value of the right-of-use asset appropriately.

17. Accordingly, we encourage the boards to clarify that the interest rate implicit in the lease should be used if the lessee has an access to such information, and the lessee's incremental borrowing rate may be alternatively used if the lessee is unable to know the interest rate implicit in the lease.

Question 8
The boards tentatively decided to adopt an amortised cost-based approach to subsequent measurement of both the obligation to pay rentals and the right-of-use asset. 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.

18. We basically agree to adopt an amortised cost-based approach to subsequent measurement of both the obligation to pay rentals and the right-of-use asset. However, we believe that different treatment would be required if short-term leases are included in a new lease accounting standard for the following reasons.

Measurement of assets and liabilities when short-term leases are not scoped out

19. As stated in paragraph 8, we believe that short-term lease contracts should be scoped out from the new lease accounting standard if the costs outweigh the benefits. If short-term leases are within the scope of a new lease accounting standard, we anticipate the following issues will arise.

20. Short-term leases often comprise many lease contracts whose leased items as well as rental payments are relatively small. However, requiring measurement of both the obligation to pay rentals and the right-of-use asset for all leases based either on discounted cash flow method or on amortised cost method would impose excessive workload on preparers, which may impede smooth implementation of a new lease accounting standard.

21. Accordingly, if short-term leases are not excluded from a new lease accounting standard, we encourage the boards to clarify that a simplified measurement, such as expensing fixed amounts over the lease term, will be permitted. Similarly, a simplified measurement should also be applied to immaterial items.

Question 9
Should a new lease accounting standard permit a lessee to elect to measure its obligation to pay rentals at fair value? Please explain your reasons.

22. We believe that relevant information will be provided through single measurement approach for similar economic substance of investments rather than for similar form of instruments. (For example, under IFRSs, measurement attribute of non-financial instruments as well as financial instruments differs by economic substance of investments (e.g. held for sale or trade (IAS 2 *Inventories*) and held for use (IAS 16 *Property, Plant and Equipment*) not by the form of investments.)

23. In addition, the boards tentatively decided not to adopt a components approach to accounting for complex lease contracts. Instead, the boards tentatively decided that the lessee should recognise a single right-of-use asset and single obligation to pay rentals (paragraph 3.33). Accordingly, obligations to pay rental are considered to be liabilities peculiar to lease accounting that comprises of multiple components. Measuring such liabilities peculiar to lease accounting at fair value will be inconsistent with the fact that many financial liabilities are subsequently measured at amortised cost.

24. Accordingly, we believe that a lessee should not be permitted to elect to measure its

obligations to pay rentals at fair value for those obligations that are specified to be measured at amortised cost.

Question 10
Should the lessee be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate? Please explain your reasons. If the boards decide to require the obligation to pay rentals to be revised for changes in the incremental borrowing rate, should revision be made at each reporting date or only when there is a change in the estimated cash flows? Please explain your reasons.

25. As stated in paragraph 4.4, obligations to pay rentals meet the definition of financial liabilities set out in IAS 32 *Financial Instruments: Presentation*. Nevertheless, requiring lessees to revise their obligations to pay rentals to reflect changes in their incremental borrowing rates will reduce the comparability of financial statements.

26. In addition, although paragraph 5.22 states that revising the incremental borrowing rate is consistent with the approach required by IAS 37, other subsequent measurement approach proposed by the DP as preliminary views are not necessarily the same as specified in IAS 37, which questions the necessity of the revision of incremental borrowing rates.

27. Accordingly, the incremental borrowing rate should not be revised in order to be consistent with the approach to other non-derivative financial liabilities, regardless of whether the discount rate is the interest rate implicit in the lease or the lessee’s incremental borrowing rate if a new lease accounting standard adopts an amortised cost-based approach to subsequent measurement of obligation to pay rentals.

Question 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.

