



December 15, 2010

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

Dear Board Members:

Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera (CINIF), the accounting standard setting body in Mexico, welcomes the opportunity to submit its comments on the Exposure Draft on *Leases* (the ED), issued for exposure in August 2010. Set forth below you will find our comments on the topics included in the ED, as well as our responses to the questions included therein.

We have divided our letter in two sections. In the first section you will find our general comments on the ED. The second section includes our responses to the specific questions raised in the ED.

General comments on the ED

In general, we support the coordinated efforts of the IASB and the FASB to issue this joint exposure draft on leases. Although we recognize that the current model for accounting by lessees may not accurately reflect the underlying economics of the lease arrangement in the statement of financial position, some of the members of our Board believe the uncertainties related to the recognition and measurement of the related assets and liabilities outweigh the potential benefits of the proposed changes to the lessee accounting model. Some believe that expanded disclosures by lessees should be sufficient to adequately communicate to financial statement users the rights and obligations under lease arrangements.

On the other hand, as a Board we are not convinced that the proposed models for accounting by lessors represent an improvement over the existing accounting model for lessors. Further, the proposed model for lessor accounting, specifically the performance obligation approach, is aligned with neither the proposed model for lessee accounting nor the recently proposed standard for revenue recognition from contracts with customers.

In addition to our general comments above, we have specific concerns regarding the proposed lease accounting models, including:

- The treatment of optional renewal periods
- The inclusion and measurement of contingent rentals

- The criteria to distinguish in-substance purchase and sale transactions from leases

Our concerns are explained in the response to the specific questions raised in the ED.

Our responses to the specific questions raised in the ED

The accounting model

The exposure draft proposes a new accounting model for leases in which:

- (a) a lessee would recognise an asset (the right-of-use asset) representing its right to use an underlying asset during the lease term, and a liability to make lease payments (paragraphs 10 and BC5–BC12). The lessee would amortise the right-of-use asset over the expected lease term or the useful life of the underlying asset if shorter. The lessee would incur interest expense on the liability to make lease payments.*
- (b) 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 and BC23–BC27).*

Question 1: Lessees

- (a) Do you agree that a lessee should recognise a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?*

Our Board is divided on the response to this question. All members of the Board recognize that existing lease accounting has long been criticized for not requiring the recognition of a right-of-use asset and the corresponding liability to make lease payments in the statement of financial position. However, some Board members believe their concerns about the recognition and measurement of the related assets and liabilities, as explained in our response to the questions that follow, exceed the potential benefits of recognizing the right-of-use asset and related lease liability. They believe that the liability related to leases previously classified as operating leases is incurred over time through the use of the underlying asset. Further, frequent renegotiation of lease terms makes up-front measurement of the liability virtually unreliable. Those Board members believe that expanded disclosures by lessees should be sufficient to adequately communicate to financial statement users the rights and obligations under lease arrangements. Other Board members agree with the recognition of a right-of-use asset and a lease liability.

- (b) Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?*

If the right-of-use asset is recorded, then yes, we agree that a lessee should recognize amortization of such asset and interest on the liability to make lease payments.

Question 2: Lessors

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

No, we do not agree. Specifically, we do not believe the performance obligation approach is conceptually consistent with lessee accounting or with the revenue recognition principles outlined in the outstanding revenue recognition proposal. If the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term, then a receivable should not be recorded and the lease arrangement should be treated as a service contract, under which revenue would be recognized on a straight-line basis over the term of the lease contract, equivalent to the continuous transfer concept addressed in the revenue recognition proposal.

(b) 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?

No, we do not agree. As proposed, the performance obligation approach results in the recording of two assets representing the same cash flow potential, one being the leased item and the other being the receivable for the right to receive payment during the lease term. This would result in significantly inflating the lessor's statement of financial position. The presentation of a net lease asset pursuant to paragraph 42 of the ED mitigates, but does not eliminate, this concern.

On the other hand, while we believe the derecognition approach is consistent with the right-of-use model for lessee accounting, it is not entirely consistent with the proposed revenue recognition standard as it is based on the exposure to significant risks and rewards associated with the underlying asset as opposed to the transfer of control concept in the revenue proposal. Additionally, when the lessor has not retained any significant risk or benefit related to the underlying asset, this suggests that the underlying asset has effectively been sold. Accordingly, in these cases we do not agree with partial derecognition of the underlying asset and recognition of a residual asset as a retained interest. We prefer the full derecognition approach as in existing lease accounting.

