

APPENDIX I

COMPILATION OF RESPONSES FROM AOSSG LEASES WORKING GROUP MEMBERS

This appendix compiles the responses from the staff of the AOSSG Leases Working Group member organisations. Views expressed are those of the staff and do not represent the official views of the respective organisations with which the staff are associated. The questions and the responses are shown below.

DISCUSSION QUESTION 1: LESSOR ACCOUNTING MODEL

The exposure draft proposes a new accounting model for leases in which a lessor would apply either a performance obligation approach or a derecognition approach to account for the assets and liabilities arising from a lease depending on whether the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected term of the lease (paragraphs 28, 29, B22 – B27, and BC23–BC27).

Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits¹ associated with the underlying asset during or after the expected lease term, and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?

Do you agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

Australia AASB staff

With regards to our comments on lessor accounting - we would prefer to see only one approach adopted rather than the hybrid approach. Although our Board preferred the performance obligation approach, they would also prefer some type of net presentation on the balance sheet to avoid the 'doubling-up' effect of the cash flows.

We support recognising a performance obligation and lease receivable approach as this is consistent with the new revenue recognition approach and we believe it to be conceptually the right answer. We understand however that without de-recognition of the tangible asset by the lessor there are concerns with the 'double-up' of the cash flows of the underlying asset (showing it in PP&E and the rental cash flows as a receivable). We note that the IASB has not considered whether lessors should be accounting for leased PP&E under IAS 16 in the first place. For example, investment property is specifically scoped out recognising that leased property is different in nature from property to be used to generate operating cash flows. One consideration is whether all leased items of PP&E should fall under IAS 16 in the first place or be considered 'investment PP&E' and accounted under IAS 40 which may solve the 'double-up' problem.

Furthermore, we understand that one reason for the leasing project was to eliminate the fine line between operating and finance leases. We are concerned that this proposal for lessor accounting introduces a fine line and a large amount of judgement back into lease accounting, which the Boards were seeking to remove.

¹ Paragraphs B22 and B24 in the ED propose that a lessor shall consider the following factors when determining whether it retains exposure to significant risks or benefits associated with the underlying asset:

During the expected term of the current lease:

- significant contingent rentals during the lease term that are based on the use or performance of the underlying asset
- options to extend or terminate the lease
- material non-distinct services provided under the current lease

After the expected term of the current lease:

- whether the duration of the lease term is not significant in relation to the remaining useful life of the underlying asset
- whether a significant change in the value of the underlying asset at the end of the lease term is expected. In making this assessment, the lessor shall consider the present value of the underlying asset at the end of the lease term and the effect that any residual value guarantees (including those provided by an unrelated third party) may have on the lessor's exposure to risks and benefits.

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China CASC staff

We are concerned about the hybrid model currently addressed by the IASB and FASB. This model does not meet the aim of leases project and may give rise to broad arguments. We also disagree the “risk/reward” judgment between performance approach and derecognition approach proposed by boards, for it doesn’t resolve the disputes in the existing leases accounting model. We believe that the basic theory and principles in the lessor accounting and lessee accounting should be consistent, so we support the derecognition approach. The derecognition approach reflects the economic substance of the lease transaction and is most consistent with the use-of-asset model. If the boards finally decide to use the hybrid model, we propose that: (a) performance obligation approach can only be used in some land and building leases; (b) derecognition approach should be used in all other leases; (c) simplified accounting method should be used for short-term leases.

Hong Kong HKICPA staff

We do not agree. We do not believe that it is appropriate that a lessor should recognize a liability when it enters into a lease which exposes it to significant risks and benefits associated with the leased asset. We also do not believe that it make sense for an entity's liability/equity gearing ratio to be adversely affected when it becomes a lessor under such leases.

Indonesia IAI staff

The hybrid approach proposed by the Board is substantially similar to the differentiation between operating and financing lease in the existing IAS 17.

We believe that the derecognition model would be the more appropriate model to be used, as it is more consistent with the lessee accounting model. The lessee will receive the unconditional right to use the asset in question over the lease term, since the lessor has granted that right when the lessor releases the obligation of permitting that use. In essence, the process in derecognition model is similar to when an entity derecognizing inventory or asset sold in exchange for a right to receive payment.

With the performance obligation model, the lessor continues to account for the leased asset while at the same time recognizing the right to receive rental payment from the lessee (lease receivable). This result in “duplication” of asset in the balance sheet (overvalued).

Japan ASBJ staff

Although we agree with using risks and benefits notion to determine when to use the performance obligation approach and the derecognition approach, we are concerned about the potential inconsistency between the lessor accounting models and the proposed revenue recognition model in terms of lessor’s revenue recognition. Under the proposed revenue recognition model, ‘control’ approach is adopted rather than ‘risks and benefits’ approach. However, under the proposed lessor accounting requirements, revenue would be recognized based on the extent of transferring risks and benefits associated with underlying asset, not based on control over the underlying asset. Although we understand the reason the risks and rewards approach was not adopted under the revenue recognition ED, we believe that both accounting models should be aligned more with each other in terms of revenue recognition.

We think the above application guidance is well designed conceptually to identify the transactions which should be accounted for by the performance obligation approach. However, we believe it is still unclear for some transactions about how to determine appropriate approaches. For example, we are not sure which approaches should be taken for following transactions:

- Contracts that cover 50% of the expected useful life of the underlying asset (3 year car lease with its useful life of 6 year)
- 7 year equipment lease with 3 year renewal option (useful life: 10 years)
- 3 year equipment lease with 7 year renewal option (useful life: 10 years)

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Also, we believe that day one profit should not be recognised for certain types of leases such as leases currently classified as operating leases and therefore applying the performance obligation approach to such leases should be appropriate.

Korea KASB staff

We haven't reached a consensus on the hybrid approach. Under the single approach for lessor accounting, we support the performance obligation approach with net presentation of three items (leased asset, lease receivable and performance obligation) as a distinct item in the SFP.

