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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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Comments on the Discussion Paper of *Leases (Preliminary Views)*

To the Board Members:

The Japanese Institute of Certified Public Accountants appreciates the continued efforts of the International Accounting Standards Board (IASB) on the leases project and welcomes the opportunity to comment on the discussion paper of *Leases (Preliminary Views).*

We are basically in favor of the approach proposed in the discussion paper which in principle requires the recognition of all lease contracts, including leases at present classified as operating leases, in the financial statements. However, depending on the content of lease contracts as in the case of contingent rentals for example, their purpose and the result of their accounting can be inconsistent with each other. Accordingly, discussion focused on more specific cases will be required. Particularly, as the result of discussion on lessor accounting can affect lessee accounting, both accounting should be discussed at the same time.

The following is our response to the items in 'invitation to comment' with which we disagree or have questions or concerns.

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.

Comment:

(1) Non-core assets leases should not be excluded.

Two reasons:

- Different entities may interpret the meanings of non-core assets differently, which, in turn, may encourage the creation of new structures, thereby reducing comparability for users.
- Non-core asset leases may give rise to material assets and liabilities.

(2) Short-term leases should not be excluded.

Two reasons:

- Even short-term leases may give rise to material assets and liabilities.
- Excluding short-term leases may encourage the creation of new structures so that the term appears to be less than the specified threshold. Consequently, exclusion may not result in the reduction of contracts treated as off-balance-sheet transactions.

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.

Comment:

We do not agree with this proposal.

As in the current standard, we believe it would be better as a general rule to use the interest rate implicit in the lease and to use the incremental borrowing rate only when such implicit rate is not determinable. The reasons include that the interest rate implicit in the lease is specific to the liability being measured and that while it is required to take account of the credit standing of the lessee and the impact on the security provided asset (i.e. the leased asset) when determining the incremental borrowing rate, it should be taken into account that both of them are difficult to determine for some lessees.

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.

Comment:

We agree with an amortised cost-based approach. However, adopting the wording 'amortised cost-based' for the right-of-use asset should be reconsidered as it may lead to confusion with the definition under other standards (e.g. IAS 39).

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.

Comment:

It should not be permitted. As described in paragraph 5.16, lease liabilities will be measured differently from similar non-lease financial liabilities and such measurement will be inconsistent with the measurement at cost on initial recognition. Accordingly, the fair value measurement should not be approved.

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.

Comment:

The incremental borrowing rate should not be revised. We believe that as a general rule the interest rate implicit in the lease should be used, and such interest rate is often fixed at the start of the lease. Moreover, it is inconsistent with the treatment that financial liabilities measured by the amortised cost under IAS 39 are not revised for future changes in market interest rates. Furthermore, the cost to preparers will be significant.

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?

Comment:

The answer depends on the nature of contingent rentals. For example, depending on whether contingent rentals are assumed to be made for the recovery of the principal amount of the lease at the inception of the lease, or whether the contingent rentals are determined based on the future performance of the lessee's business, the judgment as to whether such payment obligation becomes a liability can be different. Accordingly, different accounting in accordance with the nature of contingent rentals should be discussed.

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.

Comment:

If the obligation to pay rentals is a financial liability, a probability-weighted estimate of the rentals payable (an expected outcome technique) should be used, but it is difficult to obtain information necessary for a probability-weighted calculation and there remains doubt about the objectivity of such information. Accordingly, we support the approach based on the most likely rental payment.

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.

Comment:

We support approach (b). Changes in the payment obligation arising from changes in estimated contingent rental payments should be considered to be in effect changes to the originally assessed cost of the right-of-use asset. In this case, the method of amoritisation or depreciation for the right-of-use asset should be specified.

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?

Comment:

It should be presented separately. As such obligation is accounted for differently from most of other financial liabilities, separate presentation will provide information such as that the liability includes the payment obligation in an optional period and the payment obligation for contingent rentals.

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?

Comment:

Presentation should be made in accordance with the nature of the underlying leased item, but the right concerned is different from outright ownership of the leased item and therefore should be presented separately from owned assets.

Question 24

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

Comment:

We cannot make any comment under the current circumstances as the results of discussion of lessor accounting may have influence on this issue.

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.

Comment:

We support approach (b).

Although the lessor has granted to the lessee the right to uses the leased item, the lessor has not lost control of the leased property. However, the nature of the performance obligation recognised as a liability and the requirements for allowing net presentation should be fully discussed.

Question 29

Are there any lessor accounting issues not described in this discussion paper that the boards should consider? Please describe those issues.

Comment:

We cannot make any comment under the current circumstances.

As results of discussion of lessor accounting may have influence on lessee accounting, both issues need to be discussed as a single issue.

Yours faithfully,

Kiyoshi Ichimura

Executive Board Member - Accounting Standards

The Japanese Institute of Certified Public Accountants