MASB MALAYSIAN ACCOUNTING STANDARDS BOARD
LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA

17 July 2009

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London ED 4M 6 XH
United Kingdom

Dear Sir David

IASB DISCUSSION PAPER: LEASES—PRELIMINARY VIEWS

The Malaysian Accounting Standards Board welcomes the opportunity to provide comments on the IASB Discussion Paper: Leases - Preliminary Views (DP). We appreciate the IASB's commitment to the development of standards that effectively meet the users' need.

Generally, we support the proposals in the DP except for the followings which are elaborated in the responses to the respective questions as enclosed in Appendix 1 to this letter:

(a) leases that are in-substance purchases - eg purchase of motor vehicles under hire purchase arrangements - are a form of financing arrangement, and hence, should not be accounted using the approach proposed in the DP as it is virtually similar to situations of an entity obtaining a loan to acquire an asset vis-à-vis purchase of property financed by term loan;

(b) in determining the present value of the lessee's obligation under the lease arrangement, an entity should be allowed to use the interest rate implicit in the lease unless such rate is not evident in the lease contract, in which case the incremental borrowing rate could be used;

(c) the lessee's obligation on the rental payable should be measured using the 'most likely' rental payment approach and not 'probability-weighted estimate' approach which may be theoretically appealing but may not result in the measurement of a liability that is reflective of actual possible outcomes nor more reliable than the most likely approach.

(d) it is imperative that the boards develop lessee accounting and lessor accounting concurrently so as to avoid confusion and mismatch in accounting treatments for lessee and lessor.

The DP should also provide additional guidance when the cost of the right-of-use asset does not equal the fair value of the obligation to pay rentals.

On the drafting aspect, the wordings in paragraph 6.39 appear to be contradicting with that of paragraph 6.41 as elaborated in the response to Question 13.

Suite 5.2, Level 5, Wisma UOA Pantai, No. 11, Jalan Pantai Jaya, 59200 Kuala Lumpur
Tel : (603) 2240-9200 Fax : (603) 2240-9300 E-mail : masb@masb.org.my Website : www.masb.org.my

If you need further clarification, please contact Ms Tan Bee Leng at +603 2240 9200 or by email at beeleng@masb.org.my.

Thank you.

Yours sincerely,

Mohammad Faiz Azmi
Chairman

Question 1

The boards tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards. Do you agree with this proposed approach? If you disagree with the proposed approach, please describe how you would define the scope of the proposed new standard.

We agree with the proposed approach <u>except</u> for IASB's preliminary view on in-substance purchase leases.

In our view, leases that are in-substance purchases are in effect a form of financing arrangement as it is virtually similar to situations of an entity obtaining a loan to acquire an asset eg purchase of motor vehicles under hire purchase arrangements vis-à-vis purchase of property financed by term loan.

The proposed approach should not disregard the concept of financing otherwise the proposed approach would deny entities the fundamental objective in funding arrangements. Therefore, we are not convinced with the IASB's rationale to account in-substance purchase leases under the proposed approach.

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.

The proposed new standard should neither exclude non-core asset leases nor short-term leases.

The exclusion of short-term leases may create opportunities for entities to structure leases to the term that is less than the specified threshold eg a 5-year lease could be structured into five one-year leases.

For non-core asset leases, it may be difficult to differentiate them from core asset leases and entities may interpret them differently thus reducing comparability for users.

Generally we believe accounting for lease transactions should be based on the substance of the arrangement and not just purely on the nature of the asset.

Question 3

Do you agree with the boards' analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract? If you disagree, please explain why.

Except for in-substance purchase leases as mentioned in our response to Question 1, we agree with the boards' analysis of the rights and obligations, and assets and liabilities arising in a lease contract.

