Japan Leasing Association
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July 25, 2012

Mr. Hans Hoogervorst

Chairman

International Accounting Standards Board

Dear Mr. Hoogervorst,

Japan Leasing Association (JLA) has submitted several comment letters. However, JLA has decided to submit another comment letter before the re-exposure draft is published, considering into account the fact that IASB and FASB have tentatively made a significant decision on lease expense recognition patterns for lessees.

For the tentative decision made in June 2012, JLA is supportive of the perspective that there should be different lease expense recognition patterns for different leases. However, JLA proposes that the distinction between leases should be based on the principle in IAS 17 Leases rather than the basis of whether a lessee acquires and consumes more than an insignificant portion of the underlying asset over the lease term. JLA believes that the principle in IAS 17 leases would be the most feasible and appropriate line from the standpoint of mitigating confusion and costs arising from applying a new standard, because it enables a lessee to clearly classify leases into a lease similar to a purchase of the underlying asset and a lease similar to a service contract.

Finally, if IASB and FASB publish the re-exposure draft that includes the tentative decision in June 2012, it is likely that many constituents would submit their comment letters to IASB and FASB as they did so when the exposure draft was published in August 2010. JLA would like IASB and FASB to carefully and thoroughly consider comment letters to be received again before IASB and FASB publish a final standard, which will be published in 2013.

Yours faithfully,

Tsutomu Abe

Chairman

Japan Leasing Association

Japan Leasing Association (JLA) 's Proposal on the Tentative Decision on the Distinction between Different Types of Lease

JLA is supportive of the perspective that there should be different lease expense recognition patterns for different leases. However, JLA is strongly opposed to the tentative decision that the distinction between leases should be based on "the acquisition/consumption of a portion of the underlying asset" and "the nature of the underlying asset". The principle in IAS 17 Leases should be adopted as indicators to distinguish between two different types of lease.

1. **JLA is supportive of the perspective that there should be different lease expense recognition patterns for different leases.**

JLA has submitted several comment letters to the IASB and the FASB (the Boards).

JLA has submitted a comment letter in July 11th, 2011, in which JLA proposes as follows:

> The Boards should repeal the tentative decision in May 2011 that a lessee should apply a single accounting approach for all leases. The Boards should also restore the tentative decision made before May 2011 that there should be two types of lease (i.e. finance leases and other-than finance leases) for both lessee and lessor accounting.

This proposal by JLA is based on its cornerstone that several accounting models should be appropriately applied to various types of lease.

This is why JLA is supportive of the perspective proposed in June 2012 that there should be two types of lease.

2. **JLA is strongly opposed to the tentative decision that the distinction between leases should be based on "the acquisition/consumption of a portion of the underlying asset" and "the nature of the underlying asset".**

For the purpose of classifying leases into two types of lease, the boards have tentatively decided as follows:

> In principle, a lessee should distinguish between these two different types of lease on the basis of whether the lessee acquires and consumes more than an insignificant portion of the underlying asset over the lease term. However, as a practical expedient, the distinction can be based on whether the underlying asset is property or an asset other than property.

JLA is strongly opposed to the tentative decision for the following reasons.

<Reasons>

A. It is not rational to draw a line between leases of property and those of assets other than property.

It is explained that property (except land) is usually expected to retain its significant value over the lease term and the lease payments the lessor would charge for renewing the lease term at the end of the initial lease term would be approximately the same lease payments. It is also explained that this characteristic of property is different from that of assets other than property.

However, it is expected that some property loses its value as time passes and the lessor would not expect to charge approximately the same lease payments at the end of the lease if the lessee renewed the lease at that time. Although an asset other than property decreases in its value, the lease payments after the lessee renews the lease of the asset could be often the same lease payments at the end of the lease. For example, this case is applied to leases of a vehicle or measuring machine in which the same underlying asset is leased to multiple lessees over the economic life of the asset. A lessor who is engaged in this kind of leasing business prices each lease to obtain a desired return on the whole underlying asset over the entire period for which it intends to hold the asset. Consequently, regardless of whether the underlying asset is expected to retain a significant portion of its value, or whether the underlying asset loses a significant portion of its value over the lease term, lease payments for each lease remain the same as long as each lease term is same to each other (assuming that there is no change in significant economic conditions or significant obsoleteness.).

