

September 5, 2013

To the International Accounting Standards Board
(CC: The Financial Accounting Standards Board)

Japanese Bankers Association

Comments on the IASB's Exposure Draft "Leases"

We, the Japanese Bankers Association ("JBA"), are an organization that represents the banking industry in Japan; and our members comprise banks and bank holding companies operating in Japan.

We would like to express our gratitude for this opportunity to comment on the Exposure Draft "Leases" published by the International Accounting Standards Board ("IASB").

We respectfully expect that the following comments will contribute to your further discussion on this issue.

1. Overall Comment

The accounting model proposed by the Exposure Draft addresses issues on the current lease accounting (e.g. the off-balance sheet accounting of operating leases by lessees) raised by users of financial statements, etc. However, there still remain some practical implementation issues for preparers of financial statements such as complicated lease classification, a complicated approach to include optional periods for extension/termination in the lease term, impractical standard for short-term leases and so forth.

In finalising the Standard, it is necessary to give careful consideration to lessees' burden in practice and other issues arising from recognising operating leases on balance sheet or changes to accounting treatment. If the IASB decides to require lessees to recognise operating leases on balance sheet, it is requested that the IASB give due regard so as to prevent problems occurring from the application of the Standard by, for example, simplifying and clarifying the Standard as well as enhancing guidance.

2. Comment on specific questions provided in Exposure Draft

Question 4: classification of leases

Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 28–34, which differ depending on whether the underlying asset is property? Why or why not? If

not, what alternative approach would you propose and why?

(Summary)

- We disagree with the proposed treatment.

(Basis, etc.)

(1) Lessee

- While the Exposure Draft proposes that in principle an entity shall classify a lease of assets other than property as a Type A lease and a property as a Type B lease; it also indicates in paragraph 30 that a lease may be classified as a Type A lease even if the underlying asset is property, depending on the proportion of the lease term to the total economic life or the proportion of present value of lease payments to the fair value of the underlying asset at the commencement date. It is unreasonable to apply different accounting treatments to homogeneous assets based on such classification criteria because it is likely to increase complexity and thus may confuse users of financial statements. In this view, requiring all leases of property to be classified as a Type B lease without exception should be more practical for entities.
- For Type B leases, it is proposed that the amortization of right-of-use asset should be determined as the difference between the periodic lease cost and the periodic unwinding of the discount on the lease liability so that the remaining lease cost is allocated over the remaining lease term on a straight-line basis.. This proposal cannot be supported from a practical perspective because the calculation method is complicated and the calculated amount of the amortization is not based on any theoretical grounding.. Instead, the IASB should consider other approaches such as, for example, recognising the right-of-use asset and lease liability as an aggregated amount of future lease payments to recognise a lease cost on a straight-line basis.

(2) Lessor

- The Exposure Draft proposes that an entity shall classify a lease based on the nature of the underlying asset and does not take into account those benefits and risks from the underlying asset unique to the lessor. The proposed classification may fail to appropriately reflect in financial statements real economic conditions of lease transactions as well as the lessor's business model.
- Therefore, it is recommended to retain the criteria under the existing IAS 17 applied in classifying a lease into a finance lease and operating lease based on the extent of the lessor's benefits and risks from the underlying assets; specifically based on whether a lease "transfers substantially all the risks and rewards incident to ownership." Further,

the IASB should allow an entity to apply the accounting treatment for a Type B lease to those transactions classified as an operating lease under the current criteria.

(3) Symmetry of lease classification criteria for lessees and lessors

- Unlike lessees, lessors are also exposed to those risks associated with a residual asset. This, and other factors, indicates that lessees and lessors address different risks and thus there is no particular reason that the lease classification criteria of lessees and lessors need to be similarly treated.

Question 5: lease term

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

(Summary)

- Including the optional periods to extend/terminate the lease in lease term, requires careful consideration from practical perspectives, etc.

(Basis, etc.)

- The Basis for Conclusion on the Exposure Draft specifies (in paragraph BC171) that the 'significant economic incentive' threshold is higher than the 'more likely than not' threshold proposed in the 2010 Exposure Draft, thereby giving rise to certain practical implementation considerations.
- However, while the Basis for Conclusion explains (in paragraph BC140) that the concept of 'significant economic incentive' is almost the same as the concept under existing standards, the assessment of 'significant economic incentive' will be considerably subjective in practice even if all relevant factors are taken into account.
- For example, a number of lease agreements Japanese banks enter into to rent their offices are renewed automatically unless there is a prior notice from the lessee (i.e. noncancellable by the lessor), and the amount of lease payments after renewal is negotiated and determined at the time of renewal. Therefore, in most cases, management decisions on whether to exercise an option to extend the lease agreement are made immediately before the expiry of exercising such an option, and thus it is impracticable to assess the 'significant economic incentive' before such decisions are made (including the date on which the agreement is signed) and such assessment will be considerably subjective.
- Given the above, there is a serious concern, from perspectives of reliability and

comparability, about recognising the right-of-use asset or lease liability based on the lease term which reflects the optional periods. It is considered that this approach will not result in providing useful information to users of financial statements.