The effort to distinguish, and recognize as separate assets, the rights held by the lessee and those held by the lessor is a step forward in reporting Ijarah (commonly known as Islamic leasing) transactions. In Islamic jurisprudence, there is a distinction between the right of usufruct held by the lessee and ownership rights held by the lessor. Both these rights are deemed separate assets (or, *mal*), thus, there have been some conceptual arguments against applying the 'whole asset' approach of IAS 17 to Ijarah as only one party to the transaction would recognize the 'whole asset'. The recognition of the separate rights of the lessee and lessor as separate assets would be more reflective of the nature of Ijarah transactions.

Question 4

The boards tentatively decided to adopt an approach to lessee accounting that would require the lessee to recognise:

(a) an asset representing its right to use the leased item for the lease term (the right-of-use asset)

(b) a liability for its obligation to pay rentals.

Appendix C describes some possible accounting approaches that were rejected by the boards. Do you support the proposed approach? If you support an alternative approach, please describe the approach and explain why you support it.

Except for in-substance purchase leases as mentioned in our response to Question 1, we agree with the boards' analysis of the rights and obligations, and assets and liabilities arising in a lease contract.

Question 5

The boards tentatively decided not to adopt a components approach to lease contracts. Instead, the boards tentatively decided to adopt an approach whereby the lessee recognises:

(a) a single right-of-use asset that includes rights acquired under options

(b) a single obligation to pay rentals that includes obligations arising under contingent rental arrangements and residual value guarantees.

Do you support this proposed approach? If not, why?

We support the board's tentative decision not to adopt a components approach to lease contracts as we believe components approach complicates lessee accounting.

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.

We disagree with the boards' tentative decision.

We believe the boards' should develop a hierarchy whereby if it is practicable for an entity to determine the interest rate implicit in the lease, the entity should be allowed to use that rate. Incremental borrowing rate should only be used when the interest rate implicit in the lease is not evident in the lease contract or when it is not practicable to determine.

Although the interest rate implicit in the lease may not be determinable in some instances, we are concerned that the incremental borrowing rate may factor other elements of risk that are not related to the specific leased asset.

Question 7

Do you agree with the boards' tentative decision to initially measure the lessee's right-of-use asset at cost? If you disagree, please explain why and describe how you would initially measure the lessee's right-of-use asset.

We agree to measure the lessee's right-of-use asset at cost, represented by the present value of the expected leased payments.

Nonetheless, there could be instances where the present value of the expected lease payment may not always equal to the fair value of the right-of-use on initial recognition. For example, there could be situations where rentals between related parties are not conducted on arms length basis resulting in the fair value of the obligation to pay rentals different from the lessee's value right-of-use asset.

In addition, there may be situations where the present values of the expected lease payments of a single transaction do not equal to the fair value of the right-of-use on initial recognition. This could be due to structuring arrangements where in substance multiple arrangements should be accounted for as a single transaction i.e. when one arrangement considered on its own is not economically justifiable but it is economically justifiable when considered together with other arrangements. For example, a management service agreement entered into at the same time with a rental arrangement with low rental payments where the occurrence of the management service agreement is dependent on the occurrence of rental agreement.

The boards should therefore consider providing additional guidance when the cost of the right-of-use asset does not equal the fair value of the obligation to pay rentals.

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.

We agree that the amortised cost-based approach to be adopted as the subsequent measurement basis for both the obligation to pay rentals and the right-of-use asset. This approach is consistent with the measurement basis of other non-financial assets and non-derivative financial liabilities.

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.

The measurement basis for the lessee's obligation to pay rentals should be consistent with the measurement of other liabilities where they are predominantly measured at amortised cost.

However, for circumstances involving back-to-back leases such as sub-leases, it may be appropriate to measure the obligations to pay rentals at fair value so as to eliminate accounting mismatch, if any.

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.

The lessee should not be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate unless the lease term has changed substantially in which case the revision to the rate may be appropriate.

Requiring the incorporation of rate changes triggers a new value of the obligation to pay rentals, and hence, indirectly it may result in the entity using the fair value approach which is inconsistent with the proposed amortised cost-based approach. In addition, the requirement to revise the incremental borrowing rate would not be consistent with the IAS 39 requirements on amortised cost measurement concept.