Macau CRAC staff

We do not agree that a lessor should apply the performance obligation approach when the lease exposes the lessor to significant risks and benefits associated with the underlying asset, and a derecognition approach otherwise. The aim of the lease project is to develop a single accounting model, and therefore, proposing two approaches for lessor accounting deviates from the aim of the project. Among the two approaches, we support the derecognition approach because this approach reflect the economic substance of the transaction and is consistent with the lessee accounting model. The lessee has unconditional obligation to pay rentals because the lessor has performed by delivering a right-of-use asset to the lessee.

Malaysia MASB staff

As in-substance purchases and sales will be outside the scope of lease contracts, we therefore support the performance obligation approach to lessor accounting for leases that expose the lessor to significant risks and benefits associated with the underlying asset. A derecognition approach would be applied to all other leases.

New Zealand FRSB staff

FRSB staff support the derecognition approach for all leases. Derecognising a portion of the leased asset in exchange for a right to receive rental payments is comparable to derecognising inventory on the sale of goods in exchange for a right to receive payment. The derecognition approach is most consistent with the substance of a leasing arrangement whereby the lessor's asset is no longer the whole leased item but is the portion of the leased item remaining after the lessees use thereof. By derecognising a portion of the leased asset, the lessee accounting reflects that the lessor has satisfied a performance obligation created by the lease contract and has no ongoing performance obligation in respect of the right-of-use asset. This approach is also consistent with the lessee accounting model because the lessor must have transferred an asset in order for the lessee to have acquired an asset from the lessor. The performance obligation approach to lessor is inconsistent with the lessee accounting model. It is not clear how the lessee can have received an unconditional right to use the leased asset over the lease term if the lessor continues to have an obligation to permit that use.

FRSB staff consider that scope of any lessor standard should be consistent with the scope of any lessee standard. As such, the scope of the lessor standards should be based on control and supplemented by consideration of the transfer of risks and rewards. The indicators the IASB have proposed are best used to assist in determining whether the contract is a sale of the asset or a lease, not as a means of distinguishing between two types of leases to which differing accounting methods are to be applied.

Pakistan ICAP staff

We have concerns for both approaches.

Under performance obligation approach, the underlying leased asset continues to be accounted for as an economic resource of the lessor and remains on the lessor's balance sheet. The lessor recognizes a lease receivable, representing the right to receive rental payments from the lessee, with a corresponding performance obligation,

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representing the obligation to permit the lessee to use the leased asset. It appears that this treatment will lead to grossed up balance sheet (duplication) and is therefore not supported.

For the derecognition approach, the lessor would derecognize the leased item from its balance sheet and recognize a receivable. In our view a derecognition of asset is not desired as the lessor would still own it and using it to earn income. Further, an initial derecognition and then on completion of lease period, re recognition may not present the economic substance of the transaction. Further how the situation will be handled where the value of asset is significant compared to the value of lease rentals which may be because of the short period of lease or other reasons.

Singapore ASC staff

We are supportive of using the derecognition approach when the lessor do not retain the significant risks or benefits in the underlying asset.

With the performance obligation approach, lessors continue to retain significant risks or benefits of the underlying asset as this treatment allows lessors to continue to recognise the asset in its balance sheet which seems to better reflect the economic substance of the transaction. However, we have concerns on the grossing-up of the assets and liabilities on the the statement of financial position. Also it appears inconsistent with lessee accounting, as we are unsure how the lessee can receive an unconditional right to use the leased asset over the lease term if the lessor continues to have an obligation to permit that use. Some of our constituents are concerned that the proposed accounting leads to front-loading of revenues for lessors.

We noted that Paragraph B26 of the final ED states that the existence of one or more indicators is not conclusive in determining whether the lessor retains exposure to significant risks and benefits associated with the underlying asset. This leaves preparers of financial statements with little guidance on how that judgment is to be made. Further guidance is needed to provide the general principle in the determination of whether the lessor retains exposure to significant risks and benefits associated with the underlying asset. Please also see our response to Q2 as to the challenge for a lessor to distinguish a contract that represent a sale or purchase of the underlying asset and a lease to be recognised under the derecogniton approach.

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DISCUSSION QUESTION 2: CONTRACTS THAT REPRESENT PURCHASES OR SALES OF THE UNDERLYING ASSET

The exposure draft proposes that an entity shall not apply the proposed IFRS to a contract, which represent a purchase or sale of an underlying asset, where the contract results in an entity transferring control of the underlying asset and all but a trivial amount of the risks and benefits associated with the underlying asset to another entity. The criteria² for distinguishing a lease from a contract that represents a purchase or sale are set out in paragraphs B9 and B10 of the ED (paragraphs 8, B9, B10 and BC59–BC62).

- (a) Do you agree with the proposed accounting for a contract that represent a purchase or sale of an underlying asset and do you agree with the criteria in paragraphs B9 and B10 of the ED for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?

Paragraph BC 38 in the Basis of Conclusions on the ED clarifies that long-term leases of land should be within the scope of the proposed IFRS.

- (b) Do you agree that long-term leases of land should be within the scope of the proposed IFRS? Why or why not? Do you think that additional guidance is necessary? If so, what guidance should be provided?

(a) Proposed accounting for a contract that represent a purchase or sale of an underlying asset and the criteria for distinguishing a lease from a contract that represents a purchase or sale

Australia AASB staff

We agree that it is necessary to distinguish a lease from a sale and hence agree that the ED should include criteria for entities to be able to make such an assessment.

China CASC staff

No comments.

Hong Kong HKICPA staff

No. We believe that if a contract meets the criteria of a lease, it should be accounted for based on the lease accounting requirements. We believe that having separate requirements for "in-substance purchases or sales" will add unnecessary rules and requirements to the standard without obvious benefits.

² Criteria for distinguishing between a lease and a purchase or sale

Paragraph B9 in the ED proposes that an entity shall not apply this [draft] IFRS to contracts that meet the criteria for classification as a purchase or sale of an underlying asset. A contract represents a purchase or sale of an underlying asset if, at the end of the contract, an entity transfers to another entity control of the entire underlying asset and all but a trivial amount of the risks and benefits associated with the entire underlying asset. That determination is made at inception and is not subsequently reassessed.

