

**Australian Government****Department of Finance and Deregulation**

Reference: 09/05739
Contact: Mr Peter Gibson
Telephone: 02 6215 3551
e-mail: peter.gibson@finance.gov.au

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
COLLINS STREET WEST VIC 8007

Dear Mr Stevenson

IASB Discussion Paper DP/2009/1 Leases - Preliminary Views

The Department of Finance and Deregulation (Finance) encloses for your information our comments provided to the International Accounting Standards Board (IASB) on Discussion Paper *2009/1 Leases – Preliminary Views*. Finance usually contributes to the Heads of Treasuries' Accounting and Reporting Advisory Committee (HoTARAC) comments on proposals. However, as the issues set out in the discussion paper are of significance to Finance and that Finance's views diverge from those of the majority of HoTARAC, Finance has elected to submit its own comments.

Finance would encourage the AASB to consult more widely on the issues raised in the discussion paper and not solely rely on constituents responding in writing to the invitation to comment, due to the significant implications this paper could have on accounting for leases.

Finance acknowledges the desirability of simplifying accounting for leases and the reasons given by the IASB for issuing the paper. At a high level, the core proposal to abolish the current distinction between finance and operating leases is attractive. However, when subject to more detailed scrutiny, we do not believe that the proposals, in their current form, are acceptable. Our reasons for this view are both conceptual and practical.

In addition to the comments attached, Finance notes that Government Finance Statistics currently retains the distinction between operating and finance leases and the IASB proposals will result in a divergence which has implications for AASB 1049 *Whole of Government and General Government Sector Financial Reporting* in the Australian public sector content.

In our view, the issues raised by the IASB would be better resolved by either of the following strategies:

- Greater disclosure (the approach taken with financial instruments); and/or
- A clearer principle for distinguishing between finance and operating leases, perhaps considering the control principle and/or the ability to cancel the lease.

Finance's detailed comments on the proposals are set out in the Attachment.

Please contact Mr Peter Gibson on 02 6215 3551 if you require an additional information or explanations.

Yours sincerely



Tim Youngberry
A/g Deputy Secretary
General Manager, Financial Management Group
13 July 2009

The Department of Finance and Deregulation's Response to DP/2009/1 Leases – Preliminary Views.

General Comments

For the following reasons, the Department of Finance and Deregulation (Finance) is not convinced the benefits of a standard based on the preliminary views set out in the discussion paper exceed the costs.

Conceptual Issues

1. There are conceptual difficulties with the conclusion that rights and obligations under all lease agreements do actually constitute assets and liabilities, particularly when compared with the approach to recognising assets and liabilities in other accounting standards, and when considering the issue of control.
2. "Future" rights and obligations under lease agreements can give rise to executory contracts in many cases, particularly in the case of leases that can be cancelled.
3. The preliminary views on the determination of the lease term and the measurement of the assets and liabilities involve a high degree of management judgement. The reliability and objectivity of the assets and liabilities determined using the approaches set out in the preliminary views could be dubious, resulting in the need for increased disclosure of information to allow users to assess the suitability of the judgement and the impact on the entity's bottom line.
4. The inherent assumption in the paper is that all leases are a means of financing an acquisition. However, Finance does not agree with this assumption as not all lessees want to acquire the asset they just want to use it for a period.
5. The proposals made in the paper result in measurement of assets and liabilities on a hybrid basis, and may not represent either cost or fair value.

Practical Issues

1. Finance is of the view that a lease accounting standard based on the preliminary views set out in the paper will not be superior to the current standard. While a new accounting standard may address the criticisms noted by the IASB in the paper, a range of new issues will arise due to the high level of subjectivity and management judgment in measurement. Finance is of the view that the IASB could address a number of the issues through improved disclosure rather than discarding the current standard.
2. While we note that the paper specifies that there will only be a single asset and liability disclosed rather than “componentised” items, we believe that the inherent subjectivity and management expectation in many of the proposals set out in the document will result in future calls for greater disclosure of the “components”, particularly of the liability, and potentially of much greater detail. Finance notes some analysts have already suggested the components approach, which is the direction that disclosure surrounding financial instruments has evolved.
3. The nature of the proposed requirements is such that a much greater amount of work will be required to implement and maintain the standards. The cost of this will exceed the benefits to be obtained from improved disclosure.

While Finance does not support the principles in the paper, it has outlined below its views on the individual questions asked by the IASB.

Specific Questions

1. *The boards tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards.*

Do you agree with this proposed approach?

If you disagree with the proposed approach, please describe how you would define the scope of the proposed new standard.

Agree, in part. The narrower scope of SFAS 13 that limits the scope to property, plant and equipment (land and/or depreciable assets) could result in leases involving intangible assets being treated differently with no adequate justification.

The IASB needs to clearly state if leases that can be cancelled are included in the scope of the standard. The assumption is that they are, and this is a key factor in our comments.

We note, however, that the scope needs to include accounting by lessors to ensure no mismatching of assets and liabilities.

2. *Should the proposed new standard exclude non-core asset leases or short-term leases? Please explain why.*

Please explain how you would define those leases to be excluded from the scope of the proposed new standard.

No.

Finance is of the view that conceptually both non-core assets and short-term leases should be included in the scope of the standard if it can be demonstrated that they contain financing elements and that the rights and obligations constitute assets and liabilities. Whilst Finance recognises that these leases have unique characteristics they are no different in substance to other leases.

However, for practical reasons very short term cancellable leases should not be included as the cost would exceed the benefit.

3. *Do you agree with the boards' analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract?*

If you disagree, please explain why.

Finance agrees that rights and obligations arise in simple lease contracts but they do not inevitably always give rise to the recognition of assets and liabilities.

Assets can only be recognised where the entity has control, modified in the leasing standard to encompass risks and rewards incidental to ownership. This subject was not adequately explored in the paper.

Finance is of the view that the IASB needs to review and compare the way other non-derivative commitments/obligations are recognised as liabilities under the accounting standards. Finance does not see any difference between lease agreements and executive service contracts, social benefit commitments and capital commitments. These obligations currently do not require the recognition of a liability under the standards, usually on the basis that the future rights and obligations are executory.

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

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

(b) a liability for its obligation to pay rentals

Do you support the proposed approach?

If you support an alternative approach, please describe the approach and explain why you support it.

No.

Further to question 3, consideration should be given to the treatment of executory contracts.

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

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

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

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

No.