Furthermore, factoring changes in an entity's incremental borrowing rate will result in factoring the undesirable results of credit risk changes of an entity in the re-measurement of obligation to pay rentals, an issue which IASB has yet to resolve.

However, if the boards do decide to require an entity to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate, an entity should only be required to do so when there is a change in the estimated cash flows of the lease obligation.

Question 11

In developing their preliminary views the boards decided to specify the required accounting for the obligation to pay rentals. An alternative approach would have been for the boards to require lessees to account for the obligation to pay rentals in accordance with existing guidance for financial liabilities. Do you agree with the proposed approach taken by the boards? If you disagree, please explain why.

We agree with the approach proposed in the DP. As the DP does not propose to adopt the component accounting for leases, it would be inappropriate to require lessees to account for the obligation to pay rentals in accordance with existing guidance which generally premise on the component concept.

Question 12

Some board members think that for some leases the decrease in value of the right-of-use asset should be described as rental expense rather than amortisation or depreciation in the income statement. Would you support this approach? If so, for which leases? Please explain your reasons.

We believe the decrease in value of the right-of-use asset should be described as amortisation in the income statement.

Question 13

The boards tentatively decided that the lessee should recognise an obligation to pay rentals for a specified lease term, ie in a 10-year lease with an option to extend for five years, the lessee must decide whether its liability is an obligation to pay 10 or 15 years of rentals. The boards tentatively decided that the lease term should be the most likely lease term. Do you support the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why.

We agree with the boards' tentative decision that the lease term should be determined based on the lessee's most likely lease term because the 'probability-weighted estimate' approach, although theoretically appealing, is not meaningful as it may not be reflective of the actual possible outcomes.

However, we note that paragraph 6.39 of the DP seems to contradict with the boards' preliminary views in paragraph 6.41 and we believe the boards should clarify whether the lessee's intentions and past practice could or could not be considered in determining the lease term.

Paragraphs 6.39 and 6.41 read:

6.39 Factors that could affect the lease term can broadly be characterised as follows:

Category	**Description**	**Examples**
...continued		
Lessee specific factors	Lessee specific considerations	**- Lessee intentions** **- Past practice**

6.41 The boards tentatively decided to provide guidance on the factors to consider when determining the lease term. Their preliminary view is that the guidance should specify that contractual, non-contractual and business factors are considered in determining the lease term. **The lessee's intentions and past practice would not be considered.**

Question 14

The boards tentatively decided to require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances. Changes in the obligation to pay rentals arising from a reassessment of the lease term should be recognised as an adjustment to the carrying amount of the right-of-use asset. Do you support the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why.

We support the proposed approach to require reassessment of the lease term at each reporting date on the basis of new facts or circumstances. This approach is consistent with other IFRS requirement on accounting for changes in estimates.

Would requiring reassessment of the lease term provide users of financial statements with more relevant information? Please explain why.

We believe requiring reassessment of the lease term is likely to provide users of financial statements with more relevant information.

Question 15

The boards tentatively concluded that purchase options should be accounted for in the same way as options to extend or terminate the lease. Do you agree with the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why.

We agree with the boards' proposed approach that purchase options should be accounted for in the same way as options to extend or terminate the lease.

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?

We support the boards' proposed approach that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements. Excluding contingent rentals could lead to an understatement of the right-of-use asset and the proposed approach improves comparability for users because it is consistent with the treatment of other asset acquisitions.

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.

We believe the most likely rental payment approach, as decided by the FASB, is more appropriate and reflective of the possible outcomes.

We disagree with the probability-weighted estimate approach in the measurement of the lessee's obligation on the contingent rental payable. The probability-weighted approach, notably more scientific than the most likely approach and may give a moderated effect of the lessee's obligation to pay rentals, will require the lessee to determine the probability of each possible outcomes. Such requirement may ultimately result in the measurement of a liability that reflects an outcome which may not happen nor more reliable than the most likely approach and thereby, not providing useful information to users of financial statements.