Paragraph B10 in the ED proposes that an entity shall consider all relevant facts and circumstances when determining whether control of the underlying asset is transferred at the end of the contract. A contract normally transfers control of an underlying asset when the contract:

(a) automatically transfers title to the underlying asset to the transferee at the end of the contract term; or

(b) includes a bargain purchase option. A bargain purchase option is an option to purchase the asset at a price that is expected to be significantly lower than the fair value of the asset at the date that the option becomes exercisable. If the exercise price is significantly lower than fair value, it would be reasonably certain at the inception of the lease that such options will be exercised.

An entity that has a bargain purchase option is in an economically similar position to an entity that will automatically obtain title to the underlying asset at the end of the lease term. By exercising its bargain purchase option, the transferee would be able to direct the use of, and receive the benefits from, the whole of the underlying asset for the whole of its life.

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No. We do not agree with the criteria. We believe it is rather rules-based, for example, inclusion of a bargain purchase option results in a contract becoming an "in-substance sale or purchase" but not inclusion of other bargain clauses, eg bargain renewal clause in perpetuity.

Indonesia IAI staff

The guidance on the indicators of control for determining whether a contract is an in-substance sales/purchases of the underlying asset must be consistent with principles that will be adopted in IASB's new revenue recognition standard. Need to discuss and provide additional guidance on how to draw the line between a lease and an in-substance sales/purchases of underlying asset, as it can be seen as a similar issue in separating between operating and financing lease. Having said that, the current guidance offered in IAS 17 can be used as a platform.

Japan ASBJ staff

We do not consider it meaningful much to distinguish a lease from a purchase or sale. We question whether there is a need to draw a line between the sale or purchase of the underlying asset and the derecognition approach. As you mentioned, the IASB and the FASB tentatively decided to use a hybrid approach and that the approach to be used would be determined based on whether the lessor retains exposure to the significant risks and benefits associated with the underlying asset. Considering this tentative decision, it can be argued that main difference between the sale or purchase of underlying asset and the derecognition approach would only be the extent of risks and benefits associated with the underlying asset which lessor would transfer (ie. whether lessor transfers all but trivial risks and benefits or significant risks and benefits). We believe that the sale or purchase of the underlying asset should be considered the approach that encompasses the transactions captured by the derecognition approach as it makes easier to understand and provides one dividing line for two approaches (the performance obligation approach and in-substance purchase/sale, which includes sale and purchase of underlying asset and derecognition approach) for lessor accounting.

Referring to the derecognition approach in this context, we believe the full derecognition approach can be applied instead of partial derecognition approach because, considering the above tentative decisions for the hybrid approach, the situations in which the derecognition approach applies are limited those where the lessor's exposure to the risk and benefits associated with the underlying asset (that is, the residual asset) is not significant and therefore there would not be less of a concern about the overstatement of day one profits at the commencement of the lease. In that case, accounting for the derecognition approach would be much closer to the accounting for the sale or purchase of the underlying asset.

Korea KASB staff

No comments.

Macau CRAC staff

We agree with the criteria for distinguishing a lease from a purchase or a sale. We believe the criteria are sufficient to avoid misclassifying those contracts that are in-substance purchase or sale with financing arrangements as lease contracts. If title is automatically transferred or a bargain purchase option that is reasonably certain to be exercised exists, the lessor may have retained title during the term of the contract simply as a protection against non-payment only.

Malaysia MASB staff

We agree with the proposed accounting for in-substance purchases or sales. Primary indicators of control could be:

- whether ownership / title is transferred to the lessee at the end of the lease term.
- whether lessee is able to sell the asset to another party for the lessee's own benefit without due permission / consent from the lessor once the lessee settles its lease liabilities.

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We believe additional criteria are necessary. For example, conditions that could change the status of very long term leasehold land from in substance purchase to the proposed scope for leases. Also if there are any other legal criteria under specific lease agreement that should be considered in the assessment.

New Zealand FRSB staff

FRSB staff agree with the proposed accounting for in-substance purchases. FRSB staff agree with the criteria for distinguishing a lease from a purchase or sale. It is appropriate to base the distinction on the transfer of control supplemented by the consideration of risks and rewards.

FRSB staff consider the existing IAS 17 *Leases* guidance on distinguishing between finance operating leases to be sufficient. FRSB staff do not consider that further guidance needs to be developed. However, any guidance that is developed should be consistent with guidance in the IASB’s Revenue Project.

Pakistan ICAP staff

We agree. Guidance given on control indicators is sufficient.

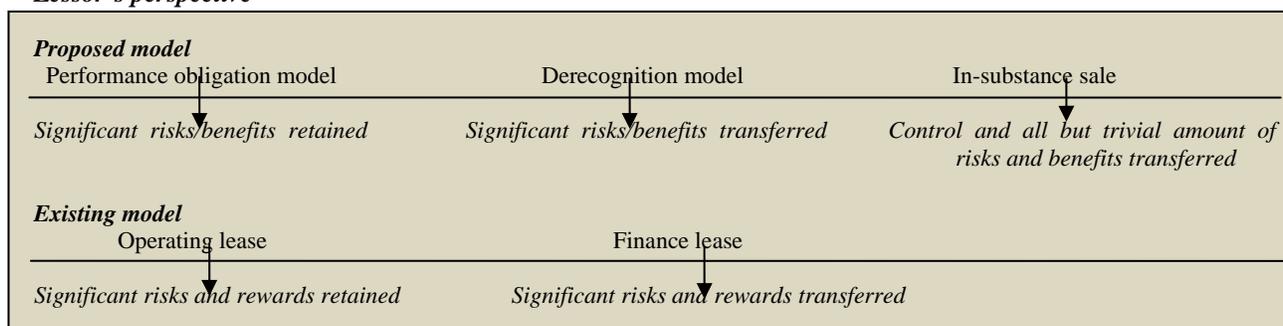
Singapore ASC staff

Consider the following:

- (i) Contracts that represent the sale or purchase of the underlying asset: transfers control and all but trivial amount of the risks and benefits associated with the underlying asset;
- (ii) Leases that fall under the derecognition approach: lessor does not retain exposure to significant risks or benefits associated with the underlying asset.