28. The view 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 is based on the notion of ‘a linked approach to subsequent measurement,’ which is described paragraph 5.5 onward.

29. However, as the boards reject this approach in paragraph 5.12, this approach focuses on the difference between *financing leases* and *operating leases* in current standards and is inconsistent with the *right-of-use model* that the DP proposes.

30. Accordingly, we believe if a new lease accounting standard adopts an approach that accounts for all leases based on the *right-of-use model*, the decrease in value of the right-of-use asset should be described as amortisation or depreciation in the income statement.

Question 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.

Timing of recognising options

31. We disagree with the boards' decision that the lessee should recognise an obligation to pay rentals for a specified lease term and the lease term should be the most likely lease term.

32. As stated in paragraphs 3.32(e) and 6.38, whether a lessee exercises an option to extend or terminate a lease may depend not only on the economic position of the option during the lease term, but also on various elements such as economic climate surrounding the entity, the entity's own performance, and the degree of obsolescence (physical and economic) of leased items. Although factors to be considered in determining the lease term are listed as examples in paragraph 6.39, it seems practically difficult to reasonably estimate many of these factors at the end of, say, 10 years.

33. Accordingly, even if a new lease accounting standard adopts single asset and liability approach, we believe lessee should recognise obligation to pay rentals based on the minimum contractual term at the inception of the lease except when, as some board members argue in paragraph 6.37, exercise of the option is evident because the option is priced to give the lessee a significant incentive to do so or when exercise of the option is evident or virtually certain due to the condition of lease contract or the nature of leased item. An option period (a secondary period) should be reflected in obligation to pay rentals when exercise of the option becomes evident or virtually certain as a result of subsequent reassessment of lease term.

Determination of lease term

34. The boards tentatively decided to require the lessee to determine the most likely lease term after considering three possible approaches listed in paragraph 6.24 (paragraph 6.36).

35. However, under this approach, the probabilities of lease terms in Example 5 in paragraph 6.35 (e.g. 35% for 10 years and 20% for 15 years) can be intentionally altered by the preparer (say, 20% for 10 years and 35% for 15 years). In addition, when there are five possible lease terms as in Example 5 and the probability of occurrence of each term is equally 20%, then, the preparer can freely choose the most likely outcome, in effect, within the range of 5-25 years by increasing the probability of a possible outcome by 1% (and instead decreasing the probability of another possible outcome by 1%). Permitting such arbitrary selection by preparers in effect will reduce comparability of financial statements and thus make it difficult to provide relevant information.

36. Accordingly, we recommend adopting a probability threshold approach in determining lease term. Term options of lease contracts should be reflected in the measurement of obligations to pay rentals when probability of exercising the options exceeds a specified threshold.

Question 16
The boards propose that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements. Do you support the proposed approach? If you disagree with the proposed approach, what alternative approach would you recommend and why?

Contingent rental payments when reasonably determining probability of occurrence and contingent amount is difficult in practice

37. As stated in paragraph 7.3, contingent events under contingent rentals include (a) changes in price or index, (b) lessee's performance derived from the leased item, and (c) usage of leased item. It would be possible to recognise assets or liabilities for contingent rental arrangements whose rental payments are determined based on future short-term performance or usage of leased item.

38. However, there are contingent rental arrangements whose trigger is affected by many factors such as, as stated in paragraph 13, economic climate surrounding the entity, long-term performance, and degree of obsolescence (physical and economic) of leased item. For these contingent events, it seems difficult in practice to determine reasonably their probability of occurrence and contingent amount.

39. Admittedly, IFRS 3 *Business Combinations* (as issued in 2008) specifies that the acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree (IFRS 3 paragraph 39), which is consistent with including contingent rental payments in the initial measurement of obligation to pay rentals. However, in general, while such contingencies can be resolved under business combination-related contracts in relatively short period of time, it often takes longer time until contingent event occurs under a contingent rental arrangement.

