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15 December 2010

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

Dear Sir David:

re: Comments on Exposure Draft
"Leases"

The Corporate Accounting Committee (CAC) of the Securities Analysts Association of Japan (SAAJ) is pleased to comment on the exposure draft *Leases* put out by the International Accounting Standards Board (the Board). The SAAJ is a not-for-profit organization providing investment education and examination programs for securities analysts. Its certified members number 24,000. The CAC is a standing committee of the SAAJ composed of 14 members, most of whom are users including equity and credit analysts, and portfolio managers, while a few others are academicians and public accountants. Before drafting this comment letter, the SAAJ sponsored a study session on the discussion paper, inviting two ASBJ (the Accounting Standards Board of Japan) staff as lecturers. Some 107 of our certified members participated. A questionnaire was subsequently sent to each participant and 68 responded, making for a 64% response rate. This comment letter fully takes into account the views expressed in the questionnaire replies as well as discussion among CAC members. The survey results are attached as an Appendix.

General Remarks

The CAC welcomes the exposure draft's proposal regarding lessee accounting and views it as an improvement. Based upon the right-of-use approach, the exposure draft proposes putting all lease assets and liabilities on the balance sheet. The CAC regards this as a more realistic reflection of corporate activities in financial statements and thus supports the direction of the exposure draft. On the other hand, the CAC's opinions are divided on some important issues in lessor accounting. The opinions of the Board and Financial Accounting Standards Board are also divided in some respects. The CAC respectfully asks both boards to deliberate further and to then put forward improved proposals.

Question 1(a)

Do you agree that a lessee should recognize a right-of-use asset and a liability to make lease payments?

The CAC agrees. In our survey, 79% of respondents answered "*Yes"* to Question 2 "*The exposure draft proposes the 'right-of-use model' which will recognize all leased assets and lease payment liabilities on the balance sheet of a lessee. Do you think this approach offers useful information for corporate analysis?*"

Putting operating lease assets and liabilities, which are currently shown in the notes, on the balance sheet with the same approach applied to financial leases would lead to accurate and easy corporate analysis. Further, disguising a financial lease as an operating lease to avoid balance sheet disclosure would no longer be possible. The balance sheet would thus more precisely depict the reality of a company.

Question 1(b)

Do you agree that a lessee should recognize amortization of the right-of-use asset and interest on the liability to make lease payments?

The CAC agrees. In our survey, 79% of respondents answered "*Yes*" to Question 2 "*At the inception of a lease, a lessee will measure the lease payment liability as the present value of expected future payments. Do you think this approach offers useful information for corporate analysis?*"

The CAC thinks the proposed lease liability calculation well represents lease payments that will most likely occur in the future.

Question 2(a)

Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term, and (ii) the derecognition approach otherwise?

The CAC agrees. A single approach is desirable for a lessee to put all assets used for business on the balance sheet. On the other hand, a lessor's business is so broad, including anything from a short-term rental to long-term finance, that it would be too approximate to apply a single approach.

The CAC's opinion above is not supported by the survey results.

Question 5 of the survey was "*The performance obligation approach or the derecognition approach should be applied to a lessor depending on the retainment of exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term. Do you think this would provide useful information for corporate* *analysis?*"

In answering the above question, 69% voiced concern that a similar lease would be accounted for differently. As to the use of the two approaches for a lessor (Question 6), only 36% said "*Two approaches should be allowed as proposed*", while 53% answered "*Only the performance obligation model should be used*".

In the comments to the survey, some mentioned that Examples 1 to 5 of the exposure draft did not offer clear criteria for choosing either one of the approaches. The survey respondents apparently felt that appropriate application of the approaches was difficult based on guidance given in B22 to B27 of the exposure draft, and that profit manipulation through arbitrarily choosing one of the approaches could be induced. The CAC asks the Board to provide further guidance and examples in this regard.

Question 3(a)

At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognize lease payments in profit or loss over the lease term.

The CAC agrees. The CAC thinks short-term leases should not be an exception to the principle of applying a single approach to all leases. However, except for periods of exceptionally high interest rates, the impact of interest rates on short-term lease obligation measurement should be limited, making discounted present value calculation not very relevant. Also, in view of the cost to preparers, the proposed method of putting short-term leases on the balance sheet is rational. The CAC applauds the Board for this practical proposal.

Question 6

Do you agree with either (the IASB or the FASB) approach to accounting for leases that contain service and lease components?

The IASB and the FASB approaches are the same for lessee accounting with respect to which the CAC agrees. In our survey, the majority (56%) answered "*Yes*" to Question 4 "*The exposure draft proposes applying the proposals in Revenue from Contracts with Customers when a service component is distinct in a contract that contains both service and lease components. It also proposes that a lessee should apply the lease accounting requirements when the service component is not distinct. Do you think this approach offers useful information for corporate analysis?*"

Theoretically, it is desirable to separate service and lease components. However, practically, the two components are often hard to distinguish, making application of lease accounting to a combined contract acceptable.