Current finance leases can fall under (i) or (ii) under the proposed ED depending on the extent of risks and benefits transferred to the other entity, and depending if control is transferred. The criteria requires a fair degree of judgement in order to differentiate the extent of risks and benefits transferred to the other entity so as to determine whether the contract should be accounted for as a lease or a contract that represent a sale or purchase of the underlying asset. How do we draw the line between “all but trivial amount of the risks and benefits” as opposed to “significant risks or benefits”? Thus it opens the way to structuring if the accounting for lease and in-substance purchases or sales is significantly different.

Lessor’s perspective



A suggestion is to remove the separate requirements for in-substance purchases or sales as the complexity of distinguishing leases from sales/purchases seem to outweigh the benefits. Thus we think that the proposed accounting for in-substance purchases may not be necessary.

The ED includes 2 indicators where the lease contract is a in-substance sale or purchase, ie. (a) automatically transfers title to the underlying asset to the transferee at the end of the contract term, (b) includes a bargain purchase option and it is reasonably certain that the transferee will exercise the option. Additional examples would be useful

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in considering what is considered “significantly lower” and “reasonably certain” in determining whether a purchase option is a bargain purchase option.

(b) Long-term leases of land

Australia AASB staff

Agree.

China CASC staff

No comments.

Hong Kong HKIPCA staff

We do not believe it is necessary to have additional guidance and criteria for long term leases, as it would add complexity without obvious benefits; for instance how would the proposed treatment for long term leases as "in-substance sales or purchases" vary from the proposed lease accounting treatment?

Indonesia IAI staff

Generally agree that long-term leases should not be excluded from the scope. Further guidance for long-term leases of land can also be applied to leases of all indefinite life assets. Long-term lease of land in Indonesia currently considered as an asset (in-substance sales/purchases). It is seen as a purchase of the right to use the land for a period of time, and can be extended indefinitely with minimum requirements, provided that the owner (purchaser) use the land according to the agreement with the landholder (government).

Accounting for land in Indonesia is regulated by a standard that has not been updated since 1998. In this standard, land is accounted as a fixed asset. It has been acknowledged that this standard is not aligned with the spirit of IFRS. This issue is in The Indonesian Financial Accounting Standard Board’s convergence agenda.

The law regarding land in Indonesia differentiates the right over land into four different categories:

- Right of ownership.
- Right to control and use – right to control and use the land over the period of 95 years.
- Right to build – right to build and own unit/building over land owned by other entities. The right is strictly for the building and not the land. The period of use is 80 years.
- Right to use – right to use and obtain benefits from land controlled by government or other entities over the period of 70 years.

All rights present the right holders with title over the land during the “lease” period, that is the name of the right holders is stated in the land title. Other than the right of ownership, all three rights can be extended indefinitely through an extension mechanism submitted to the governing bodies, with a minimum amount paid to the government. As long as the purpose/objective of the rights does not go against any government laws they can be extended with minimum requirements. An evaluation over the land and the agreement of use between the landholders and the right holders is performed by the government in this mechanism, ensuring the condition, nature, and objective of the given rights are still aligned with what has been agreed in the initial agreement.

Government has the right to discontinue the rights over land given to right holders if the right holders judged to have neglect/abandon the land, harm public interest, and use the land not according to what has been agreed on the initial agreement. In the case of land being deserted by the right holders, government has the right to take control over the land. Also, in the case of land takeover for public/social interest, government has the right to take over the land according to the objective and required to pay compensation to the right holders.

Thus, land can be accounted as fixed asset due to the nature of the rights given over the land, and how they can be extended indefinitely, making the nature of the rights in essence similar to right of ownership over the land.

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One issue with treating long-term lease of land as a finance lease is the infinite useful life of the land. Considering that it will be depreciated based on the lease term, it is difficult to determine the term since the lease can be extended indefinitely. Due to the indefinite nature of the rights, one possible suggestion that can be considered is to treat the rights as intangibles with indefinite useful life, thus making it subject to impairment every period, and the option of using the revaluation model is there.

We believe that in order to draw the line between lease and sale/purchase of underlying asset one must consider the nature (substance) of the contract, and not the length of the lease term and the size of the initial payment. Need to provide some guidance regarding circumstance like this, on how it can be addressed. The new proposed lease standard must be able to cater for this type of long-term lease, at the very minimum provide guidance on how this can be recognized for accounting purposes. Our proposal is: to keep the ED silent about land so user can use the professional judgment according to IAS 16, IAS 38 or IAS 17, or to clarify in the ED leases that for land it is scope out and users need to exercise their judgment on leasehold land.

Japan ASBJ staff

There are long term (from 30 to 70 years) land leases in Japan, in which premium or key money are paid in advance at the inception. Some of those transactions are substantively considered as a lease and the other are substantively considered as a partial transfer of the land. Consequently, we believe it would be inappropriate to draw the line between leases and purchases or sales of underlying assets depending on the length of lease term and the size of initial payments. We believe that it should be judged considering the nature of the contract.

Korea KASB staff

No comments.

Macau CRAC staff

No comments.

Malaysia MASB staff

We believe additional criteria are necessary. For example, conditions that could change the status of very long term leasehold land from in substance purchase to the proposed scope for leases. Also if there are any other legal criteria under specific lease agreement that should be considered in the assessment.

New Zealand FRSB staff

Additional guidance would be helpful. For example, if the IASB were to use the guidance in paragraph 10 of IAS 17 to determining if there has been an in-substance purchase or sale, a long lease might fail criteria (a) to (c), but pass criterion (d). This may not be an issue for the lessee under a leasing model that results in operating leases being recognised on-balance-sheet, however, for the lessor, whether the lease is an in-substance sale or a lease will be cause for concern.