Finance is of the view that economic effects and the substance of the separate components should determine how the transaction is recorded and there should not be an absolute rule/requirement in the accounting standards.

Whilst recognising a single asset and liability maybe straightforward and uncomplicated, Finance is of the view that in the longer term this approach is unsustainable. We believe that users will request greater information on the composition of, and the assumptions behind, the asset and liability due to the high level of subjectivity involved in measurement. This has been the case with financial instruments. For this reason an approach based on greater disclosure could be a better alternative solution to the issues raised by the IASB.

6. *Do you agree with the boards' tentative decision to measure the lessee's obligation to pay rentals at the present value of the lease payments discounted using the lessee's incremental borrowing rate?*

If you disagree, please explain why and describe how you would initially measure the lessee's obligation to pay rentals.

Disagree.

Finance is of the view that the rate implicit in the lease should be used to discount the lease payments as this reflects the risks associated with the leased item and will ensure that the discounting of lease payments is inline with discounting requirements in other standards.

Finance notes, however, that for practical reasons the incremental borrowing rate could be applied to all leases, since many operating leases do not incorporate an implicit rate as they are not financing arrangements.

The determining of the lessee's incremental borrowing rate over the life of the lease at inception may be difficult and involve significant judgment particularly when the entity does not otherwise borrow and does not neatly fit the profile of existing borrowers. The costs of determining this rate will outweigh the perceived benefits.

If the IASB does implement this measurement method Finance would strongly recommend that the IASB include guidance in the standard about determining a lessee's incremental borrowing rate for long term leases.

Finally, Finance notes that the preliminary view does not consider the fair value of the underlying asset at the inception of the lease, as is the case under the present standard. Removal of this requirement, and basing initial measurement solely on discounting cash flows could in many cases result in initial measurement that has no relationship with either the cost or fair value of the underlying asset.

7. *Do you agree with the boards' tentative decision to initially measure the lessee's right-of-use asset at cost?*

If you disagree, please explain why and describe how you would initially measure the lessee's right-of-use asset.

Agree in part.

We agree with the concept of measurement at cost, but disagree with the method used to calculate it (refer to the answer to Question 6).

8. *The boards tentatively decided to adopt an amortised cost-based approach to subsequent measurement of both the obligation to pay rentals and the right-of-use asset. Do you agree with this proposed approach?*

If you disagree with the boards' proposed approach, please describe the approach to subsequent measurement you would favour and why.

Agree.

9. *Should a new lease accounting standard permit a lessee to elect to measure its obligation to pay rentals at fair value? Please explain your reasons.*

No.

The amortised cost method best reflects the value of the obligation to pay and is considered to be consistent with the initial measurement basis.

10. *Should the lessee be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate? Please explain your reasons.*

If the boards decide to require the obligation to pay rentals to be revised for changes in the incremental borrowing rate, should revision be made at each reporting date or only when there is a change in the estimated cash flows?

Please explain your reasons.

No.

The incremental borrowing rate should be considered each year but the liability should only be adjusted when the changes are material.

11. *In developing their preliminary views the boards decided to specify the required accounting for the obligation to pay rentals. An alternative approach would have been for the boards to require lessees to account for the obligation to pay rentals in accordance with existing guidance for financial liabilities.*

Do you agree with the proposed approach taken by the boards?

If you disagree, please explain why.

Agree, noting the answer to question 8 – 10 above.

12. *Some board members think that for some leases the decrease in value of the right-of-use asset should be described as rental expense rather than amortisation or depreciation in the income statement.*

Would you support this approach? If so, for which leases? Please explain your reasons.

Yes. Rent is the term currently used, and a change may confuse users of financial statements, particularly for short term leases, but note that this is a consequence of the conceptual flaws in the model.

13. *The boards tentatively decided that the lessee should recognise an obligation to pay rentals for a specified lease term, i.e. in a 10-year lease with an option to extend for five years; the lessee must decide whether its liability is an obligation to pay 10 or 15 years of rentals. The boards tentatively decided that the lease term should be the most likely lease term.*

Do you support the proposed approach?

If you disagree with the proposed approach, please describe what alternative approach you would support and why.

Disagree.

Finance believes this approach is too subjective especially for long term leases and would prefer the obligation to pay to be based on the minimum lease term, unless an extension of the term is reasonably certain, with additional information disclosed via the notes.

14. *The boards tentatively decided to require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances. Changes in the obligation to pay rentals arising from a reassessment of the lease term should be recognised as an adjustment to the carrying amount of the right-of-use asset.*

Do you support the proposed approach?

If you disagree with the proposed approach, please describe what alternative approach you would support and why.

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

Finance would only support the reassessment of the lease term where the impact is material.

Finance does not consider it appropriate to adjust the carrying amount of the right-of-use asset for changes in the obligation to pay rentals as a result of a change in the lease term as the asset's carrying value will be a hybrid valuation rather than cost or fair value.

15. The boards tentatively concluded that purchase options should be accounted for in the same way as options to extend or terminate the lease.

Do you agree with the proposed approach?

If you disagree with the proposed approach, please describe what alternative approach you would support and why.

Finance disagrees that this should be on the basis of “most likely” outcome.

Finance believes this approach is too subjective especially for long term leases. The “reasonable certainty” approach should be adopted (see question 13)

Under the proposed approach if a purchase option is accounted for and the asset is not subsequently purchased it has been overvalued in the earlier years.

16. The boards propose that the lessee’s obligation to pay rentals should include amounts payable under contingent rental arrangements.

Do you support the proposed approach?

If you disagree with the proposed approach, what alternative approach would you recommend and why?

Conceptually we note that this is an acceptable approach. However, we do not agree with the preliminary view. As the name implies these rentals are dependent on other factors which will not be known until a future date.

Once again this requirement is too subjective and could allow for the financial positions of entities to be manipulated. For example, an entity could initially recognise the contingent rentals in line with the preliminary view. However, in future periods if the financial position of the entity is under pressure there would be incentives to manipulate remeasurement of the contingent rentals with the objective of reducing the liability.

In respect to very long term leases particularly, it may even be impossible for management to reliably estimate future contingent rentals e.g. rentals on premises that are contingent on price indices, market reviews or rental turnover figures. Rules could be specified as to how these are to be treated, but they will remain subjective and difficult to provide assurance on.

Finance supports the expensing of the contingent rentals as they are incurred.