The CAC supports the IASB approach of lessor accounting. In the derecognition approach, the right-of-use sales gain is recognized at the inception of a lease. However, as the service is provided throughout the life of a lease, it is rational to apply revenue recognition accounting to recognize the service component throughout the life of a lease. In the performance recognition approach, as lease income (amortization of performance obligation) is recognized throughout the lease term, separation of the service and the lease components will not result in material differences.

The CAC thinks service component distinction guidance shown in paragraph B7 is inadequate for practical application and that further detailed guidance is necessary.

Question 8

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease?

The CAC has divided opinions. In the survey, opinions were also divided. Only 34% of the respondents supported the proposal, while 25% supported "*Should use the term that has more than 50% probability of occurrence*", and another 41% opined "*Should not take into account the extension or termination option*". (Question 3)

In the first place, an objective estimate of possible lease term would be so difficult that practical application would not be workable. This concern over arbitrary estimation results in a preference for "*Should use the term that has more than 50% probability of occurrence".* In the CAC's deliberations, some opined extension/cancellation options should not be considered at all because of possible arbitrary application, while others asserted that leased assets and liabilities might be intentionally less estimated if extension/cancellation options were fully neglected.

To recognize a lease, the exposure draft focuses on the asset side using the right-of-use concept. To measure a lease, the draft focuses on the liability side and applies measured liabilities as the value of right-of-use. The CAC thinks this is unnatural and inconsistent. According to the assertion of the exposure draft, the extension 'option' should be considered as the extension of right-of-use (i.e. asset side) rather than extended lease payments (i.e. liability side). The proposed focus on the liability side in measurement significantly widened the traditional concept of liability. Such a proposal should only be made after thorough debate of assets and liabilities in a conceptual framework project.

Question 9

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique?

The CAC's opinions are again divided, although there is a consensus that estimating variable lease payments is extremely difficult. Those members who supported the proposal cited a concern that no recognition of variable lease payments would result in a lease contract with intentionally small fixed lease payments for balance sheet cosmetics. On the other hand, those who are against the proposal mentioned that the (i) lessor and lessee use different assumptions resulting in incomparable financial statements or (ii) the proposal might result in excessive liabilities on the lessee's balance sheet.

As in our comment to Question 8 above, the CAC thinks the inconsistency in recognition and measurement of lease assets and liabilities causes a problem here too.

If you have any questions or need further elaboration, please do not hesitate to contact Sei-Ichi Kaneko, Executive Vice President, SAAJ (s-kaneko@saa.or.jp).

Sincerely yours,

Keiko Kitamura

Keiko Kitamura
Chair
Corporate Accounting Committee

APPENDIX

Results of SAAJ Survey on "Leases"

Background and methodology

The Securities Analysts Association of Japan (SAAJ) sponsored a study session on IASB's exposure draft *Leases,* inviting two lecturers from the Accounting Standards Board of Japan (ASBJ). Some 107 of our certified members participated in the session held on 19 November. A questionnaire was subsequently sent to each participant and 68 responded, making for a 64% response rate. The respondents were also invited to make comments. The survey, although small in size, focused on a cohort with the same background (certified members of the SAAJ) and same knowledge level (participation in the study session). This focus and very high response rate gives credibility to the reliability of the survey.

Survey questions and answers

Q1: The exposure draft proposes the 'right-of-use model' which will recognize all leased assets and lease payment liabilities on the balance sheet of a lessee. Do you think this approach offers useful information for corporate analysis?

A1:

Yes.	78.8%
No.	7.6%
Cannot judge at this moment.	13.6%

Q2: At the inception of a lease, a lessee will measure the lease payment liability as the present value of expected future payments. Do you think this approach offers useful information for corporate analysis?

A2:

Yes.	78.5%
No.	10.8%
Cannot judge at this moment.	10.8%

Q3: In calculating lease payment liability, a lessee will assume the longest possible term that is more likely than not to occur, taking into account the effect of any options to extend or terminate the lease. What do you think of this treatment of lease term?

A3:

Seems appropriate.	35.5%
Should use the term that has more than 50% probability of occurrence.	17.8%
Should not take into account extension or termination option.	46.7%

Q4: The exposure draft proposes applying the proposals in *Revenue from Contracts with Customers* when a service component is distinct in a contract that contains both service and lease components. It also proposes that a lessee should apply lease accounting requirements when the service component is not distinct. Do you think this approach offers useful information for corporate analysis?

A4:

Yes.	56.1%
No.	7.6%
Cannot judge at this moment.	36.4%

Q5: The performance obligation approach or the derecognition approach should be applied to a lessor depending on the retainment of exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term. Do you think this would provide useful information for corporate analysis?

A5:

Two approaches will be appropriately applied.	16.4%
Similar leases will be accounted differently.	68.7%
Cannot judge at this moment.	14.9%

Q6: What do you think of the opinion that lessor accounting should be limited to either the performance obligation approach or the derecognition approach?

A6:

Two approaches should be allowed as proposed.	36.4%
Only the performance obligation approach should be used.	53.0%
Only the derecognition approach should be used.	10.6%