Pakistan ICAP staff

In many countries very long leases like purchase of leasehold land is shown as assets as in substance it is a purchase rather than a lease. Further, these leases are renewable at a very nominal amount and at the time of resale title usually passes from the seller (i.e. the lessee) to the purchaser (i.e. sublessee) directly without the involvement of the initial seller (i.e. lessor). Currently this practice is not compliant with the extant IAS 17 too. It is therefore suggested that some guidance should be provided so that this situation could be addressed. That guidance should include as to what is considered to be a 'long term lease' in relation to real estate.

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In Pakistan, the leasehold land is usually held for a specific period of time (usually a maximum of 99 years) in Pakistan. Further, the Companies Ordinance 1984 (the local corporate law) requires that the leasehold land should be classified under fixed assets. As the requirements of the Companies Ordinance, 1984 prevail over those of the International Financial Reporting Standards, therefore the leasehold land is accounted for as a part of fixed assets and not as an operating lease. It is to be noted that in majority of the leases, the lease costs, where the government is the lessor, are not material. This lease cost is usually paid upfront.

Further, recording a transaction involving a long leasehold interest as an operating lease would not accord with the economic reality underlying such a transaction. Transactions involving purchases of such leasehold interests which typically contain a large component of land costs usually have the following characteristics:-

- (i) The buyer (or lessee) has in fact acquired an asset with an upfront payment;
- (ii) the lessee has acquired the right to do a variety of things with the leasehold interests just as if these leasehold interests were outright purchases, like freehold properties;
- (iii) the lessee's interest is for a reasonably long and a definite period of time;
- (iv) the lessee can transfer his interest and obligations to others whereas on the other hand a lessor can neither use the land nor can it sell it for a gain if the price of such land goes up; and
- (v) the legal structure governing the conveyance of long leasehold interests in Pakistan effectively treats a sale and purchase of such interests as a complete transfer of risks and rewards incident to ownership of those interests which is considered to be the acid test for recognition of an asset.

In view of the specific features discussed above a lessee will have an issue in accounting for leasehold land as a lease rather than as a part of PPE as instead of the asset (i.e. land) an asset (i.e. right to use) will be recorded and the corresponding liability of performance obligation will not be recorded as the same would not arise due to a full payment having been made up front. The asset's right to use will have to be amortised over the lease term of the asset while in the case of land no depreciation is usually charged at present as its fair value is always assumed to be much higher and expected to increase. As the lessor is usually the government therefore the upfront receipt would be accounted for as a part of its current revenues. If the lessor is not a government agency even then the upfront receipt would be considered as a proceed on sub-leasing/disposing of the leasehold land and be set off against the upfront payment made by it at the time of the original transaction with a gain/loss (proportionate/full) on sub-lease being recognised.

Singapore ASC staff

We agree. Definition of long-term lease is arbitrary and scope exclusions should be assessed from the nature of the lease contract. Thus long term leasehold land would not meet the definition of a purchase or sales of the underlying asset and has to be accounted for under the new leasing model as the land title would revert back to the freeholder of the land at the end of the lease term, even though that liability for lease rentals would be minimal (as the premium paid upfront would comprise substantially the whole of the PV of all payments under the lease). The ED proposal to allow the revaluation model is welcomed as it would allow such leasehold interests (which are not investment properties carried at fair value) to be revalued.

However the Boards need to address the lease accounting for land and building to ensure consistency in application. Take an example of a long lease of land for 999 years with a building on it with a life of 50 years, from a lessor's perspective, this may result in having to adopt the derecognition approach for the building and the performance obligation approach for the land. It follows that the lease payments should be split into the two components to account for the lease of land and the building. The Boards should provide further guidance and illustrative examples in this area, such as that in the existing IAS 17 *Leases* on the allocation of lease payments for leasehold land and building and the accounting treatment where reliable allocation between the land and building components is not possible.

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DISCUSSION QUESTION 3a: MEASUREMENT OF LEASE TERM

The exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that assumes 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 (paragraphs 13, 34, 51, B16–B20 and BC114–BC120).

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? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

Australia AASB staff

We agree with the Board's proposals regarding lease term. We also agree with the proposals to include contingent rentals and residual value guarantees (RVG) in the measurement of lease assets and liabilities. We think that uncertainty should be accounted for consistently across standards and hence these proposals should be consistent with any decisions made in respect of the IAS 37 *Liabilities* project.

China CASC staff

No comments.

Hong Kong HKIPCA staff

No, we do not agree. We do not believe it is appropriate for a lessor to recognise lease receivable asset based on the longest possible lease term that is more likely than not to occur, as it will result in overstatement of the valuation of the asset and liability. We consider that the liability to pay rentals does not exist unless and until the option is exercised by the reporting entity. We do not believe that there is any present obligation arising in respect of the option, and hence the possible future rentals in the extended period do not meet the definition of a liability. The option, however, meets the definition of an asset and the premium for the option would have been included in the rentals for the initial period.

We recommend that only those renewal options for which there is no commercial likelihood of non-renewal and early-termination options that have no commercial effect in practice should be included as part of the lease term. In extreme cases, there will be no genuine commercial possibility that an option will fail to be exercised, in which case its future exercise should be assumed. For example, a transaction may be structured in such a way that the cost of exercising a renewal option will almost inevitably be lower than the benefits obtained from its exercise. In less extreme cases, further analysis will be required. It may be necessary to consider the true commercial objectives of the parties and the commercial rationale for the inclusion of such options in the transaction. This may reveal either that the parties in substance have outright obligations and access to benefits, or, alternatively, that the parties' obligations and access to benefits are genuinely optional or conditional. If the Boards agree with our proposal, additional guidance will be needed to determine how assessments of genuine options would be performed.