Question 3: Short-term leases

The exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is twelve months or less:

(a) At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognise lease payments in profit or loss over the lease term (paragraph 64).

(b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognise assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit or loss over the lease term (paragraph 65).

(See also paragraphs BC41–BC46.)

Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

Yes, we agree with the simplified requirements for short-term leases, since the impact on financial information would not be significant.

Definition of a lease

The exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1–B4 and BC29–BC32). The exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59–BC62) and on distinguishing a lease from a service contract (paragraphs B1–B4 and BC29–BC32).

Question 4

(a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?

Yes, we agree that a lease is defined appropriately.

(b) Do you agree with the criteria in paragraphs B9 and B10 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?

No, we do not agree. The basic difference between a lease and a sale is that at the end of the lease term, the lessee has the ability to return the underlying asset to the lessor. Accordingly, instead of a risks and benefits analysis we believe paragraph 8 should focus on the likelihood that the underlying asset will be returned to the lessor at the end of the lease term. In the event such likelihood is remote, the contract should be considered a sale and not a lease.

(c) Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

No, the guidance appears to be insufficient. The guidance was essentially carried forward from existing literature, which has resulted in numerous practice issues that are not considered critical because distinguishing between an operating lease and a service contract does not currently have significant accounting implications. On the other hand, under the ED there is a significant difference between accounting for service contracts and the proposed right-of-use model, which makes it critical that the new standard amend and expand the guidance to address these issues.

Scope

Question 5: Scope exclusions

The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33–BC46).

Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and why?

No. We do not agree with the exclusion of intangible assets from the scope of the ED. We note that the Boards themselves have identified no conceptual reasons for the exclusion of intangible assets, and we have not identified any either.

Additionally, lease contracts may contain both tangible and intangible components, in which case the complexity of separating the contract and accounting for the tangible and intangible components under different standards would not appear to be beneficial.

Question 6: Contracts that contain service components 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?

We agree that both lessees and lessors should apply the proposals in the revenue recognition proposal to a distinct service component of a contract that contains service components and lease components.

On the other hand, if the service component in a contract that contains service components and lease components is not distinct, we view the lease contract as a single unit of account for which the lessee and lessor should apply lease accounting to the combined contract, which is what both the FASB and IASB propose, with one

exception under the IASB proposal (see *iii* above). With respect to that exception, we believe that the derecognition approach by a lessor should not be allowed when the service components are substantive, since such approach could result in the recognition of revenue before it can be demonstrated that the related performance obligation has been satisfied, as required by the revenue recognition proposal.

Question 7: 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?

No, we do not agree that a lessee or a lessor should account for purchase options only when they are exercised, especially since this is inconsistent with the proposed treatment for renewal options, which are to be considered in the measurement of a lease obligation. Both purchase options and renewal options can give the lessee the ability to control the underlying asset and should be considered when there is reasonable assurance that the option will be exercised. For example, with respect to purchase options, one would expect that reasonable assurance exists when there is a bargain purchase option.

Measurement

The exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that:

- (a) 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).*
- (b) 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). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be measured reliably.*
- (c) is updated when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments, including expected payments under term option penalties and residual value guarantees, since the previous reporting period (paragraphs 17, 39, 56 and BC132–BC135).*

Question 8: Lease term

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?

No, we do not agree with the inclusion of renewal options that are more-likely-than-not to be exercised. Rather, as for purchase options, we believe that the lease term should only include renewal options that are reasonably assured of being exercised. With respect to purchase options, one would expect that reasonable assurance exists only when the lessee is economically compelled to exercise the option.

Question 9: Lease payments

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?

We agree conceptually with the proposed treatment of contingent rent payments and payments from residual guarantees for lessees. However, we do not agree that all 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. First of all, we believe that only those amounts that are not within the control of the lessee should be included. Amounts that are within the control of the lessee should be excluded. Secondly, we are unconvinced that an expected outcome technique based on the present value of the probability-weighted average of the cash flows for a reasonable number of outcomes is better than a most likely outcome (best estimate) approach.

Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be measured reliably? Why or why not?

Yes, we agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be measured reliably.

Question 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

Yes, we agree there should be periodic reassessment of estimates of both lease terms and contingent payments that could result in a significant change in the lease asset or liability.

Sale and leaseback

The exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the

underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents the sale of the underlying asset, the leaseback would also meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66–67, B31 and BC160–BC167).

Question 11

Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?