- If the IASB decides to include the optional periods for extension/termination in the lease term, the application of this approach should be limited, for example, only when it is obvious that the option to extend/terminate the lease will be exercised. This treatment would eliminate the necessity for an entity to make the ‘significant economic incentive’ assessment and hence increase practicability

Question 7: transition

Paragraphs C2–C22 state that a lessee and a lessor would recognise and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?

Are there any additional transition issues the boards should consider? If yes, what are they and why?

(Summary)

- The proposed retrospective approach requires an entity to apply the Standard to all assets retrospectively,¹ which would cause a considerable burden in practice for such an entity. Further, the modified retrospective approach, while giving considerations to such a burden, still imposes some burden on an entity’s practices because, it, among other things, requires the calculation of present value. Therefore, the IASB is requested to reconsider its proposed transition requirements. For example, we propose that the new accounting treatment for operating lease be applied only to those lease agreements entered into on or after the base date, or be applied to existing operating lease agreements assuming that they were entered into on the date of initial application of the Standard.

Question 12 (IASB-only): Consequential amendments to IAS 40

The IASB is proposing amendments to other IFRSs as a result of the proposals in this revised Exposure Draft, including amendments to IAS 40 *Investment Property*. The amendments to IAS 40 propose that a right-of-use asset arising from a lease of property would be within the scope of IAS 40 if the leased property meets the definition of investment property. This would represent a change from the current scope of IAS 40, which permits, but does not require, property held

¹ For many Japanese banks, the Standard will be applied as a first-time adopter. As such, first-time adopters need to retrospectively apply the Standard to all of its assets.

under an operating lease to be accounted for as investment property using the fair value model in IAS 40 if it meets the definition of investment property.

Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

(Summary)

The Exposure Draft requires a right-of-use asset arising from a lease of property to be accounted for using the fair value model if the leased property meets the definition of investment property under IAS 40. Guidance on fair value measurement of such a right-of-use asset is requested.

Further, it should be clarified that the disclosure item is the fair value of the right-of-use asset and not the fair value of the underlying asset.

(Basis)

- In many cases, Japanese banks rent property in accordance with a lease agreement to use it for their branches and then sublease a portion of the property as a Type B lease. In such cases, banks do not engage in leasing activities of property as their main business and the rent is determined based on the lease payment under the original lease agreement and not based on the transaction price of the property as of the commencement of the sublease. Therefore, banks do not have sufficient information to calculate the fair value of investment property.

The IASB should provide specific guidance on simplified approaches to calculate fair value under the above circumstances.

[Other issues: Short-term leases and small-amount leases, etc.]

(1) Short-term leases

- The Exposure Draft provides a lessee and lessor with an option to apply a simplified accounting method similar to the existing method currently applied to operating leases, to short-term leases (i.e. a lease for which the lease term is 12 months or less). However, they need to assess whether the lease term of a lease contract with an option to extend is 12 months or less, including the optional period, in order to determine if the lease contract can be classified as a short-term lease.
- We understand that the IASB, out of concern that leases could be structured to obtain short-term lease accounting as mentioned in paragraph BC298, decided to include any options to extend in the lease term in assessing whether a lease contract is a short-term lease. However, as a result, even in the case where such an option to extend is unlikely to

be exercised or even in the case of quantitatively immaterial short-term leases, a simplified method becomes unavailable only because a lease contract contains the option to extend and instead the right-of-use model becomes applicable, resulting in an increased cost incurred by preparers of financial statements for immaterial items.

- Therefore, the Exposure Draft should specify that in the case of quantitatively immaterial short-term leases or those short-term leases where the option to extend is unlikely to be exercised, a lessee and lessor may apply the simplified accounting method similar to the existing method currently applied to operating leases, without taking into account the option for extension.

(2) Simplified method for small-amount leases, etc. other than short-term leases

- JGAAP allows those small-amount leases of JPY3 million or less per contract to be accounted for similar to operating leases. Further, in cases where the total amount of lease assets is immaterial and the lease rate² is less than 10%, JGAAP allows an entity to apply a simplified method,³ giving due regard to practicability in such cases.
- The Exposure Draft, on the other hand, does not provide any specific guidance as to a simplified accounting method applicable to immaterial leases.
- If an entity engaging in small-amount leases other than short-term leases and recording an immaterial amount of total lease assets applies the right-of-use model in accordance with the Exposure Draft, the cost incurred by the lessee who prepares financial statements would outweigh the benefits of users of financial statements. Therefore, the IASB is requested to consider allowing a simplified method similar to the one set out under JGGAP as previously mentioned.

It is proposed that in assessing whether a lease is a small-amount lease, the criteria of quantitative materiality should be stipulated from the perspective of improving practicability, or that the Basis for Conclusion, etc. should describe that the criteria used in assessing whether to expense or capitalise property, plant and equipment upon acquisition can be referred to.

² The lease rate is derived by dividing the future lease payments outstanding at the year-end by an aggregated amount of the future lease payments outstanding at the year-end and the book value of property, plant and equipment/intangible assets outstanding at the year-end.

³ Assets/liabilities are recognised as an aggregated amount of future lease payments.