However, if the boards retain its proposal of recognising options when determining an obligation to pay rentals, we support the IASB's proposed approach to take into account the most likely lease term. The accounting under this approach would more closely reflect the expectations of management when deciding to undertake the lease and "most likely" is a concept that should not be too difficult to apply in practice.

Indonesia IAI staff

No comments.

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Japan ASBJ staff

No comments.

Korea KASB staff

No comments.

Macau CRAC staff

We support the approach to assume the lease term as the longest possible term that is more likely than not to occur taking into account the effect of the options to extend or terminate the lease. This approach is less costly for preparers to apply as compared to the other approaches (for example, the component or probability-weighted measurement approach), while at the same time, provides users with a more accurate measurement than the disclosure approach.

Malaysia MASB staff

No comments.

New Zealand FRSB staff

FRSB staff agrees that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements. Consistent with the IASB's move towards addressing uncertainty through measurement rather than through recognition, FRSB staff agrees that the lessee's estimate of its obligation to pay contingent rentals should be a probability-weighted estimate. However, this approach is not consistent with the proposed approach to renewal, cancellation and purchase options. We recommend that the IASB clarify the reason for the difference in approach. The difference in approach may be explained on the basis that there is a difference between the exercise of a discrete renewal, cancellation or purchase option compared with contingent rentals for which a range of outcomes is possible.

Pakistan ICAP staff

No comments.

Singapore ASC staff

We agree that the 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.

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DISCUSSION QUESTION 3b: MEASUREMENT OF LEASE PAYMENTS

The exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21 and BC121–BC131).

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? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?

Australia AASB staff

We believe that the obligation measurement should be consistent with those techniques developed in the current liability (revision to IAS 37) project.

China CASC staff

No comments.

Hong Kong HKIPCA staff

For contingent rentals, we agreed to the IASB's view that those linked to the performance of the asset should be treated differently from other variable payments (e.g. those linked to an index). The most common example is turnover-based rents paid by retailers (e.g. in shopping arcades). As the mix of tenants and overall management of the arcade is outside the control of an individual retail unit lessee but can have a direct impact on the success of the individual retail unit, it is very common to have a significant portion of the rent being contingent on turnover. We consider that a payment that is linked to the performance of the lessee should be expensed as incurred and should not be accrued as estimated liabilities.

For the other variable payments, we support the approach of measuring the obligation to pay rentals on the basis of the most likely rental payment because it is simpler to apply than the probability-weighted approach and the resulting information is understandable.

Indonesia IAI staff

Agree that the expected outcome technique would be sufficient, considering that the final requirements would clarify that not every possible scenario would need to be taken into account when measuring the obligation/receivable. It should take into consideration the technique that will be introduced in the revision to IAS 37. Need to provide practical guidance and example to clarify the mechanism of the process.

Japan ASBJ staff

It would not be practicable to require an entity to reasonably determine the probability and expected amounts for all contingent rental arrangements at the inception of the lease and we are concerned about the reliability of its outcome. We are considering an alternative view on this issue.

Korea KASB staff

No comments.

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Macau CRAC staff

We agree that contingent rentals and residual value guarantees that are specified in the lease contract should be included in the measurement of lease assets and lease liabilities using an expected outcome technique. This requirement avoids lease contracts to be structured with a minimal/zero fixed payment and high contingent rentals in order to minimize the obligation to be recognized. We believe the expected outcome technique provides a more reliable measurement of the obligation / receivable. Since the final requirements would clarify that not every possible scenario would be needed to take into account, the approach would not be too costly for preparers to apply.

Malaysia MASB staff

We disagree with the Boards tentative decision to use an expected outcome technique to measure the lessee's obligation on the contingent rental payable. We are concerned the approach would be subject to abuse as the entity need not need to take into account every possible scenario. In addition, although the approach may give a moderated effect of the lessee's obligation to pay rentals, it may result in the measurement of a liability that reflects an outcome which may not happen nor more reliable that the most likely approach as both methods are an estimation process that requires the use of judgement.

New Zealand FRSB staff

FRSB staff agrees that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements. Consistent with the IASB's move towards addressing uncertainty through measurement rather than through recognition, FRSB staff agrees that the lessee's estimate of its obligation to pay contingent rentals should be a probability-weighted estimate. However, this approach is not consistent with the proposed approach to renewal, cancellation and purchase options. We recommend that the IASB clarify the reason for the difference in approach. The difference in approach may be explained on the basis that there is a difference between the exercise of a discrete renewal, cancellation or purchase option compared with contingent rentals for which a range of outcomes is possible.

Pakistan ICAP staff

We agree with the approach as this appears to be logical.

Singapore ASC staff

We support the use of the "best estimate" approach, ie. based on the most likely rental payment, rather than the expected outcome approach. Rather than mandating the use of the "probability-weighted" approach for the measurement of lease payments in all cases, we think that the Boards should permit the use of the "most likely" approach (particularly in single item or small portfolio situations) if this approach results in more relevant and decision-useful financial information.

In a probability-weighted model, an entity would need to consider the existence of a continuum of outcomes, thus making the technique complex to implement in practice. Though the ED clarifies that the expected outcome approach is to be applied for a reasonable number of outcomes, this may also mean that the approach would be subject to abuse as the entity need not need to take into account every possible scenario. Whilst the use of a statistical method based on possible outcomes and probabilities typically works well for large homogeneous populations, we do not believe that it is generally appropriate for single item or small portfolios as there is often no or insufficient historical data. In many circumstances, the expected outcome approach would not be an appropriate basis for measuring the amount of contingent rentals and residual value guarantees and hence would be no more accurate than a most likely rental payment estimate.

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DISCUSSION QUESTION 4: PURCHASE OPTIONS

The exposure draft proposes that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraphs 8, BC63 and BC64).

Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?

Australia AASB staff

Given that the Board has decided to include lease terms based on the probability of occurrence, we see no reason that purchase options should be treated any differently to options over the lease term.