Question 18

The FASB tentatively decided that if lease rentals are contingent on changes in an index or rate, such as the consumer price index or the prime interest rate, the lessee should measure the obligation to pay rentals using the index or rate existing at the inception of the lease. Do you support the proposed approach? Please explain your reasons.

We support the FASB's approach to measure the obligation to pay rentals using the index or rate existing at the inception of the lease for the reasons as mentioned in our response to Question 10.

Question 19

The boards tentatively decided to require remeasurement of the lessee's obligation to pay rentals for changes in estimated contingent rental payments. Do you support the proposed approach? If not, please explain why.

We agree to require remeasurement of the lessee's obligation to pay rentals for changes in estimated contingent rental payments as this would provide more relevant and useful information to users of financial statements.

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.

We support approach (b) because such changes represent adjustments to the originally assessed cost of the right-of-use asset.

Question 21

The boards tentatively decided that the recognition and measurement requirements for contingent rentals and residual value guarantees should be the same. In particular, the boards tentatively decided not to require residual value guarantees to be separated from the lease contract and accounted for as derivatives. Do you agree with the proposed approach? If not, what alternative approach would you recommend and why?

We agree with the boards' tentative decision not to require residual value guarantees to be separated from the lease contract and accounted for as derivatives.

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?

We believe the lessee's obligation to pay rentals should be presented separately in the statement of financial position as the risk associated with the obligation to pay rentals is different from most other financial liabilities.

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?

Right-of-use asset should be presented in the statement of financial position on the basis of the nature of the leased item.

Question 24

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

The following issues should be addressed in this project:

- **a) Assessment of impairment of right-of-use asset**
- **b) Application of the revaluation accounting policy choice for right-of-use asset**
- **c) Decommissioning costs of leased assets under the proposed approach**
- **d) Accounting for large amount of prepayment by lessee**
- **e) Accounting for time-share arrangement under the proposed approach**
- **f) Timing of amortisation, particularly for assets under work-in-progress**
- **g) Transitional provision for existing leases on adoption of the new standard**
- **h) Cancellation option held by the lessor**

Question 25

Do you think that a lessor's right to receive rentals under a lease meets the definition of an asset? Please explain your reasons.

Yes, the lessor's right to receive rentals under a lease meets the definition of an asset because the lessor has an unconditional right to receive payments as a result of a past event, ie from the signed lease contract. Similarly, on the other hand, the lessee's obligation to pay rental is a liability on the part of the lessee because the signed lease contract would result in an outflow of economic benefits as proposed in the DP. In this regard, it is imperative that the boards develop lessee accounting and lessor accounting concurrently so as to avoid confusion and mismatch in accounting treatments for lessee and lessor.

In addition, we suggest the approach for lessor's accounting should be in line with the revenue project.

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.

We believe in-substance sales should apply approach (a) whilst other types of leases should apply approach (b).

Question 27

Should the boards explore when it would be appropriate for a lessor to recognise income at the inception of the lease? Please explain your reasons.

Yes, the boards should explore when it would be appropriate for a lessor to recognise income at the inception of the lease. We suggest the approach should be consistent with the revenue project. In addition, the boards may also need to consider the following issues:

a) **Short-term leases**
b) **Time-share arrangement**
c) **Deposits received before commencement of a lease**
d) **Multiple arrangements that may need to be unbundled for revenue recognition**

Question 28

Should accounting for investment properties be included within the scope of any proposed new standard on lessor accounting? Please explain your reasons.

Except for in-substance sales, we believe accounting for investment properties should be included within the scope of any proposed new standard on lessor accounting.

Question 29

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

In a transaction known as *Ijarah Mausufah*, or 'forward Ijarah', a property owner may give the future right-to-use of a yet-to-be completed building (or units in the building) in return for advance payments. Prior to completion, the advance payments would usually be reported as liabilities by the lessor. There may an issue as to whether, upon completion, the use of the property by the lessee(s) should be considered as perfection of a sale and purchase of leasehold building, in which case, the lessor may be able to recognize the entire consideration in income; or as rental, in which case, the payments may be expected to be recognized in income over the period of use.