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Mr. John Stanford
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto, Ontario, Canada M5V 3H2

Comments on Exposure Draft 64 "Leases"

Dear Mr. Stanford,

The Japanese Institute of Certified Public Accountants (hereafter "JICPA") highly respects the International Public Sector Accounting Standards Board (hereafter "IPSASB") for its continuous effort to serve the public interest. We are also pleased to comment on the Exposure Draft 64 "Leases" (hereafter "ED"). Our comments to ED 64 are as follows.

We agree with the proposal of the ED's regarding lessee accounting. On the other hand, we believe some improvement is needed regarding the accounting and proposal of the right-of-use model for lessor accounting as well.

The ED proposes for lessor accounting that at the commencement date, the lease receivables be recognized as an asset and unearned revenue as a liability, and that recognition of the underlying asset be continued. We are afraid that unearned revenue does not meet the definition of liability of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (hereinafter, the "IPSASB Conceptual Framework"). We also believe that the underlying asset should be derecognized because it causes a double-counting of assets (lease receivable and the underlying asset). Further, the proposed lessor accounting departs from IFRS 16 "Leases" (hereinafter "IFRS 16") but we don't think any reason for the public sector to justify such departure. For our more detailed opinion, please read below.

Specific Matter for Comment 1：

The IPSASB decided to adopt the IFRS 16 right-of-use model for lessee accounting (see paragraphs BC6–BC8 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

Comment:
We agree with the IPSASB decision. We agree from the standpoint of convergence with IASB and the fact that for operating leases, which have not been on balance sheets, recognizing them on the lessee's financial statements will increase the usability of the information.

Specific Matter for Comment 2 :

The IPSASB decided to depart from the IFRS 16 risks and rewards model for lessor accounting in this Exposure Draft (see paragraphs BC9–BC13 for IPSASB's reasons). Do you agree with the IPSASB's decision? If not, please explain the reasons. If you do agree, please provide any additional reasons not already discussed in the basis for conclusions.

Comment:
We do not agree with the IPSASB proposal. Lessors should use the risks and rewards model as prescribed in IFRS 16.

The IPSAS are required to use the same accounting as IFRS as long as there are not any public sector specific circumstances. We believe that there is no public sector specific circumstances which justify to divert from IFRS 16 lessor accounting. Accounting treatment consistent with IFRS 16 could increases the understandability of financial statement users. We also consider entities will not incur any additional costs in preparing financial statements. This view can be justified on cost and benefit standpoint.

BC9(a) argues against using the "risks and rewards incidental to ownership" model, saying it is not consistent with the definition for assets of the IPSASB Conceptual Framework's "the underlying asset currently controlled by the reporting entity as a result of past events." BC9(c)(ii) argues that the lessor should not derecognize the underlying asset in a lease transaction. We believe that the lessor has lost control over the use of the underlying asset at the commencement date, and therefore most of the "resources" of the underlying asset has transferred to the lessee. We propose that the IPSASB should consider whether the underlying asset, meets the definition of asset under the IPSASB Conceptual Framework.

BC9(d) argues that the "risks and rewards incidental to ownership" model does not provide complete information about the entity's management of the resource. We think this argument is irrelevant. We believe the lessor continues to recognize the underlying asset in case of operating leases. We also believe that the lessor derecognizes the underlying asset while at the same time recognizing the lease receivables in case of finance leases. The lease receivables have control over the resources that can be obtained from the subject receivable in the future, so it meets the definition of asset, and the opposing argument of BC9(d) does not hold. If entities need to disclose assets for which ownership is held although not currently controlled, notes disclosure would be sufficient to provide information on the underlying asset.

BC(10)(a) criticizes applying a 'risks and rewards' model to lessor accounting that additional records will be required if lessor and lessee are part of the same economic entity and prepare consolidated financial statements. We think it is not necessarily true because additional records will be necessary even if the same accounting model is used.

That is because the discount rate and lease term used by the lessor and lessee may differ. That is, the discount rate used by the lessee in its initial measurement of the lease liability (the interest rate implicit in the lease or the lessee's incremental borrowing rate; paragraph 75) and the discount rate used by the lessor in its initial measurement of the lease receivables (the interest rate implicit in the lease; paragraph 27) are not necessarily the same. Also, even if the lease transaction take place within the same economic entity, the lease term may differ between the lessor and lessee as well, and so there is a possibility that it may become a burden when preparing consolidated financial statements.