40. Accordingly, even if a new lease accounting standard adopts single asset and liability approach, lessee should not include contingent rentals in obligation to pay rentals if it is difficult to reasonably determine the probability of occurrence and contingent amount of these rentals at the inception of the lease. Instead, we believe the lessee should reflect the contingent rentals in obligation to pay rentals when the timing and amount of the contingent rental payments is reasonably determined as a result of subsequent reassessment of the contingent rentals.

Question 17
The IASB tentatively decided that the measurement of the lessee's obligation to pay rentals should include a probability-weighted estimate of contingent rentals payable. The FASB tentatively decided that a lessee should measure contingent rentals on the basis of the most likely rental payment. A lessee would determine the most likely amount by considering the range of possible outcomes. However, this measure would not necessarily equal the probability-weighted sum of the possible outcomes. Which of these approaches to measuring the lessee's obligation to pay rentals do you support? Please explain your reasons.

41. As stated in paragraph 40, contingent rentals should be recognised and reflected in obligation pay rentals when their amounts are reasonably determined. Accordingly, we

believe that it is appropriate to measure contingent rentals at their reasonably determined amount, that is, at the most likely amount of the rental payments.

Question 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.

42. As stated in paragraph 40, contingent rentals should be recognised and reflected in obligation pay rentals when their amounts are reasonably determined.

43. 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 would initially measure the obligation to pay rentals using the index or rate existing at the inception of the lease. However, it depends on the terms of lease contract whether an index or rate at the inception of the lease can be the basis for determining future rental payments, and thus the index or rate at the inception of the lease will not necessarily be the basis for determining future rental payments. Measuring obligation to pay rentals by using an index or rate at the inception of the lease should be limited to lease contracts whose contractual terms specify that an index or rate at the inception of the lease determines rental payments after the inception of the lease.

44. Accordingly, we disagree with the FASB's tentative decision 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 would initially measure the obligation to pay rentals using the index or rate existing at the inception of the lease.

Question 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.

45. As stated in our comment to Question 16, we believe that contingent rental payments should be reflected in obligation to pay rentals when timing and amount of the contingent rental payments are reasonably determined. Accordingly, when estimated contingent rental payments change, remeasurement of the lessee's obligation to pay rentals should be required because such amount is an accounting estimate.

Question 20
The boards discussed two possible approaches to recognising all changes in the lessee's obligation to pay rentals arising from changes in estimated contingent rental payments:
(a) recognise any change in the liability in profit or loss
(b) recognise any change in the liability as an adjustment to the carrying amount of the right-of-use asset.
Which of these two approaches do you support? Please explain your reasons. If you support neither approach, please describe any alternative approach you would prefer and why.

46. Changes in estimated contingent rental payments are different from changes in the assessed lease term and thus normally do not affect the value of right-of-use assets. For example, an increase in an obligation to pay rentals arising from an increase in market interest rates (paragraph 7.28) may not indicate the value of right-or-use asset.

47. In the meantime, as stated in paragraph 7.29, the obligation to pay rentals may increase because of an increase in expected usage for some lease contracts. Such lease contracts imply that right to use leased item during the estimated lease term has increased, and that the lessee adjusts the carrying amount of the right-of-use asset, and recognises expense as depreciation during the remaining lease term. In doing so, the incremental depreciation expense of right-of-use asset should be matched with future increase of sales that will correspond to the increased usage during the expected lease term.

48. Accordingly, we believe that changes in obligation to pay rentals arising from changes in estimated contingent rental payments should be determined in accordance with the contractual terms of contingent lease arrangement. That is, any change in the liability should be recognised as an adjustment to the carrying amount of the right-of-use asset if the change affects the value of the right-of-use asset, and any changes in the liability should be recognised in profit or loss if the change does not affect the value of the right-of-use asset.

Question 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?