According to the threshold tentatively decided by the Boards, the expense recognition pattern for a lease of property would be determined on the threshold similar to the current IAS 17. A lessee would apply the reducing lease expense recognition profile to a lease of property classified as the current finance lease, while applying the straight line expense recognition profile to the other lease of property. On the other hand, a lessee would apply the reducing lease expense recognition profile to a lease of an asset other than property unless (i) the lease term is an insignificant portion of the economic life of the underlying asset or (ii) the present value of the fixed lease payments is insignificant relative to the fair value of the underlying asset. According to this threshold, it would be difficult to apply the straight line expense recognition profile to leases of assets other than property (refer to "B" below.). As a result, even if the economic life of property is equal to that of an asset other than property and the lease term of the property is equal to that of the asset other than property, those leases would be accounted under different lease expense recognition profiles, which would raise another inconsistence. JLA cannot see any rationale to draw such a line.

Therefore, JLA disagrees to the distinction proposed by the Boards, because it is not rational to determine whether a lessee acquires and consumes more than an insignificant portion of the underlying asset over the lease term by using a practical expedient based on whether the underlying asset is property or an asset other than property.

B. According to the tentative decision, the straight line expense recognition profile could not be practically applied to leases of assets other than property.

According to the tentative decision, a lessee would be able to apply the straight line expense recognition profile to leases of assets other than property only if:

(i) the lease term is an insignificant portion of the economic life of the underlying asset; or

(ii) the present value of the fixed lease payments is insignificant relative to the fair value of the underlying asset.

However, it would be practically difficult to determine whether the lease term is a significant portion or whether the present value is significant or not. This would result in the straight line expense recognition profile not being able to be applied to a majority of leases of assets other than property, because of the inability to clearly determine whether the lease term or the present value is significant.

In addition, if a lessee were to use the remaining economic life or the fair value of the underlying asset at the commencement of the lease in determining which expense recognition profile should be adopted, a lease of the underlying asset (i.e. second-hand asset) that was previously leased out many times would be accounted for under the reducing lease expense recognition profile, because the remaining economic life of the underlying asset (second-hand asset) would be much shorter and the fair value of the asset would be much smaller. Therefore, that kind of lease would not meet either (i) or (ii) above.

The original purpose of applying two approaches to leases is to properly reflect different economics of different leases that range from those similar to a service contract to those similar to a purchase of the underlying asset. However, leases of assets other than property would effectively result in being accounted for under a single accounting model.

3. The principle in IAS 17 Leases should be adopted as indicators to distinguish between two different types of lease.

JLA proposes that the principle in IAS 17 leases should be adopted as indicators to classify leases into two types of lease for the following reasons.

<Reasons>

The aim of the right-of-use model would be achieved even if the Boards adopted the principle in IAS 17 leases to distinguish between two types of lease.

The principle in IAS 17 leases in effect differentiates between a lease in which substantially all of the risks and rewards of ownership of the underlying asset have been transferred to the lessee (finance leases) and all other lease contracts that are treated as executory contracts (operating leases).

There is a concern that the principle in IAS 17 leases was developed for a different purpose under the right-of-use model. However, the main purpose of the right-of-use model is to make a lessee to recognize a right-of-use asset (an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term) and a liability to make lease payments for the current operating leases (i.e. on-balance sheet treatment for leases). The purpose of making a lessee recognize a financing element that is not shown in current operating accounting is not specified in the Discussion Paper or the Exposure Draft and is not as important as making a lessee to recognize an asset and liability arising from leases.

The aim would be achieved that a lessee recognizes a right-of-use asset and a liability to make lease payments on its balance sheet, even if the lessee distinguishes between two types of lease by using the principle in IAS 17 leases.

Therefore, the principle in IAS 17 leases would be the most feasible and appropriate line from the standpoint of mitigating confusion and costs arising from applying a new standard, because it enables a lessee to clearly classify leases into a lease similar to a purchase of the underlying asset and a lease similar to a service contract.