



SAS Quadra 05. Bloco J. CFC
Brasília, Distrito Federal - Brazil
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December 15, 2010
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: Leases

Dear Sir/Madam,

The “Comitê de Pronunciamentos Contábeis” - CPC¹ welcomes the opportunity to comment on the Exposure Draft named **Leases**.

We are a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidances for Brazilian companies. Our members are nominated by the following entities:

- a) the São Paulo Stock Exchange;
- b) the Federal Accounting Council;
- c) the Brazilian Association of Listed Companies;
- d) the Brazilian Institute of Independent Auditors;
- e) the Research Institute of Accounting, Actuarial and Financial Foundation; and
- f) the National Association of Capital Market Investment Professionals and Analysts.

This response summarizes the views of our members, which may be supported by the opinions of external parties, sent to us for analysis and to enhance the discussion on the subject matter. We have also made efforts to encourage other external parties to send comments directly to the IASB.

If you have any questions about our comments, please contact our Board Member, Geraldo Toffanello (geraldoffanello@gerdau.com.br).

Yours sincerely,

Edison Arisa Pereira
Technical Coordinator
Comitê de Pronunciamentos Contábeis (CPC)

¹ Brazilian Accounting Standards Board



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Consultation Questions

QUESTION 1: LEASES

(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?

(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?

COMMENTS ON QUESTION 1:

Regarding the appropriateness of the model we are not aware of any other alternative that would comply more with the current version of the framework and with what would be expected of financial statements prepared according to IFRS.

As for the recognition of amortization of the right-of-use asset and interest on the liability to make lease payments, we support the proposal. However, we are concerned with the impact that it will have on loan covenants for the lessees. For that reason, maybe rent expense could be preferable to interest expense and amortization expense, at least in specific disclosures (the lessees should disclose the rent expense, which correspond to the sum of the amortization expense related to right-of-use asset with the interest expense related to lease liability). See also the answer to questions 2, 8-10.

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?

(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?



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COMMENTS ON QUESTION 2:

We are concerned that if the lessor deems that he no longer retains significant risks or benefits in the underlying asset, maybe an asset sale has in substance taken place and the entire carrying amount of the asset should be derecognised. We think that deciding between the performance obligation approach and the derecognition approach introduces unnecessary subjectivity and complexity into lessor accounting.

Therefore, we do not agree with the derecognition approach because it introduces (i) unnecessary subjectivity and complexity, and (ii) asymmetry (inconsistent measurement) between lessee and lessor accounting. For example, the Board proposes that a lessee shall recognise the changes in the expected amount of the lease payments (contingent rentals, payments under term option penalties and residual value guarantees) that relate to future periods as an adjustment to the right-of-use asset (paragraph 18), but a lessor shall recognise the same changes in profit or loss (paragraph 56b).

So, we suggest that a lessor should apply only the performance obligation approach. However, if the Board doesn't accept our suggestion, we have the following comments on this matter:

- a) As explained in the Basis for Conclusions (paragraph BC27), an entity's business model will normally indicate when a derecognition or a performance obligation approach would be appropriate. We believe this notion should be used as a principle for determining when each approach should be used, as we see no conceptual grounds for doing so based on the retention of risk and rewards by the lessor;
- b) Having in mind our comment above, we strongly recommend that intercompany lessors should be exempt from applying the derecognition approach to account for intercompany leases. We make this recommendation based on the following: (1) entities within the same group normally make use of other means to provide intercompany financing; (2) intercompany lessors are generally not exposed to credit risk, but to assets risks; (3) the adoption of this recommendation would considerably simplify consolidation procedures; and (4) information about intercompany leases presented in separated financial statements should not be regarded as being relevant, especially when consolidated financial statements are also provided; and

However, if the Board doesn't accept our suggestion that the initial carrying amount of the residual asset should not be based on relative fair value (paragraph 50), we strongly recommend the following procedure:

- A lessor shall determine the initial carrying amount of the residual asset, at the date of inception of the lease, measured as the excess of (i) the fair value



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of the underlying asset over (ii) the initial carrying amount of the right to receive lease payments determined in accordance with paragraph 49(a).

- The lessor shall recognise in profit or loss any difference between (i) the initial carrying amount of the residual asset; and (ii) the carrying amount of the underlying asset (all determined at the date of inception of the lease).
- When the initial carrying amount of the right to receive lease payments determined in accordance with paragraph 49(a) exceeds the fair value of the underlying asset, the lessor shall derecognise the entire underlying asset.

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 to 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?

COMMENTS ON QUESTION 3:

We agree with question 3(a) but do not agree with question 3(b). In order to avoid asymmetry (inconsistent measurement for a lessee's payables and a lessor's receivables), we suggest that lessees and lessors apply the same procedure.

We do not agree with the proposed simplified requirements for short-term leases as they have two distinct approaches for lessees and lessors. Instead, we believe lessees



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should also be allowed to elect on a lease-by-lease basis to recognize assets and liabilities arising from a short-term lease (measurement for a lessee's payables and a lessor's receivables, both initial and subsequently, at the undiscounted amount of the lease payments).