No, we do not agree. We believe that sale and leaseback accounting should only result in a sale if the criteria established in the revenue recognition proposal are met. The criteria in B31 should be no more or less restrictive than the criteria for recognizing a sale pursuant to the revenue recognition proposal, which is not currently the case. We believe the Boards should deliberate further the criteria in B31 and consider whether, and how, those criteria should interact with the revenue recognition proposal.

Presentation

The exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25–27, 42–45, 60–63 and BC142–BC159).

Question 12: Statement of financial position

(a) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment or investment property as appropriate, but separately from assets that the lessee does not lease (paragraphs 25 and BC143–BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?

We do not agree that a lessee should be required to present lease assets and liabilities separately in the statement of financial position, but rather we believe lessees should have the option of presenting this information in the notes to the financial statements.

(b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

As explained in our response to question 2(a) above, we do not agree with the performance obligation approach. However, if that approach is retained, we do not agree that a lessor should be required to present the lease assets and liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability, but rather we believe lessors should have the option of presenting a net lease asset or lease liability in the statement of financial position and disclose the gross information in the notes to the financial statements.

(c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should

present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

We believe that lessors should have the option of presenting this information in the statement of financial position or disclose it in the notes to the financial statements.

(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

Once again, we believe that lessors should have the option of presenting this information in the statement of financial position or disclose it in the notes to the financial statements.

Question 13: Statement of comprehensive income

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

Consistent with our response to the previous question regarding presentation in the statement of financial position, we believe that lessees and lessors should have the option of presenting this information separately in the statement of comprehensive income or disclose it in the notes to the financial statements.

Question 14: Statement of cash flows

Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

Consistent with our response to the previous questions regarding presentation in the statements of financial position and comprehensive income, we believe that lessees and lessors should have the option of presenting this information separately in the statement of cash flows or disclose it in the notes to the financial statements.

With respect to lessees, we note that the requirement to classify cash payments for leases entirely as financing activities is inconsistent with the treatment of interest payments on other financings. We believe all interest payments should be treated in a consistent manner.

With respect to lessors, we do not agree with the requirement to present all cash receipts from lease payments as operating cash flows. We believe the lessor's classification of the collection of the principal portion of lease payments should be presented as an investing or operating activity depending on the lessor's operations, as for payments from other loans receivable.

Disclosure

Question 15

Do you agree that lessees and lessors should disclose quantitative and qualitative information that:

- (a) identifies and explains the amounts recognised in the financial statements arising from leases; and*
- (b) describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows*

(paragraphs 70–86 and BC168–BC183)? Why or why not? If not, how would you amend the objectives and why?

We agree that lessees and lessors should disclose quantitative and qualitative information about their lease arrangements, although we believe that some of the proposed required disclosures are excessive and may not prove useful or relevant to users of financial statements. We strongly recommend that the Boards provide disclosure examples for any new disclosure requirements that are maintained.

Transition

Question 16

- (a) The exposure draft proposes that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186–BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?*

We agree with the simplified retrospective approach for practical reasons.

- (b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?*

Yes, we believe that full retrospective application of lease accounting should be an option.

- (c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?*

Additional transitional issues we believe should be addressed include:

- Whether or not sale and leaseback transactions of prior periods must be re-evaluated using the revised rules, as well as how to handle any related deferred gains at transition.
- Whether the determination of which model to apply by a lessor should be made as of the inception of the lease or as of the date of initial application.
- How to handle some lease contracts that are currently accounted for as leases but would be accounted for as in-substance purchase and sale transactions under the ED.
- The use of hindsight in the retrospective determination of estimates of lease terms and contingent lease payments should be clarified.

Benefits and costs

Question 17

Paragraphs BC200–BC205 set out the boards’ assessment of the costs and benefits of the proposed requirements. Do you agree with the boards’ assessment that the benefits of the proposals would outweigh the costs? Why or why not?

As explained in the introduction to this letter, as a Board we are not convinced that the proposed models for accounting by lessors, and for some Board members the proposed accounting model for lessees, represent an improvement over the existing lease accounting model. Accordingly, it is very difficult to conclude that the benefits of the proposals would outweigh the costs of implementing them.

Other comments

Question 18

Do you have any other comments on the proposals?

We have nothing additional at this time.

Should you require additional information on our comments listed above, please contact William A. Biese at (52) 55 5596 5633 ext. 113 or me at (52) 55 5596 5633 ext. 103 or by e-mail at wbiese@cinif.org.mx or fperezcervantes@cinif.org.mx, respectively.

Sincerely,

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