17. The IASB tentatively decided that the measurement of the lessee's obligation to pay rentals should include a probability-weighted estimate of contingent rentals payable. The FASB tentatively decided that a lessee should measure contingent rentals on the basis of the most likely rental payment. A lessee would determine the most likely amount by considering the range of possible outcomes. However, this measure would not necessarily equal the probability-weighted sum of the possible outcomes.

Which of these approaches to measuring the lessee's obligation to pay rentals do you support? Please explain your reasons.

A probability-weighted estimate is conceptually superior:

However, Finance believes both methods are subjective and would rely too much on management judgement. Neither option of measurement is unacceptable as it is impractical to measure without subjectivity (refer to question 16 above). However of the two methods the probability-weighted estimate is preferable as it is consistent with the way other liabilities are determined and best reflects uncertainty.

18. The FASB tentatively decided that if lease rentals are contingent on changes in an index or rate, such as the consumer price index or the prime interest rate, the lessee should measure the obligation to pay rentals using the index or rate existing at the inception of the lease.

Do you support the proposed approach? Please explain your reasons.

No. Finance sees this simply as a rule to overcome the otherwise critical subjectivity in measurement of contingent rentals.

Finance does not support the inclusion of contingent rentals at the beginning of the lease term. Contingent rentals should be expensed as they are incurred.

Refer to question 16 regarding subjectivity.

19. The boards tentatively decided to require remeasurement of the lessee's obligation to pay rentals for changes in estimated contingent rental payments.

Do you support the proposed approach? If not, please explain why.

If the Board requires contingent rentals to be included at inception, the remeasurement of the obligation should only occur when a change is material.

20. *The boards discussed two possible approaches to recognising all changes in the lessee's obligation to pay rentals arising from changes in estimated contingent rental payments:*

- (a) recognise any change in the liability in profit or loss*
- (b) recognise any change in the liability as an adjustment to the carrying amount of the right-of-use asset.*

Which of these two approaches do you support? Please explain your reasons.

If you support neither approach, please describe any alternative approach you would prefer and why.

Finance would prefer any changes in the liability to be recognised in the profit and loss as this approach is similar to financial liabilities.

If the changes are adjusted against the carrying amount of the right-of-use asset the measurement of this asset will become a balancing item rather than reflecting the fair value or the cost of the asset.

21. *The boards tentatively decided that the recognition and measurement requirements for contingent rentals and residual value guarantees should be the same. In particular, the boards tentatively decided not to require residual value guarantees to be separated from the lease contract and accounted for as derivatives.*

Do you agree with the proposed approach? If not, what alternative approach would you recommend and why?

Finance agrees with the aligning of the accounting treatment. However, we do not agree with the accounting for contingent rentals and residual value guarantees refer to our responses to questions 16 – 19.

22. *Should the lessee's obligation to pay rentals be presented separately in the statement of financial position? Please explain your reasons.*

What additional information would separate presentation provide?

Agree.

This project is being undertaken by the IASB to improve the understandability of leases by users.

Due to the significant level of management judgment in measuring the liability it needs to be clearly identifiable in the financial statements.

23. *This chapter describes three approaches to presentation of the right-of-use asset in the statement of financial position.*

How should the right-of-use asset be presented in the statement of financial position?

Please explain your reasons.

What additional disclosures (if any) do you think are necessary under each of the approaches?

Finance is of the view that the right-of-use asset should be presented with similar assets but clearly identified as leased assets. If recognised as an intangible asset it effectively undermines the IASB argument that all leases constitute financing the acquisition of an asset.

However, Finance appreciates that this creates an additional conceptual problem since the right-of-use asset is recorded at neither cost nor fair value unlike property, plant and equipment or intangibles.

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

Refer to question 3 and the additional information at the end of this attachment.

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

Yes.

Finance is of the view that when the asset recognition test set out in the Framework is met and the contract is not executory, the lessor has the right to recognise an asset.

26. *This chapter describes two possible approaches to lessor accounting under a right-of-use model:*

(a) derecognition of the leased item by the lessor or

(b) recognition of a performance obligation by the lessor.

Which of these two approaches do you support? Please explain your reasons.

Finance believes the approach is dependent on the level of control that is transferred to the lessee. If all the future economic flows are transferred to the lessee then the leased item should be derecognised, but if only some of the future economic flows are transferred then a performance obligation should be recognised.

27. *Should the boards explore when it would be appropriate for a lessor to recognise income at the inception of the lease?*

Please explain your reasons.

Yes, in the broader context of the revenue recognition projects.

28. *Should accounting for investment properties be included within the scope of any proposed new standard on lessor accounting?*

Please explain your reasons.

Yes.

Finance does not believe that this topic can be ignored as most investment properties are leased. Even if a separate standard is retained for investment properties its provisions need to be consistent with the leasing standard.

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

All lessor accounting issues in the paper need to be explored more thoroughly by the IASB.

Additional Information

Finance is of the opinion that the IASB needs to consider the following additional issues prior to issuing an exposure draft for a new leasing accounting standard:

1. Relationship with relevant interpretations including IFRIC 4 *Determining whether an Arrangement contains a Lease*, IFRIC 5 *Rights to Interest arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*, IFRIC 12 *Service Concession Arrangements*, SIC-15 *Operating Leases – Incentives*, SIC -27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*, and SIC-29 *Service Concession Arrangements: Disclosures*.
2. Treatment of perpetual leases;
3. Measurement of “peppercorn rentals” or nominal dollar value leases;
4. Arrangements that involve the construction of the leased assets; and
5. Treatment of sub leases when the entity is the lessee and lessor.



Group Finance
Level 12, 100 Queen Street
Melbourne Vic 3000
Phone 03 9273 4397
Fax 03 9273 6150
buggles@anz.com
www.anz.com

Shane Buggle
Group General Manager Finance

17 July 2009

Sir David Tweedie
Chairman
International Accounting Standards Board
First Floor, 30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Submitted electronically through the IASB Internet site (www.iasb.org)

Dear Sir David

Discussion Paper DP/2009/1: LEASES Preliminary Views

Thank you for the opportunity to comment on this Discussion Paper (DP).

Australia and New Zealand Banking Group Limited (ANZ) is listed on the Australian Stock Exchange and remains one of a select group of banks who continue to be AA rated. Our operations are predominantly based in Australia, New Zealand and Asia and our most recent annual results reported profits of USD2.6 billion and total assets of USD376 billion.