Specific Matter for Comment 3：

The IPSASB decided to propose a single right-of-use model for lessor accounting consistent with lessee accounting (see paragraphs BC34–BC40 for IPSASB's reasons). Do you agree with the requirements for lessor accounting proposed in this Exposure Draft? If not, what changes would you make to those requirements?

Comment:

We do not agree with the IPSASB's proposal. Please refer to our comments to Specific Matter of Comment 2, considering qualitative characteristics under the IPSASB Conceptual Framework. In addition to our above comment on Specific Matter for Comment 2, we would like to point out the following four standpoints.

(1) Double-counting of assets (resources)

Under the right-of-use model, the lessee on the one hand recognizes the right-of-use asset, while the lessor does not derecognize the underlying asset. We believe that the "resource" obtained from the use of the underlying asset has transferred from the lessor to the lessee at the point where the lessee has recognized the right-of-use asset. Therefore, for the lessor to record both the underlying asset and the lease receivable on its financial statements constitutes a double-counting of assets (resources).

IPSASB should consider;

Whether it is appropriate for the lessor to account for the underlying assets same book value as the former asset on its statement of financial position; or

Whether the underlying assets are written down by the transfer of right-of-use asset.

(2) Unearned revenue

Unearned revenue that the lessor recognizes at the time of the lease agreement could be considered as an obligation to perform the duty of leasing the underlying asset to the lessee. However, in the case of operating leases, we consider that obligation as an executory contract and the lessor should consider whether it meets the definitions for liabilities and assets on the date of the contract. Also, in the case of finance leases, almost the entire risk accompanying the ownership of the underlying asset and its all economic value transfer to the lessee on the commencement date of the lease, there would be no performance obligation of outflow of economic benefit in the future. In both case, we consider unearned revenue would not meet the definition of liability defined in the IPSASB Conceptual Framework: "A present obligation of the entity for an outflow of resources"

(3) From the standpoint of burden of preparing consolidated financial statements

Where the lessor and lessee are the part of economic entity and prepare consolidated financial statements, the argument of that additional recordkeeping is not necessary due to the use of the same accounting model is not necessarily correct. The reason is set forth in our comment to Specific Matter for Comment 2.

(4) The character of lessors in the public sector

Furthermore, for the most part, the transactions of lessors in the public sector involve fixed term leases of land or the leasing of public housing, etc. where ownership does not transfer, and are currently classified as operating leases. With these kinds of leases, to recognize the lease receivable by taking the unrecovered lease investment amount and dividing it by the interest rate implicit in the lease will be a large burden for public sector entities which does not manage lease business as their significant business, and it is questionable whether the benefit outweighs the cost.

Specific Matter for Comment 4：

For lessors, the IPSASB proposes to measure concessionary leases at fair value and recognize the subsidy granted to lessees as a day-one expense and revenue over the lease term consistent with concessionary loans (see paragraphs BC77–BC96 for IPSASB's reasons). For lessees, the IPSASB proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23 (see paragraphs BC112–BC114 for IPSASB's reasons). Do you agree with the requirements to account for concessionary leases for lessors and lessees proposed in this Exposure Draft? If not, what changes would you make to those requirements?

Comment:

We do not agree with the lessor's accounting. The lessor's accounting should use the risks and rewards model.

We agree with the lessee's accounting. The lease should be measured at fair value and the revenue recognized pursuant to IPSAS 23 "Revenue from non-exchange transactions (taxes and transfers)."

Based on the reasons explained in our comments to Specific Matter for Comment 2 and 3, we think that the lessor's accounting should use the risks and rewards model. Further, in the case of concessionary leases which are made for terms below market value, we consider it to be substantively equivalent to the granting of a subsidy. Therefore, the effect on the financial statements should be the same regardless whether an actual subsidy is granted or whether the form of a lease agreement is taken.

Accordingly for the lessor's accounting for operating leases, the fair value of the lease earnings should be measured each accounting period, and a cost should be recognized each period to the extent actual earnings are less than fair value. In the case of finance leases, for the lessor's accounting, the fair value of the lease should be measured, and for any variance from fair value, day-one cost should be recognized equal to the amount equivalent to a subsidy, and the underlying asset should be derecognized.

Yours sincerely,

Shuichiro Akiyama

Executive Board Member - Public Sector Accounting and Audit Practice

The Japanese Institute of Certified Public Accountants