49. As stated in paragraph 4.12, the lessee may have little knowledge of the residual value of the leased asset at the end of the lease and it is extremely difficult for lessee to reasonably estimate the residual value a number of years (or a number of decades) later. The residual value could be affected by such as economic environment, price index, and technological innovations besides physical obsolescence of the leased item.

50. Accordingly, consistent with our comment to Question 13, we believe that the lessee should not include residual value guarantees in obligation to pay rentals at the inception of the lease except when the amount of payments under the residual value guarantees is evident or virtually certain. Residual value guarantees should be reflected in obligation to pay rentals when the amount of the residual value guarantees becomes evident or virtually certain after the inception of the lease.

Question 22
Should the lessee's obligation to pay rentals be presented separately in the statement of financial position? Please explain your reasons. What additional information would separate presentation provide?

51. As specified in paragraph 55 of IAS 1 *Presentation of Financial Statements*, the lessee's obligation to pay rentals may be presented separately in the statement of financial position if the lessee decides it necessary. Accordingly, we do not believe that a new lease accounting standard have to require separate presentation of the obligation to pay rentals.

52. In addition, as referred in paragraphs 8.23 – 8.29, the boards should pay particular attention to maintaining consistency with ongoing project of the financial statement presentation in the future deliberation.

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

53. As noted in paragraph 8.13, conceptually, the approach (b), presenting the right-of-use asset as an intangible asset, achieves the most consistent presentation with the DP's basic approach, right-of-use model.

54. However, we believe that it is more useful for users of financial statements to indicate the nature of assets that an entity uses to generate inflow of economic benefits. Accordingly, we agree with the boards' preliminary views (i.e. adopting the approach (a)) and the right-of-use asset should be presented according to the nature of the underlying leased item.

55. In addition, if the boards adopt the approach (a) (i.e. presenting right-of-use asset according to the nature of underlying leased item), we believe that additional disclosure of (i) details of owned assets and leased items and (ii) depreciation policy for leased items should be required.

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

Implicit options including options to extend a lease

56. The DP does not present detailed analysis or preliminary views on implicit options, which is referred to in paragraphs 6.4 – 6.6.

57. Some lease contracts can be extended beyond initial lease term when the initial lease term ends (which is normally after the economic life of the leased item passes) at significant bargain rate and with option to terminate any time (usually renewed every year) (such contracts are hereinafter referred to as 'extended leases'). Under lease contracts classified as finance leases in current lease accounting standards, a lessor recovers investments in leased assets at the end of initial lease term and thus such extended leases are often contracted. Accordingly, the boards need to consider whether such optional lease periods should be included in the initial recognition and clarify how implicit options, including extended leases, should be accounted for.

58. We anticipate that it is usually difficult for a lessee to reasonably estimate at the inception of the lease whether the lessee extends the lease after initial lease term or how long it extends. Accordingly, we believe that a new lease accounting standard should clearly specify that implicit options (including the possibility of extending the lease) for which it is practically difficult to reasonably estimate the probability of occurrence and the amount at the inception of lease should be scoped out from the obligation to pay rentals and then such options should be reflected in the obligation to pay rentals when the timing of occurrence

and the amount of the implicit options becomes evident or virtually certain.

Lease transactions that is continuously renewed in short term

59. In some real estate leases, contractual lease terms are short but in reality the lease terms are repeatedly extended and result in a long-term usage (e.g. leasing of land and building for corporate headquarters).

60. In these cases, it is very difficult to reasonably estimate the lease terms at the inception of the leases, and the estimate of the lease terms, if any by its nature, cannot help but being arbitrary. Accordingly, we believe additional guidance should be necessary for the leases that are expected to be repeated in short cycle.

Timing of initial recognition

61. We believe that it is necessary to ensure consistency with the timing of initial recognition of other non-financial assets when considering the timing of recognising assets and liabilities arising from lease contracts by lessees. Accordingly, as stated in paragraph 9.5(a), we observe that it is inconsistent if a lessee recognises right-of-uses asset and obligation to pay rentals at the inception of the lease when corresponding assets and liabilities out of non-financial executory contracts are not recognised in the financial statements.