General comment

We support the intention of the IASB to update existing standards, as some concepts need to be revised to maintain quality of financial reporting. We welcome implementation of a principles-based approach, one without undue complexity and compliance cost though, and we see merits in the proposed right-of-use model that could well appear to be a practical model in accounting for leases.

We observe that the DP presents only one simplified example to illustrate rights and obligations arising in a lease from the perspective of the lessee, as well as provides only high level thoughts on the accounting by the lessor. Our preference is to see conceptual models for lessor and lessee accounting presented together. We are not criticising the DP on these grounds as our understanding is that the objective of this discussion paper is to seek preliminary views on the proposed right-of-use model. We however anticipate that these observations will be addressed when the project proceeds to the exposure draft phase.

Accounting for more complex leases and measurement of lease obligation

We welcome the proposal to not recognise the components of a lease separately (e.g. options to extend the lease or terminate early, or purchase the leased asset and other). This simplifies financial reporting as well as allows for greater weight of the "management approach" in measurement.

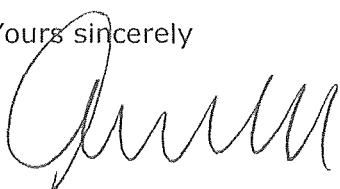
In regard to measurement, the IASB should utilise the opportunity to reduce the variety of measurement bases (and reduce complexity in financial reporting), if subsequent measurement of the lease obligation becomes aligned with measurement of financial liabilities subsequent to the initial recognition (e.g. amortised cost basis). However, the initial measurement of the obligation (and hence the right-of-use asset) should reflect the economics of the arrangement and therefore be based on the rate implicit in the lease where it is practicable to determine.

In summary, we are supportive of the model proposed in the DP. The existing requirements to analyse and classify leases at inception, and disclosure requirements should also keep incremental implementation costs of the new model to minimum.

The above documents our fundamental position, we have also taken the opportunity to provide comments on some questions raised in the exposure draft. Detailed comments on select questions raised in the Exposure Draft are attached to this letter.

Should you have any queries on our comments, please contact Rob Goss, Head of Accounting Policy, Governance and Compliance at Rob.Goss@anz.com.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Shane Buggle', written in a cursive style.

SHANE BUGGLE
Group General Manager Finance

Copy: Australian Accounting Standards Board (AASB)

DP/2009/1: Leases - Detailed answers to comment questions

Scope of lease accounting standard

Question 1

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

We agree with the Boards tentative view to base the scope of the proposed new lease accounting standard on existing lease standards, including guidance in IFRIC 4 *Determining whether an Arrangement contains a Lease*.

Question 2

Should the proposed new standard exclude non-core asset leases or short-term leases? Please explain why. Please explain how you would define those leases to be excluded from the scope of the proposed new standard.

An exemption for short term leases would be desirable for various reasons, as in some instances costs could outweigh the benefits; however we also consider that many short-term leases could give rise to material obligations and there would be other impediments making it practically hard to define such a scope exemption. We also note that the existing guidance on materiality will lead to a similar outcome in practice but in a more efficient manner. For example, where the entity rents a single vehicle for 1 month as a one-off event, this transaction practically will be treated as an operating lease under the current standard.

Approach to lessee accounting

Question 3

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

We agree. See our responses to Question 4.

Question 4

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

- (a) an asset representing its right to use the leased item for the lease term (the right-of-use asset)*
- (b) a liability for its obligation to pay rentals.*

Appendix C describes some possible accounting approaches that were rejected by the boards.

Do you support the proposed approach? If you support an alternative approach, please describe the approach and explain why you support it.

We agree with the conceptual analysis of the rights and obligations arising in a lease contract from the perspective of the lessee, as illustrated by means of a simple example in the DP. We also are of the view that the right-of-use approach provides more relevant and faithful representation of the economics of a lease compared to the other approaches considered by the IASB including the current standard (which inter alia is susceptible to structuring). This also applies to the recognition of the lessee' obligation to pay rental which is useful to understand in assessing future cash flows prospects of the entity.

The complexities arising in practice (e.g. termination options etc.) should be reflected in measurement, also giving appropriate weighting to management intentions where appropriate.

DP/2009/1: Leases - Detailed answers to comment questions

Question 5

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

- *a single right-of-use asset that includes rights acquired under options*
- *a single obligation to pay rentals that includes obligations arising under contingent rental arrangements and residual value guarantees.*

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

We support the approach of a single right-of-use asset and a single lease obligation. Some components of a lease transaction often would have an inverse value relation so decomposing it would not practically provide much additional relevant information about economics of the arrangement. In addition there are limitations to the degree of faithful presentation that could be achieved by decomposing.

In the financial instruments space a relevant example would be a fixed rate loan, which economically comprises a variable rate loan with an interest rate swap fixing the cash flows on the loan. This sort of analysis however does not provide any decision useful information because the two financial instruments in the single contract are inextricably linked. Similar logic would apply to most normal components of a customary lease.

We also consider that the nature and amount of any material component of a recognised lease asset or lease liability would be disclosed in notes to financial statements, in line with general reporting requirements.

Initial measurement

Question 6

Do you agree with the boards' tentative decision to measure the lessee's obligation to pay rentals at the present value of the lease payments discounted using the lessee's incremental borrowing rate?

If you disagree, please explain why and describe how you would initially measure the lessee's obligation to pay rentals.

We disagree. Although in certain cases it may be difficult to determine the interest rate implicit in the lease, in many cases it can be readily determined. The interest rate implicit in the lease is conceptually superior to using the incremental borrowing rate as the interest rate implicit is specific to the leasing transaction (which in some instances also has features of secured lending transaction different to incremental borrowing). Using the incremental borrowing rate hinders the economics of leasing. We therefore prefer the status quo, i.e. the discount rate to be used is the interest rate implicit in the lease, if this is practicable to determine; only if not, the lessee's incremental borrowing rate shall be used.

Question 7

Do you agree with the boards' tentative decision to initially measure the lessee's right-of-use asset at cost?

If you disagree, please explain why and describe how you would initially measure the lessee's right-of-use asset.

We agree.

DP/2009/1: Leases - Detailed answers to comment questions

Subsequent measurement

Question 8

The boards tentatively decided to adopt an amortised cost-based approach to subsequent measurement of both the obligation to pay rentals and the right-of-use asset. Do you agree with this proposed approach?

If you disagree with the boards' proposed approach, please describe the approach to subsequent measurement you would favour and why.

