13 September 2013

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

Dear Mr. Hoogervorst

EXPOSURE DRAFT ED/2013/6 — LEASES

The Malaysian Accounting Standards Board (MASB) welcomes the opportunity to provide comments on the IASB Exposure Draft on Leases (ED/2013/6).

We appreciate the IASB's efforts to revise its proposal on Leases. Generally, we find this proposed approach less complex and more operational as compared to the original Exposure Draft issued in 2010.

We generally agree with the proposals in the Exposure Draft except for the classification of lease contracts and the accounting model for lessees. We do not agree with the dual model approach for lessee accounting primarily because the classification criteria proposed in the Exposure Draft is overly complex and the resultant accounting treatment for Type B leases lacks conceptual basis.

Our detailed responses are enclosed in the Appendix of this letter.

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

APPENDIX

Question 1: identifying a lease

This revised Exposure Draft defines a lease as "a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration". An entity would determine whether a contract contains a lease by assessing whether:

(a) fulfilment of the contract depends on the use of an identified asset; and

(b) the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.

Do you agree with the definition of a lease and the proposed requirements in paragraphs 6–19 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

Response

We agree with the proposed definition of a lease.

We however believe the Exposure Draft (ED) is not clear whether in-substance purchase / sale of assets is within the scope of the ED. We note that paragraph 118 of the Basis for Conclusion explains that the ED does not apply to transactions for which control of the underlying asset is transferred to the "lessee". However, there is no equivalent exclusion in the ED itself.

In addition, we also believe that it is important to provide clarification on how to distinguish a lease transaction from an in-substance purchase / sale transaction. For example, a lease contract with a deep-in-the-money purchase option is, in substance, similar to a purchase of an asset contract.

Whilst the accounting for leases that are economically similar to the sale / purchase of the underlying asset would be accounted for similarly to a large extent, we nevertheless believe that it is important to define the scope of the new lease Standard. In addition, we note that there are some differences between a lease and a sale / purchase, as analysed below:

(a) Line item presented on the statement of financial position

Right-of-use assets are presented separately from owned assets by virtue that they are not identical in terms of the economic substance.

(b) Impairment model for lease receivable

The ED proposes that lessor with lease receivable applies the IASB Exposure Draft on *Financial Instruments: Expected Credit Losses.*

Accordingly, for lease receivables, the lessor has an accounting policy choice to either always recognise a loss allowance at an amount equal to lifetime expected losses (i.e.

the simplified approach) or to apply the full 3-stage approach as prescribed in the IASB ED on *Expected Credit Losses.* In contrast, the simplified approach is not made available for financial assets which are within the scope of IFRS 9 *Financial Instruments.* This could lead to inconsistency in application and non-comparability of financial statements.

Another area that we believe the scope of the ED should clarify relates to transactions that are in substance collateralised borrowings.

We wish to highlight that there are 2 common types of transactions in Malaysia where such distinction is important, namely hire purchase transactions and Islamic *Sukuk Ijarah.* These transactions are not leases and therefore should not be accounted for as such.

(a) Hire purchase transaction under the Hire Purchase Act 1967 (Amendment 2011) in Malaysia

In a typical hire-purchase transaction, the hirer hires goods with an option to purchase from the owner (the financier, which is normally a bank) by paying scheduled instalments to the owner. Ownership of the goods will be transferred to the hirer after all instalments have been paid.

(b) Islamic *Sukuk Ijarah*

One of the commonly discussed issues in accounting of Islamic *Sukuk Ijarah* contracts is the assessment of whether *Sukuk Ijarah* should be accounted as a financial asset in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* / IFRS 9 or the sales and leaseback principle in IAS 17 *Leases*

Often the principle in the *SIC 27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease* is referred to in assessing whether an Islamic *Sukuk Ijarah* transaction meets the definition of a lease. It is not uncommon in Malaysia that *Sukuk Ijarah* transactions are accounted for similar to conventional debt securitisation transactions and not as lease transactions.

We note that the ED on Leases, upon issuance as a Standard, will supersede SIC 27 and we recommend that the IASB provides guidance in distinguishing lease contracts from a collateralised borrowing transaction that is in legal form a lease contract.

Question 2: lessee accounting

Do you agree that the recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

<u>Response</u>

We agree with the proposed right-of-use (RoU) model where both a RoU asset and lease liability are recognised at the commencement of a lease.

APPENDIX

However, we do not support the dual accounting model for lessees. We do not agree with the proposed accounting for Type B leases, where the amortisation of a RoU asset is in effect, a balancing figure. The proposed accounting results in the RoU asset being carried at an amount which is inconsistent with the cost model for other non-financial assets.

We therefore recommend that the IASB reconsiders the proposal and retains a single lessee accounting model.