China CASC staff

We noticed the discussion of the accounting for purchase option and agree on the tentative decision reached by the boards. That is, both lessees and lessors should account for purchase options only when they are exercised. We think it is more workable and easy in practice, because it can greatly reduce the judgments between leases and purchases/sales, and about whether the purchase option be exercised more likely than not, etc.

Hong Kong HKICPA staff

We agree that a contract ceases to be a lease when an option to purchase the underlying asset is exercised and should be accounted as a purchase as this essentially represents the termination of the right of use of the asset and the lessee is being granted access to the underlying asset instead.

Indonesia IAI staff

No comments.

Japan ASBJ staff

This issue is still under discussion.

Korea KASB staff

No comments.

Macau CRAC staff

We support the Boards tentative decision to account for purchase options when they are exercised because we do not view purchase option as an option to extend the lease over the whole economic life of the underlying asset. In our opinion, when a lessee exercises a purchase option, it terminates the lease and purchases the underlying asset. To account for purchase options in the same way as option to extend the lease requires the lessor to determine if the lessee will exercise the purchase option and this judgment is rather subjective.

Malaysia MASB staff

No comments.

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New Zealand FRSB staff

The FRSB staff considers that, for consistency, purchase options should be accounted for in the same way as options to extend or terminate the lease. Therefore, if it is likely that an entity would exercise the purchase option, the contract should be accounted for as the purchase of the underlying asset. Suggesting that the lease contract only ceases to be a lease upon exercising of the option places undue emphasis of legal form over substance and is inconsistent with the IASB's proposals in its revenue project. In our view, holding a currently exercisable option to acquire control is sufficient to demonstrate that the holder already controls the leased asset because the holder of the option can, at any time, unilaterally and without the consent of any other party, take ownership of the asset.

Singapore ASC staff

We tend to agree that purchase options should be accounted for when they are exercised, as a contract ceases to be a lease when purchase option is exercised. Purchase options are seen as fundamentally different from renewal options - a renewal option provides an additional period of a right to use while a purchase option gives access to the underlying asset. These are different in substance and require different accounting. Thus the exercise price of the option is not a lease payment and should not be included in the measurement of assets and liabilities arising from a lease contract. The above discusses the treatment of purchase options in general. We noted that bargain purchase options are to be considered when determining if a transaction is a lease or a purchase or sale.

However the opposing view of some constituents is that purchase options are similar to lease extension options hence the accounting should be consistent. Providing a purchase option is essentially the same as providing renewals that extend over the entire economic life of the lease. Consider a 5-year lease of an asset usable for 10 years. A enters into 5-year lease with 5-year extension option that is likely to be exercised, while B enters into a 5-year lease with purchase option that is likely to be exercised. Scenarios for A and B are essentially similar, but scenario A will result in a larger lease asset and liability than B. Thus we suggest that the final IFRS should clarify that the underlying substance of the lease option, rather than the terminology used for the lease option should be assessed in determining its accounting. A lease renewal option that allows renewal of the lease for the entire economic life of the asset would be no different in substance as compared to a purchase option.

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DISCUSSION QUESTION 5: CONTRACTS WITH SERVICE AND LEASE COMPONENTS

The exposure draft proposes that lessees and lessors should apply the proposals in Revenue from Contracts with Customers to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B5–B8 and BC47–BC54). If the service component in a contract that contains service components and lease components is not distinct:

(a) the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.

(b) the IASB proposes that:

(i) a lessee should apply the lease accounting requirements to the combined contract.

(ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.

(iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements, and the service component in accordance with the proposals in Revenue from Contracts with Customers.

Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

Australia AASB staff

We agree that components of a contract with distinct elements should be split. However we do not agree with the default to lease accounting. The entity should look to the underlying substance of the transaction and account for it accordingly.

China CASC staff

No comments.

Hong Kong HKIPCA staff

We disagree that the lease accounting requirements should be applied to the whole contract. The guidance on whether a contract contains service and lease components that are distinct is rather rule-based and will result in contracts that clearly contains service components to be accounted for as wholly lease payments, even though portions of the payments under the contract are for future services to be rendered by the lessor.

Indonesia IAI staff

Generally agree. The lease component and the service component in the contract are different in nature and should be accounted according to the appropriate approach. It is essentially two contracts in one, thus the service element must be extracted and treated outside the lease as a standalone contract. We acknowledge the fact that it would be difficult to separate this in practice, however it would inappropriate to automatically “dump” all the arrangement as payment of lease. The reasons behind the decision and why it is not practical to separate the payments must be disclosed properly.

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Japan ASBJ staff

We agree with these treatments for lessee. We do not agree with these treatments for the lessor using the derecognition approach. We believe it should not be required to bifurcate non-distinct services from the lease components because it should be consistent with the proposed revenue recognition model (although the notion of distinct function and distinct margin described in the revenue recognition ED should be clearly articulated more.). Also, based on the application guidance to distinguish the performance obligation approach and the derecognition approach, revenue from leases with non-material distinct service are recognized over the lease term under the performance obligation approach. Therefore, it would be less of a concern for the overstatement of day one profits at the commencement

Korea KASB staff

No comments.

Macau CRAC staff

We agree with the lessee requirement to account for contracts containing service and lease components that are not distinct as lease contract as a whole. However, we do not agree with the requirement that lessor (using the derecognition approach) should bifurcate non-distinct services from the lease components because this is inconsistent with the proposed revenue recognition requirements for recording non-distinct services as a single performance obligation.

Malaysia MASB staff

The Boards tentatively decided that both lessors and lessees would be required to evaluate whether the lease payments should be allocated between service and lease components, considering all concurrently negotiated contracts with a third party and the Boards also tentatively decided that if the lessor or lessee is unable to allocate the total payments among the service and lease components of an arrangement, the entire arrangement should be considered and accounted for as a lease - We agree with the proposal to require lessors and lessees to evaluate whether the lease payments should be allocated between service and lease components, considering all concurrently negotiated contracts with a third party.