We agree. Further, we suggest that the measurement requirements should cross-refer to existing guidance wherever possible.

We believe that from a conceptual point of view, all similar contracts should be accounted for consistently. On this platform, we do not see arguments not to measure the right-of-use asset consistent with how other similar non-financial assets are measured.

Similarly, if the IASB concludes (and we agree with this conclusion) that the obligation to pay rentals is a financial liability, then it should be measured subsequent to initial recognition at amortised cost similar to the current requirements in IAS 39 *Financial Instruments: Recognition and Measurement*. Unless there are very good reasons to depart from how other similar obligations are measured, subsequent measurement of the carrying amount should be consistent, with a few alterations if required to reflect the nature of a lease obligation. For example, a catch-up adjustment to reflect the revised estimated cash flows could be adjusting the carrying amount of the lease asset, rather than be recognised in the income statement (as would apply to a pure financial contract, under IAS 39.AG8).

Question 9

Should a new lease accounting standard permit a lessee to elect to measure its obligation to pay rentals at fair value? Please explain your reasons.

See our response to Question 8 above. We would expect to see entities allowed to measure rental obligations at fair value provided they meet the criteria for classifying as financial liabilities at fair value in IAS 39. In practice these criteria are unlikely to be met often.

Question 10

Should the lessee be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate? Please explain your reasons.

If the boards decide to require the obligation to pay rentals to be revised for changes in the incremental borrowing rate, should revision be made at each reporting date or only when there is a change in the estimated cash flows? Please explain your reasons.

We disagree. The discount rate should reflect the economic conditions at the time the original lease was entered into and should not be revised unless there is a fundamental change to the economics of that original agreement (similar to the treatment of a substantial modification of the terms of an existing financial liabilities, as per IAS 39.40). See also our responses to Questions 6 and 8.

Question 11

In developing their preliminary views the boards decided to specify the required accounting for the obligation to pay rentals. An alternative approach would have been for the boards to require lessees to account for the obligation to pay rentals in accordance with existing guidance for financial liabilities.

Do you agree with the proposed approach taken by the boards? If you disagree, please explain why.

We disagree. See our responses to Questions 6, 8, 9 and 10.

DP/2009/1: Leases - Detailed answers to comment questions

Question 12

Some board members think that for some leases the decrease in value of the right-of-use asset should be described as rental expense rather than amortisation or depreciation in the income statement.

Would you support this approach? If so, for which leases? Please explain your reasons.

We believe that subsequent measurement and as a result, amortisation or depreciation, should follow as a consequence of recognising the right-to-use asset on the balance sheet. Therefore, the classification of the expense should reflect the classification of the lease asset.

Leases with options

Question 13

The boards tentatively decided that the lessee should recognise an obligation to pay rentals for a specified lease term, ie in a 10-year lease with an option to extend for five years, the lessee must decide whether its liability is an obligation to pay 10 or 15 years of rentals. The boards tentatively decided that the lease term should be the most likely lease term.

Do you support the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why.

No comment.

Question 14

The boards tentatively decided to require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances. Changes in the obligation to pay rentals arising from a reassessment of the lease term should be recognised as an adjustment to the carrying amount of the right-of-use asset.

Do you support the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why.

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

We support the proposal to treat the changes in the obligation to pay rentals as an adjustment to the carrying amount of the right-of-use asset. This is consistent with the measurement basis of the asset (at cost). As we commented above, the asset should be carried on a basis consistent with other similar assets, which presumably means that it should be subject to review of remaining useful life, impairment and other assessments.

Question 15

The boards tentatively concluded that purchase options should be accounted for in the same way as options to extend or terminate the lease.

Do you agree with the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why

No comment.

Contingent rentals and residual value guarantees

Questions 16 to 21

No comment.

DP/2009/1: Leases - Detailed answers to comment questions

Presentation

Questions 22 to 23

No comment.

Other lessee issues

Question 24

No comment.

Lessor accounting

Question 25

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

We agree. In practice, every lease contract would have a determinable (e.g. contractually specified) duration and rentals. The contract would also contain clauses imposing penalties for exiting the contract prematurely with varying degree of severity depending on value and nature of the underlying asset(s). This indicates existence of future economic benefits to the lessor.

Question 26

This chapter describes two possible approaches to lessor accounting under a right-of-use model: (a) derecognition of the leased item by the lessor or (b) recognition of a performance obligation by the lessor.

Which of these two approaches do you support? Please explain your reasons.

Our overall comment is that we believe it is important that the approach to lessor accounting be consistent with the outcome from the revenue recognition project.

We note that alternative (a) above demonstrates certain advantages and is familiar to the users as it is close to the existing accounting treatment for finance leases. The DP does not illustrate sufficiently how it would apply to what currently are treated as operating leases. The IASB should provide more detailed analysis in this regard.

Question 27

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

Our overall comment is that we believe it is important that the approach to lessor accounting be consistent with the outcome from the revenue recognition project.

Question 28

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

No comment.

Question 29

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

No comment.

Macquarie Group Limited
ABN 94 122 169 279

No.1 Martin Place Telephone (61 2) 8232 3333
Sydney NSW 2000 Facsimile (61 2) 8232 7780
GPO Box 4294 Internet <http://www.macquarie.com.au>
Sydney NSW 1164 DX 10287 SSE
SWIFT MACQAU2S

Treasury 8232 3600 Facsimile 8232 4227
Foreign Exchange 8232 3666 Facsimile 8232 3019
Metals and Energy Capital 8232 3444 Facsimile 8232 3590
Futures 8232 7580 Facsimile 8232 4412
Debt Markets 8232 8569 Facsimile 8232 8341
Agricultural Commodities 8232 7672 Facsimile 8232 3633



Sir David Tweedie
International Accounting Standards Board
30 Canon Street, London, EC4M 6XH
United Kingdom

By Electronic Submission at: www.iasb.org

CC:
Mr. Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
Melbourne, VIC, 8007

17 July 2009

IASB Discussion Paper DP/2009/1 Leases – Preliminary Views

Dear David,

We are responding to the IASB Discussion Paper DP/2009/1 Leases – Preliminary views.

We are supportive of some of the changes in the discussion paper, primarily because lease arrangements that marginally fell short of the arbitrary limit for finance lease classification resulted in an accounting treatment (ie no recognition until payments made) that lacked decision-useful information and no conceptual basis for its differing treatment to finance leases.