Question 3: lessor accounting

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Response

We agree with the proposed dual accounting model on lessor accounting on the grounds of practicality.

We note the operational challenge if all property leases are to be accounted for using the Type A lease approach. However, we wish to highlight that, for Type B leases, users of the financial statements may not be able to comprehend the rationale why a lessor does not recognize a financial receivable whilst the financial liability is recognised by the lessee. This non symmetrical accounting is inconsistent with the definition of a financial instrument where a contract gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

In addition, we do not agree with the proposal to recognise the unwinding of the discount on the gross residual asset as interest income over the lease term. The proposal imposes a requirement of a financial asset (i.e. recognition of interest income over a period) on the residual asset which is a non-financial asset. IAS 16 *Property, Plant and Equipment*, for example requires an entity to review the residual value of a property, plant and equipment at least at each financial year end, with any changes from the previous expectation being accounted for as changes in estimates. No interest income is recognised on the residual value.

We are also concerned that there could be implementation challenges and associated costs in applying the requirement for Type A leases. Some of the examples include estimating the fair values of residual assets and systems required to track the movement of the underlying assets (when such assets are not leased out) and residual assets (when the underlying assets are leased out).

APPENDIX

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?

Response

Whilst we appreciate the IASB's effort in developing 2 different accounting models in order to better reflect the economic substance of various lease transactions, we however believe that the classification criteria are overly complex.

Firstly, we are of the view that the core classification criterion based on the nature of the underlying asset is a rule-based criterion.

Secondly, we believe that the degree of complexity is also attributed to the various thresholds - ("insignificant", "substantially all" and "major part") used in the classification criteria. These terms are used in existing IAS 17 for lease classification purposes and have caused diverse interpretations. We understand that there are some local GAAPs that provide "bright lines" on these terms, for example, 75% or more is considered as "major part of the economic life of the leased asset" and 90% or more is considered as "substantially all the fair value of the lease asset". The challenge of using similar terms in the new Standard without providing further guidance may inadvertently result in preparers continuing with the existing practice of applying the implicit bright lines.

If the underlying asset is a property, the indicators (that refer to economic life and fair value of the underlying asset) used in IAS 17 for finance leases are similar to the criteria for Type A leases. As such leasehold land that is currently classified as a finance lease in accordance with IAS 17 would be classified as a Type A lease. We believe this is not the intent of the ED.

If the IASB decides to proceed with the proposal in the ED, we recommend that the IASB considers providing guidance on how an entity would assess what constitutes as "insignificant", "substantially all" and "major part" in classifying leases as either Type A or Type B.

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?

Response

We agree with the proposal. However, we note that the proposal may pose some practical difficulty for lessors in determining the lease term. It may be highly judgmental for a lessor to assess whether a lessee has a significant economic incentive either to exercise an option to extend a lease, or not to exercise an option to terminate a lease.

APPENDIX

Question 6: variable lease payments

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

Response

We agree with the proposal.

In addition, we would suggest the IASB provides a definition or guidance on the term "in-substance fixed payments" that form part of the variable lease payments.

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?

Response

We agree with the proposed transition arrangement.

In addition, we suggest that the IASB considers providing transitional exemptions for transactions that are currently accounted for as lease transactions (e.g. transactions within the scope of IFRIC 4 *Determining whether an Arrangement contains a Lease,* charter arrangement in the shipping industry or power purchase agreements) but are not "leases" within the scope of the new proposal.

Question 8: disclosure

Paragraphs 58–67 and 98–109 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments; reconciliations of amounts recognised in the statement of financial position; and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

Response

We agree with the proposals.

APPENDIX

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 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?

Response

We agree with the proposal.

Other comments

(1) Revaluation of right-of-use (RoU) asset

If the IASB decides to proceed with the dual model approach for lessee accounting, we recommend the IASB provides clarification on how the "straight line lease expense" approach should be applied when the RoU asset is revalued.

(2) Finance leasehold land

We note that the scope of the ED does not exclude RoU asset that also satisfies the definition of inventories in IAS 2 *Inventories*.

In Malaysia, it is common that leasehold land is held for property development purpose by entities engaged in property development activities. We agree with the proposal in the ED which permits amortisation of the RoU asset to be capitalised as part of the carrying amount of another asset (for example: inventories) in accordance with other application Standards. In addition, we note that the ED proposes the RoU asset is subject to the impairment assessment and requirements in IAS 36 *Impairment of Assets*.

We wish to highlight that in a situation where the leasehold land a also falls within the definition of inventories, the RoU asset is therefore subject to two different impairment models, IAS 2 requires the asset to be carried at the lower of cost and net realisable value as opposed to IAS 36 which requires assets be carried at no more than their recoverable amount.