New Zealand FRSB staff

It is necessary to ensure that accounting appropriately represents the substance of the entire arrangement between parties to the arrangement. Therefore, FRSB staff support the IASB's tentative decisions except for the requirement that a lessor (using the derecognition approach) should bifurcate non-distinct services from the lease components. This is because, if the services are truly non-distinct, then it is difficult to see how a lessor might be able to distinguish the services from the lease component. This proposal would also be in conflict with the IASB's proposals in its revenue project whereby entities are not required to account for performance obligations separately if the performance obligations relate to goods or services that are not distinct or are delivered at the same time.

Pakistan ICAP staff

The Boards tentatively decided that both lessors and lessees would be required to evaluate whether the lease payments should be allocated between service and lease components, considering all concurrently negotiated contracts with a third party and the Boards also tentatively decided that if the lessor or lessee is unable to allocate the total payments among the service and lease components of an arrangement, the entire arrangement should be considered and accounted for as a lease - The Board's proposals appear to be appropriate.

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Singapore ASC staff

We agree that lessees should split components of a contract with distinct service and lease components. If the service component can be identified to be distinct, it would be rare that an entity would not be able to allocate the payments between the components. However, where the service component is not distinct from the lease component, the substance of the arrangement should be assessed to determine whether the entire contract meets the definition of a lease for both lessees and lessors.

We noted IASB's rationale that a lessor (using the derecognition approach) is required to bifurcate non-distinct services from the lease components to ensure that income from the service component is not recognized before the lessor provides that service. However we believe the costs of bifurcating non-distinct services from the lease components by the lessor outweigh the benefits of the information to users. In addition, if the services are truly non-distinct, it is difficult to see how a lessor might be able to bifurcate the services from the lease component. It is also inconsistent with the proposals in the boards exposure draft *Revenue from Contracts with Customers*. We think that lessors should not bifurcate non-distinct services from the lease components in a lease arrangement under the derecognition approach to lessor accounting. The more fundamental issue would be for the Boards to ensure that the criteria for identifying distinct elements are appropriate and sufficient, which uses the same principles as those in the ED *Revenue from Contracts with Customers*.

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DISCUSSION QUESTION 6: INVESTMENT PROPERTIES

The exposure draft proposes that an entity shall apply the proposed IFRS to investment property that it holds under a lease. However:

(a) after initial recognition, a lessee may measure a right-of-use asset in accordance with the fair value model in IAS 40 Investment Property. The lessee shall recognise in profit or loss changes in the liability to make lease payments arising after initial recognition in accordance with IAS 40.

(b) a lessor shall apply IAS 40 and not this [draft] IFRS to leases of investment properties

Do you support the proposed approach? Why or why not?

Australia AASB staff

Bringing investment properties measured at cost into the new lease accounting will still cause concerns with the lessor 'doubling-up' on the balance sheet its cash flows from the leased asset . We believe that IAS 40 should remain the accounting for all investment property (and should possibly be extended to apply to all [non-financial] investment assets).

China CASC staff

No comments.

Hong Kong HKICPA staff

We do not believe that it is desirable to have very different accounting treatment for lessors having similar leases, depending on whether the lessor adopts the fair value model or not for its investment properties. We also see inconsistency issues if this proposal is adopted for property, plant and equipment which have been revalued, ie leases of revalued PPE are accounted for using the proposed lessor lease accounting treatment, but leases of revalued investment properties aren't.

Indonesia IAI staff

Generally agree. This will solve the “duplication” of asset issue in the performance obligation approach. Also, the introduction of fair value is more aligned with the purpose of providing more relevant information and depiction of the lessor’s financial position. We acknowledge the fact that different entities might choose to use different cost basis, and this will lead to inconsistency and the lack of comparability between entities.

Japan ASBJ staff

We are still under consideration but we are concerned that it would be inconsistent to treat accounting model differently depending on the type of the underlying asset (ie. depending on whether it is real estate or machine)

In addition, in our understanding, the tentative decision for investment properties are made mainly for the purpose of addressing the concerns for double counting under performance obligation approach raised by constituents in investment property industry (except for the issue of the presentation of income). If so, as the IASB and the FASB tentatively decided to take a net presentation approach under performance obligation approach subsequent to the discussion for investment property, we think the concerns raised for investment properties no longer be appropriate given the current tentative decisions.

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Korea KASB staff

No comments.

New Zealand FRSB staff

FRSB staff do not support the proposed approach. The fact that the new lessor accounting model does not provide useful information for all lessors, whether they measure their investment property at cost or fair value, casts doubt over whether the model is appropriate in the first place.

If the IASB proceeds with exempting from the scope of the new leases standard investment property, FRSB staff consider that both investment property at cost and investment property at fair value ought to be exempted. It could be argued that there is an economic difference between leasing out a long-lived appreciating asset (such as land and buildings) and leasing out a short-lived depreciating asset (such as most plant and equipment). This stems from the fact that granting a lessee a right-of-use over short-lived depreciating assets has a significant impact on their residual value. In this case it makes more sense to unbundle the leased asset into the account receivable and the residual asset. For long-lived investment property however, the IAS 40 approach may provide more useful information for both investment property at fair value and investment property at cost.

Macau CRAC staff

We support the proposed approach to account for investment properties.

Malaysia MASB staff

We support the proposed approach to account for investment properties.

Pakistan ICAP staff

We agree.

Singapore ASC staff

We support the proposed approach that the lessor would measure its investment properties at fair value in accordance with IAS 40 *Investment Properties* rather than using the new lessor accounting requirements. This would present more decision –useful information to users in this industry which value the fair value information.

However the new lessor accounting requirements would be required if the lessor measures its investment properties at cost. The different treatment on the leases would result in the financial statements of companies engaging in the same leasing business becoming not comparable if the companies adopt different cost bases for their properties. Whether the investment property is carried at cost or fair value has no bearing on the leasing activity. To avoid confusion, one way is to scope out all investment properties (accounted at fair value and at cost) from the proposed lease requirements and to address all issues relating to investment properties under IAS 40.