In principle, we consider the general approach of recognising on balance sheet arrangements previously considered operating leases to now open the door at a conceptual level for considering whether all commitments / forward purchase contracts over non-financial items (eg. simple inventory purchase orders) should also be recognised on balance sheet as obligations and rights to receive assets. While this specific topic would be outside the scope of the project, in developing principle-based standards we consider the Board should give this some consideration in developing their rationale.

Our main concerns with the proposals are:

- We consider the revisions to lease accounting should cover the treatment for both lessors and lessees simultaneously. Otherwise, financial statements may become less comparable to users, since we expect interpretive questions will arise as lessors develop their accounting policies in consideration of the changed requirements for lessees.

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- We would prefer that the US FASB and IASB seek to converge their proposals now, because without complete convergence, it would seem likely that the points of contention would be revisited again in the future, and possibly give rise to further subsequent amendments.
- We consider the obligation should be based on the non-cancellable commitment period (& the related minimum payments) under the terms of the contract, along with renewal options (and therefore the related payments) that are assessed as 'bargains' virtually certain to be exercised. The rights and obligations arising from other options, contingent rentals and residual value guarantees should fall to other existing standards (eg IAS 39). We consider this basis more faithfully reflects the obligations of the lessee, and provides more decision-useful information for users.
- Macquarie, in addition to being a lessee of property and equipment, also has a significant lease portfolio over many assets as lessor. We are concerned that the increased costs of compliance to meet new accounting standards for many small value lease arrangements will outweigh the benefits of making this change. We therefore recognise the increased effort for our clients and would like the Board to consider a simplified version of reporting for SMEs.
- The proposal that all leases be recognised on balance sheet may prima facie create, from a business and regulatory perspective, an adverse impact for regulated entities. This is because more gross assets may result in the need to hold additional capital, unless the regulator considers that from an economic perspective nothing has changed. While we acknowledge these consequences may be of little concern to the IASB, the Board's assistance in raising the profile of this issue with regulators would assist in resolving the regulatory treatment expeditiously.

Our responses to the questions included within the discussion paper are provided in the attached Appendix.

If you have any questions in relation to this submission, or would like our assistance, please do not hesitate to contact myself (+61 2 8232 8670) or Frank Palmer (+61 2 8232 5193).

Yours sincerely



PP: Stuart Dyson
Group Financial Controller
Macquarie Group

About Macquarie Group

Macquarie Group ('Macquarie') is a global provider of banking, financial, advisory, investment and funds management services. Macquarie's main business focus is making returns by providing a diversified range of services to clients. Macquarie acts on behalf of institutional, corporate and retail clients and counterparties around the world.

Macquarie Group Limited is listed in Australia (ASX: MQG) and is regulated by APRA, the Australian banking regulator, as it is the parent of Macquarie Bank Limited, an authorised deposit taker. Macquarie also owns a bank in the UK, Macquarie Bank International, which is regulated by the FSA. In addition, Macquarie's activities are subject to scrutiny by other regulatory agencies around the world.

As an owner and manager of significant community assets, Macquarie works closely with governments around the world to deliver important services including transport, roads, airports and utilities.

Founded in 1969, Macquarie operates in more than 70 offices locations in 26 countries. Macquarie employed approximately 12,700 people and had assets under management of AUD 243 billion at 31 March 2009.

APPENDIX

CHAPTER 2: SCOPE OF LEASE ACCOUNTING STANDARD**Question 1**

The boards tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards.

Do you agree with this proposed approach?

If you disagree with the proposed approach, please describe how you would define the scope of the proposed new standard.

We agree.

Question 2

Should the proposed new standard exclude non-core asset leases or short-term leases? Please explain why. Please explain how you would define those leases to be excluded from the scope of the proposed new standard.

We consider there should be no exclusion for non-core leases, because this is subject to interpretation difficulties. The scope of standards should not be ambiguous.

Genuinely short term leases where there is no obligation to purchase, nor likelihood of lease extension (eg, less than 6 months), should be excluded from the scope because their consequences are likely to be immaterial, the costs of administration (capitalisation of a right to use asset and amortisation) will outweigh the benefits, and the treatment does not provide additional decision-useful information (since note disclosure is already provided for the minimum payments during the non-cancellable period)..

CHAPTER 3: APPROACH TO LESSEE ACCOUNTING**Question 3**

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

We agree with the analysis of the rights and obligations under a lease contract and the resulting right to use assets and lease liabilities being on balance sheet. The arbitrary limit currently used to distinguish existing finance leases from operating leases has no conceptual basis, particularly for those arrangements that marginally fell short of having to be recognised on balance sheet.

Question 4

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

- (a) an asset representing its right to use the leased item for the lease term (the right-of-use asset)
- (b) a liability for its obligation to pay rentals.

Appendix C describes some possible accounting approaches that were rejected by the boards.

Do you support the proposed approach?

If you support an alternative approach, please describe the approach and explain why you support it.

As noted in question 3, we agree. However, in principle, we consider this approach now raises the issue for considering whether all commitments / forward purchase contracts over non-financial items (eg. simple inventory purchases) should also be recognised on balance sheet as obligations and rights to receive assets. While this specific topic would be outside the scope of the leasing project, in developing principle-based standards we consider the Board should give this some consideration in developing their rationale for the leasing proposals.

Question 5

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

- (a) a single right-of-use asset that includes rights acquired under options
- (b) a single obligation to pay rentals that includes obligations arising under contingent rental arrangements and residual value guarantees.

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

We agree with the single asset / single obligation approach to some extent.

However, we consider the obligation should be based on the non-cancellable commitment period (& the related minimum payments) under the terms of the contract, along with renewal options (and therefore the related payments) that are assessed as 'bargains' based on a commercial expectation that the lease renewal is virtually certain to be exercised. The rights and obligations arising from other options, contingent rentals and residual value guarantees should fall to other existing standards (eg IAS 39). We consider this basis more faithfully reflects the obligations of the lessee.

If the Board continues with its approach to determining the lease period and measuring the obligations, then we consider this would add too much diversity in making assessments of lease periods and measuring the obligations. A lessee and a lessor (if using the same approach as in these proposals) could come to very different conclusions for the same lease arrangement. We consider this reduces the decision-usefulness of financial statements, and would draw many users to request more disclosure information to help them reconcile the differences in views. Our responses to the questions below are on the basis that the Board continues with its approach.