If the Board accepts our suggestion that lessees and lessors should be allowed to elect on a lease-by-lease basis, we recommend including a condition:

“At the date of inception of a lease, a lessor or lessee that has a short-term lease may elect on a lease-by-lease basis, unless the assets and liabilities that otherwise would be recognised in accordance with this IFRS are material². When a lessee or a lessor elect on a lease-by-lease basis, they recognise assets and liabilities arising from a short-term lease in the statement of financial position”.

QUESTION 4: DEFINITION OF LEASE

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

(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?

(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?

COMMENTS ON QUESTION 4:

We agree with questions 4(a) and 4(b) but do not agree with question 4(c). We understand that making a distinction between a lease and service contract is critical to provide relevant and representationally faithful information to users of financial statements. This distinction depends on judgment but the guidance in paragraph B3 is insufficient. For example, in paragraph B3, it is mentioned that “a contract that permits or requires the supplier to substitute other assets only when the specified asset is not operating properly may be a lease”, but did not clarify the circumstances that would indicate a lease or a service contract.

QUESTION 5: SCOPE EXCLUSIONS

² As defined in Framework for the Preparation and Presentation of Financial Statements.



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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?

COMMENTS ON QUESTION 5:

We agree with the proposed scope, except leases of intangible assets. We agree with the Board's view (paragraph BC 36) that there is no conceptual reason why a lease accounting standard should exclude intangible assets (especially licensing and rights to use that are granted on an exclusive basis). So, we suggest that a lease of intangible assets and tangible assets are included in the scope of the proposed IFRS. Otherwise, the definition of the term lease should mention only tangible assets.

In addition, in order to avoid asymmetry, we suggest that lessees and lessors apply the same procedure related to investment property, contrary to required in paragraph 7. We noticed that there is no paragraph in the Basis for Conclusions to justify the difference between the application of the IAS 40 and the proposed IFRS for lessees (7a) and lessors (7b). Besides, we have identified no conceptual reason why a lessor shall apply IAS 40 and not the proposed IFRS.

Considering the scope and requirements of the IAS 40, we understand that IAS 40 concerns the underlying asset. So, we suggest that a lessor of investment property should (i) apply IAS 40 to the underlying asset (recognition, measurement and disclosure), and (ii) apply the proposed IFRS to lease (contracts in which the right to use a specified asset - the underlying asset - is conveyed, for a period of time, in exchange for consideration, but the contract does not represent a sale of the underlying asset). See also the answer to questions 2, 8-10.

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



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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?

COMMENTS ON QUESTION 6:

We agree that lessees and lessors should apply the proposals in the ED Revenue from Contracts with Customers to a distinct service component of a contract that contains service components and lease components.

However, if the Board doesn't accept our suggestion that a lessor should apply only the performance obligation approach (question 2), and if the service component in a contract that contains service components and lease components is not distinct, we agree with the procedure proposed by the FASB because (i) the procedure proposed by the IASB would result in inconsistent measurement for a lessee's payables and a lessor's receivables; and (ii) the procedure proposed by the FASB would result in a more principles-based approach.

We also believe that additional guidance should be provided in order to help lessees and lessors evaluate when services would have a distinct profit margin; especially when the service would be subject to distinct risks. We believe this is important because it is still unclear for us how an entity could sell a service separately when no market exists for it. Explaining the intentions associated to the condition would also facilitate its application.

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?



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COMMENTS ON QUESTION 7:

We agree that a lessee or a lessor should account for purchase options only when they are exercised, except a bargain purchase option that represents the transfer of the control of the underlying asset and indicates that the contract represents a purchase (or sale) instead a lease.

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?

COMMENTS ON QUESTION 8:

In order to avoid asymmetry (inconsistent measurement for a lessee's payables and a lessor's receivables) and considering our suggestion that a lessor should apply only the performance obligation approach (question 2), we do not agree. Only the base lease period should be accounted for as an asset with a liability because:

- a) predicting renewals (if 10 or 15 or 20 years) or estimating the probability of occurrence for each possible term cannot be done with any reasonable accuracy;
- b) the renewal options are not obligations until exercised and there is a possibility that the renewal option will not be exercised; and
- c) there would be large financial adjustments when the term previously estimated is not confirmed.

We suggest that the lease term should be the non-cancellable period that was contracted together with any further terms for which the lessee has the option to continue to lease the underlying asset (like a bargain renewal option), when at the inception of the lease it is reasonably certain that such options will be exercised, as specified in IAS 17 (paragraph 4).

It would be simpler and more reliable if the lessee and lessors determine the lease term without taking into account a renewal (or termination) option, except when it would be reasonably certain at the inception of the lease that such options will be exercised. The effects that would result in a renewal option should be disclosed in footnotes. When a renewal option is exercised at the end of the original lease term, a lessee or a lessor should apply (again) the procedures required in the proposed IFRS to recognition and measurement of a new lease.



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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?

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?

COMMENTS ON QUESTION 9:

Taking into account the answer to question 8, we 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, but not using an expected outcome technique (the present value of the probability weighted average of the cash flows for a reasonable number of outcomes).