Leases that contain service contracts

62. As referred in paragraphs 2.6 and 9.23, there are leasing contracts that include other services or contracts that only include services incidental to leased items. However, it is usually difficult for lessees to distinguish payments for services from lease payments because the amount of payments for services is not specified in most lease contracts.

63. Accordingly, we believe that, as stated in paragraph 2.20 (b), it is necessary to provide specific guidance on how to distinguish payments for services and those for right to use leased items. In addition, when it is impossible to reasonably identify service components, the boards should permit not to distinguish payments for services and account for such payments together with the payments for underlying lease contracts as a whole.

Accounting for contracts when there is a time gap between when the lease contract is signed and when the leased assets are delivered to the lessee

64. As stated in paragraph 9.3 onward, there is often a time gap between when the lease contract is signed (the inception date) and when the leased assets are delivered to or accepted by the lessee (the commencement date). In addition, as stated in paragraph 9.6, there are lease contracts that require construction of the leased asset before delivery and advance payments before the delivery, which are, for example, in effect used for the construction of the leased asset.

65. Accordingly, we believe that when there is a time gap between the inception date and the commencement date, a new lease accounting standard should clarify the accounting treatment in this effect.

Question 25
Do you think that a lessor's right to receive rentals under a lease meets the definition of an asset? Please explain your reasons.

66. As stated in paragraphs 10.11 and 10.12, a lessor's right to receive rentals (a receivable) in exchange for the right to use a leased item normally meets the definition of assets as far as it meets the criteria of assets in the *Framework*. However, the DP does not show any preliminary views on the lessor accounting in the new lease accounting standard. Accordingly, we cannot express our views on this issue at this moment.

Question 26
This chapter describes two possible approaches to lessor accounting under a right-of-use model: (a) derecognition of the leased item by the lessor or (b) recognition of a performance obligation by the lessor.
Which of these two approaches do you support? Please explain your reasons.

67. If we employ the same definition of leases as specified in current standard (paragraph 4 of IAS 17 *Leases*), a lease shall be 'an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.' We will respond to this question based on this definition.

68. Generally, when a lessor transfers a leased asset to a lessee, the right-of-use of the leased asset is also transferred to the lessee and the lessor cannot expect inflow of economic benefits arising from the use of the leased asset during the lease term (except the return of the leased asset at the end of the lease). In this kind of lease contracts, the leased item does not meet the definition of assets for the lessor during the lease term, and thus approach *(a) derecognition of the leased item by the lessor* should be adopted.

69. However, a lessor may enter into a lease contract where the lessor retains right to the economic benefits from the leased item even after a part of the right to use the leased item is transferred to the lessee. Accordingly, we believe that a new lease accounting standard should clearly state that the leased item should not be derecognised when such economic substance is found in lease contracts.

Question 27
Should the boards explore when it would be appropriate for a lessor to recognise income at the inception of the lease? Please explain your reasons.

70. US GAAP (SFAS 13 *Accounting for Leases*) specifies leveraged leases as well as sales-type leases and direct financing leases for lessor accounting (paragraph 1.7 and paragraphs 41 – 47 of SFAS 13). Accordingly, we believe that besides paragraphs 10.24 – 10.30, the boards should undertake comprehensive deliberation on leases other than simple ones that are found in current practice to provide detailed guidance.

Question 28
Should accounting for investment properties be included within the scope of any proposed new standard on lessor accounting? Please explain your reasons.

71. As stated in paragraph 10.26, besides real estate, movable property (or personal property) is held for investment, not for own use. We observe that it creates inconsistency, if the boards

differentiate lease accounting models depending on whether leased asset is movable property or real estate. Accordingly, we believe that investment properties should be included within the scope of new accounting standard for leases.