CHAPTER 4: INITIAL MEASUREMENT**Question 6**

Do you agree with the boards' tentative decision to measure the lessee's obligation to pay rentals at the present value of the lease payments discounted using the lessee's incremental borrowing rate?

If you disagree, please explain why and describe how you would initially measure the lessee's obligation to pay rentals.

We agree. The incremental borrowing rate would be acceptable for discounting all leases. Currently, in the case of a finance lease, determining the implicit interest rate is dependent on an accurate estimate of the residual value (which is difficult to determine), and if the RV is properly assessed then the implicit rate should be reasonably similar to the lessee's incremental borrowing rate.

Question 7

Do you agree with the boards' tentative decision to initially measure the lessee's right-of-use asset at cost?

If you disagree, please explain why and describe how you would initially measure the lessee's right-of-use asset.

We agree.

CHAPTER 5: SUBSEQUENT MEASUREMENT**Question 8**

The boards tentatively decided to adopt an amortised cost-based approach to subsequent measurement of both the obligation to pay rentals and the right-of-use asset.

Do you agree with this proposed approach?

If you disagree with the boards' proposed approach, please describe the approach to subsequent measurement you would favour and why.

We agree. Amortised cost will give an equivalent profile in the income statement as an asset acquired with debt funding.

We also consider transaction costs should be included within this initial measurement, in order to consistent with the amortised cost approach to financial instruments under IAS39.

Question 9

Should a new lease accounting standard permit a lessee to elect to measure its obligation to pay rentals at fair value? Please explain your reasons.

Yes. We consider a lease obligation to be similar to a financial liability (in fact, current finance lease obligations are within the scope of IAS39 for derecognition purposes). Since the measurement of the liability is based on cash flows, we see no reason to not permit an entity the choice of carrying these at fair value. Many would hedge these cash flows, and therefore electing to carry the lease obligation at fair value would avoid the need to apply onerous hedge accounting rules. Our view would also be the same if lessors were also to recognise the right to receive rentals under all leases as assets.

Question 10

Should the lessee be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate? Please explain your reasons.

If the boards decide to require the obligation to pay rentals to be revised for changes in the incremental borrowing rate, should revision be made at each reporting date or only when there is a change in the estimated cash flows?

Please explain your reasons.

The lessee should not be required to revise its liability under the lease as a result of a change in the incremental borrowing cost, because the contractual payments remain unchanged which reflects a fixed interest cost charged by the lessor. Changing the incremental borrowing rate would be misleading to users of financial statements. To remain consistent with the current requirements of IAS 39 when calculating the amortised cost (as proposed by the Board in question 8) To remain consistent with the current requirements of IAS 39 when calculating the amortised cost (as proposed by the Board in question 8) of a fixed rate borrowing, the borrowing rate of the lease liability should not be changed (ie the original effective interest rate should be used). Our view is also consistent with the US FASB proposals, which would bring more convergence between the two Boards..

Question 11

In developing their preliminary views the boards decided to specify the required accounting for the obligation to pay rentals. An alternative approach would have been for the boards to require lessees to account for the obligation to pay rentals in accordance with existing guidance for financial liabilities.

Do you agree with the proposed approach taken by the boards?

If you disagree, please explain why.

We agree, but acknowledge once a lease obligation and right of use asset is recognised the obligation is no different from a financial liability.

Question 12

Some board members think that for some leases the decrease in value of the right-of-use asset should be described as rental expense rather than amortisation or depreciation in the income statement.

Would you support this approach? If so, for which leases? Please explain your reasons.

Overall, we consider the decrease in the value of the asset should always be expressed as depreciation/amortisation, because it would confuse users if the decline in value is presented as a rental expense and the initial accounting reflects that the entity has funded an asset through a borrowing.

We recognise that if the decrease is presented as depreciation/amortisation, then this would have a dramatic effect for the comparable information (eg EBITDA) of some companies. Generally, we consider a change in accounting treatment should not have this type of impact, and we understand others having the motivation to continue presenting the decrease in value as a rental expense.

CHAPTER 6: LEASES WITH OPTIONS

Question 13

The boards tentatively decided that the lessee should recognise an obligation to pay rentals for a specified lease term, ie in a 10-year lease with an option to extend for five years, the lessee must decide whether its liability is an obligation to pay 10 or 15 years of rentals. The boards tentatively decided that the lease term should be the most likely lease term.

Do you support the proposed approach?

If you disagree with the proposed approach, please describe what alternative approach you would support and why.

As mentioned in our response to Question 5, we consider that renewal periods should be included only where options are assessed as 'bargains'. However, if the Board proceeds with its approach, then we recommend additional disclosure to give users information about the minimum non-cancellable lease period.

We ask the Board to clarify that when determining the most likely lease term, whether a portfolio approach can be taken to a group of leases where the nature of the underlying asset and the contractual minimum lease period is the same. For instance, after the end of a lease term, lessees often have the ability to continue leasing the asset or return the asset at any time (which economically can be viewed as a series of daily options). History on a portfolio basis can sometimes give information on the percentage of lessees likely to continue renting and the likely extension period. Determining the most likely lease term of an individual lease will likely derive a term different from the most likely lease term determined on a group basis. We consider the issue to be similar to collective loan provisioning.

Question 14

The boards tentatively decided to require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances. Changes in the obligation to pay rentals arising from a reassessment of the lease term should be recognised as an adjustment to the carrying amount of the right-of-use asset.

Do you support the proposed approach?

If you disagree with the proposed approach, please describe what alternative approach you would support and why.

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

Consistent with our response to Question 5 we consider a periodic reassessment of the lease term should be made only where the reassessed term is virtually certain to change (a compelling commercial reason). We don't consider an on-going reassessment based on a 'most likely' term to provide decision-useful information for users, because while there will always be measurement uncertainty with respect to contingent payments there should never be measurement uncertainty when it comes to the period.

Question 15

The boards tentatively concluded that purchase options should be accounted for in the same way as options to extend or terminate the lease.

Do you agree with the proposed approach?

If you disagree with the proposed approach, please describe what alternative approach you would support and why.

As mentioned in our response to Question 5, we consider that renewal periods should be included only where options are assessed as 'bargains'.

CHAPTER 7: CONTINGENT RENTALS AND RESIDUAL VALUE GUARANTEES

Contingent rentals

Question 16

The boards propose that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements.

Do you support the proposed approach?