We disagree with the proposal that an expected outcome technique should be used to measure assets and liabilities arising from lease arrangements. Although we understand the concepts behind such treatment, we consider it to be excessively onerous and estimating the probability of each outcome will introduce very much subjectivity into the process. We suggest a measurement on the basis of the most likely rental payment, which we believe to be less complex to apply and still capable of providing useful information, especially when combined with appropriate disclosures about future cash flow uncertainties and taking into account the fact that the amounts recognized in the statement of financial position would be remeasured whenever changes in facts or circumstances indicate that they have changed significantly since the last reporting period.

Additionally, any amounts in the financial statements should be required to be reliably measured, then, we agree that lessees and lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right-of-use asset (lessee) and of the right to receive lease payments (lessor) if they can be measured reliably.

QUESTION 10: REASSESSMENT



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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?

COMMENTS ON QUESTION 10:

Taking into account the answer to questions 2, 8 and 9, we 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 only from changes in contingent payments (contingent rentals, expected payments under term option penalties and residual value guarantees).

However, we disagree with the proposed method for recognition of changes in the expected amounts of contingent rentals and other expected payments. We believe this method will be considerably complex to apply and inconsistent with existing requirements for relatively similar estimates (IFRIC 1). In fact, applying IFRIC 1 already demands a lot of resources, despite the reduced number of items to be controlled when compared to lease arrangements.

We suggest that:

- a) A lessee shall recognise all changes in the expected amount of the lease payments (contingent rentals, expected payments under term option penalties and residual value guarantees) as an adjustment to the right-of-use asset (regardless of those changes that relate to future, current or prior periods). This is consistent with procedure required in IFRIC 1 (In our view, only those considered to be amortization adjustments, calculated since the last date of revision, should be expensed).
- b) A lessor shall recognise any resulting changes to the right to receive lease payments as an adjustment to the lease liability (performance obligation approach).

QUESTION 11: 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



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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). 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?

COMMENTS ON QUESTION 11:

We do not agree. The fact that the contract would actually be selling the underlying asset does not necessarily imply that the leaseback also meets the definition of a lease and it would be structured to transfer to the lessee the effective control of the underlying asset (practically all risks and benefits associated with the underlying asset). In that case it indicates a repurchase, rather than a lease. We suggest that the sale and leaseback should be separately analysed.

QUESTION 12: STATEMENT OF FINANCIAL POSITION

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).

(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?

(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?

(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



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information in the notes instead? What alternative presentation do you propose and why?

(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?

COMMENTS ON QUESTION 12:

We agree with questions 12(a), 12(b) and 12(d).

According to our comment on question 2, we do not agree with the derecognition approach. However, if the Board doesn't accept our suggestion (that a lessor should apply only the performance obligation approach), we agree that a lessor should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment.

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?

COMMENTS ON QUESTION 13:

We agree, but we are concerned that the impact that this will have on loan covenants will be profound for the lessees. For that reason, maybe rent expenses (for the lessees) are preferable to interest and amortization expense, at least in specific disclosures (the lessees should disclose the rent expense, which correspond to the sum of the amortization expense related to right-of-use asset with the interest expense related to lease liability).

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?

COMMENTS ON QUESTION 14:



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We agree that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows, but we do not agree that a lessor shall classify the cash receipts from lease payments only as operating activities in the statement of cash flows. A entity of which ordinary activities is other than lease and it conveys to another entity the right to use a specified asset, for a period of time, in exchange for consideration (a lease) shall classify the cash receipts from lease payments as investment activities in the statement of cash flows.

QUESTION 15: DISCLOSURE

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?

COMMENTS ON QUESTION 15:

We agree.

QUESTION 16: TRANSITION

(a) The exposure draft proposes that lessees and lessors should recognise 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?

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

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

COMMENTS ON QUESTION 16:

We agree with the question 16(a) and we think that a full retrospective application of lease accounting requirements should not be permitted in order to avoid problems of comparability.

QUESTION 17: BENEFITS AND COSTS



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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?

COMMENTS ON QUESTION 17:

We agree, but not entirely. We think that the proposals in the exposure draft (a new lease accounting) should be simpler (less costly) and offer the same benefits if the lessee and lessors determine the lease term without taking into account a renewal (or termination) option, except when it would be reasonably certain at the inception of the lease that such options will be exercised (see answers to questions 2, 8-10). If a renewal option would be exercised, the lessee should adjust the right-of-use asset and corresponding liability to reflect the new lease (and the lessor should adjust the right to receive lease payments in the same way).

We think that deciding between the performance obligation approach and the derecognition approach introduces unnecessary subjectivity and complexity into lessor accounting. We do not agree with the derecognition approaches and we suggest that a lessor should apply only the performance obligation approach.

QUESTION 18: OTHER COMMENTS

Do you have any other comments on the proposals?

COMMENTS ON QUESTION 18:

We are concerned about the complexity and subjectivity of the new proposed rules, particularly with regard to (i) real estate leases which are common to most companies (so, we suggest including more guidance and illustrative examples) and (ii) the entities that have debt covenants that include liquidity and debt-to-equity provisions (see the answer to question 13).