If you disagree with the proposed approach, what alternative approach would you recommend and why?

Consistent with our response to Question 5, contingent rentals should only be included in the obligation when their measurement is virtually certain. All other contingent amounts should fall to other existing standards (eg IAS 39).

The reasons for our view are that 1) we consider our approach more faithfully reflects the obligations of the lessee, 2) including contingencies will cause too much diversity in measuring the obligations (eg a lessee and a lessor – if both use the same accounting approach as in these proposals – could come to very different conclusions for the same lease arrangement), and 3) many users may be drawn to request more disclosures to help them either reconcile differences or estimate the amounts that are subjective.

Question 17

The IASB tentatively decided that the measurement of the lessee's obligation to pay rentals should include a probability-weighted estimate of contingent rentals payable. The FASB tentatively decided that a lessee should measure contingent rentals on the basis of the most likely rental payment. A lessee would determine the most likely amount by considering the range of possible outcomes.

However, this measure would not necessarily equal the probability-weighted sum of the possible outcomes.

Which of these approaches to measuring the lessee's obligation to pay rentals do you support? Please explain your reasons.

Subject to our comments in question 16, we would support the FASB's approach because this will be closer to the actual cash outflow for leasing the asset. The IASB's approach will get closer to a fair value measurement that is less meaningful for users when management is expected to lease rather than transfer its liability to a third party.

Question 18

The FASB tentatively decided that if lease rentals are contingent on changes in an index or rate, such as the consumer price index or the prime interest rate, the lessee should measure the obligation to pay rentals using the index or rate existing at the inception of the lease.

Do you support the proposed approach? Please explain your reasons.

See response to Question 16 above.

Question 19

The boards tentatively decided to require remeasurement of the lessee's obligation to pay rentals for changes in estimated contingent rental payments.

Do you support the proposed approach? If not, please explain why.

See response to Question 16 above.

Question 20

The boards discussed two possible approaches to recognising all changes in the lessee's obligation to pay rentals arising from changes in estimated contingent rental payments:

- (a) recognise any change in the liability in profit or loss
- (b) recognise any change in the liability as an adjustment to the carrying amount of the right-of-use asset.

Which of these two approaches do you support? Please explain your reasons.

If you support neither approach, please describe any alternative approach you would prefer and why.

If the Board proceeds with the inclusion of contingent rentals in the recognised obligation, we consider any change in that obligation should be reflected as an adjustment to the right to use asset. This is because the change in the obligation would only be commercial if the underlying asset also had more inherent value.

Residual value guarantees

Question 21

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

See response to Question 16 above.

CHAPTER 8: PRESENTATION

Question 22

Should the lessee's obligation to pay rentals be presented separately in the statement of financial position?

Please explain your reasons.

What additional information would separate presentation provide?

Separate presentation should only be necessary if material and necessary for an understanding of the financial position under IAS1 paragraph 55.

Question 23

This chapter describes three approaches to presentation of the right-of-use asset in the statement of financial position.

How should the right-of-use asset be presented in the statement of financial position?

Please explain your reasons.

What additional disclosures (if any) do you think are necessary under each of the approaches?

We consider the answer comes from the view of whether a lease represents a realisation/disposal of the underlying leased asset, or a separate arrangement. We ask the Board to consider testing its recently proposed derecognition rules for financial instruments against lease arrangements. While the scope of the derecognition proposals are contained to financial instruments, we consider principle-based rules are robust when similar outcomes result from various forms of transactions.

Entities regulated in the financial services industry may be required to hold additional capital as a consequence of the proposals. While we acknowledge these consequences may be of little concern to the IASB, the Board's assistance in raising the profile of this issue with regulators would assist in resolving the regulatory treatment expeditiously.

CHAPTER 9: OTHER LESSEE ISSUES

Question 24

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

The treatment of sale and leaseback transactions should be addressed.

Transitional arrangements should be explored.

Disclosure of the most likely lease term as compared to the economic life of the underlying asset should be considered because the current proposals do not facilitate an understanding of how organisations manage their residual value risk of the underlying leased asset.

CHAPTER 10: LESSOR ACCOUNTING

Question 25

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

Yes, but the question is whether the asset represents a realisation / disposal of the underlying leased asset. Our view is that a non-financial asset subject to a lease arrangement can be componentised into an asset representing the right to receive cash from the lessee and an asset representing the residual value of the underlying asset at the end of the lease term.

Question 26

This chapter describes two possible approaches to lessor accounting under a right-of-use model: (a) derecognition of the leased item by the lessor or (b) recognition of a performance obligation by the lessor. Which of these two approaches do you support? Please explain your reasons.

We support option (a) as that reflects the economic reality and results in financial information that is relevant and understandable for users of the financial statements. An asset, however it's described, represents future economic benefits to the entity. Whether an entity consumes the asset in its operations, or transfer the use of that asset to another entity (in whole or in part) in return for another asset (eg cash or non-monetary exchange), we consider it to be misleading when the economic benefits are represented twice on the balance sheet (once as the underlying leased asset, and second as a right to cash flows from transferring part of the rights of the leased asset to the lessee).

If an asset is depreciated (representing a consumption) when used in operations and therefore depreciated based on the pattern of consuming the benefits (time based or unit of production), then we consider the economic benefits of an asset subject to a lease arrangement could be componentised with part (based on a proportionate interest in the whole of the asset) or all of the asset derecognised upon entering the lease arrangement. This approach faithfully represents the assets with which the lessor has control - the right to receive rentals from the lessee, and the residual value risk retained at the end of the lease term. This approach could be applied to any lease arrangement - from hire purchase where the purchaser gains title to the asset through to short-term leases where the lessor retains substantial residual value risk of the asset.

As we commented in question 25, we consider that the Board should test the new derecognition principals for financial instruments against these proposals for consistency.

Question 27

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

Yes, particularly for manufacturers that become lessors at the end of the manufacturing process (ie multiple-element arrangements).

Question 28

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

Yes, as we consider the principle of leasing applies regardless of the form of the leased asset.

Question 29

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

The treatment of initial direct costs should be covered.

OTHER CONSIDERATIONS

There will be implications where a lease is denominated in foreign currency to the functional currency. If the asset is considered an non-monetary right-of-use asset (revaluing at historic f/x rates) whereas the obligation is monetary (revaluing at current f/x rates), the volatility will arise in the income statement even though economically there is no f/x risk. This forces entities to consider hedge accounting for the foreign currency risks.