AASB Exposure Draft

Tier 2 Supplement to ED 202R

November 2010

Leases

Comments to AASB by 31 January 2011

Australian Government

Australian Accounting Standards Board

Commenting on this Tier 2 Supplement to AASB Exposure Draft

Comments on this Tier 2 Supplement to AASB Exposure Draft ED 202R *Leases* are requested by 31 January 2011. Comments should be addressed to:

The Chairman
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Collins Street West Victoria 8007
AUSTRALIA
E-mail: standard@aasb.gov.au

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chairman of the AASB agrees to those submissions being treated as confidential. The latter will only occur if the public interest warrants such treatment.

Obtaining a Copy of this Tier 2 Supplement to AASB Exposure Draft

This Tier 2 Supplement to AASB Exposure Draft ED 202R is available on the AASB website: www.aasb.gov.au. Alternatively, printed copies of this Supplement are available by contacting:

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AASB REQUEST FOR COMMENTS

Reduced Disclosure Requirements

AASB 1053 *Application of Tiers of Australian Accounting Standards* establishes a differential reporting framework consisting of two tiers of reporting requirements for preparing general purpose financial statements:

(a) Tier 1: Australian Accounting Standards; and

(b) Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements (RDR).

Tier 2 comprises the recognition, measurement and presentation requirements of Tier 1 and substantially reduced disclosures corresponding to those requirements.

This Tier 2 Supplement to AASB Exposure Draft ED 202R *Leases* sets out the disclosures proposed in ED 202R (which incorporates International Accounting Standards Board [IASB] ED/2010/9 *Leases*) and analyses whether they should be included in Tier 2 reporting requirements. The proposals should not be seen as any indication of AASB support or otherwise for the IASB's proposed disclosures in ED/2010/9. That will be determined through the ED 202R due process.

Due Date for Comments to the AASB

Comments on this Tier 2 Supplement to ED 202R should be submitted to the AASB by 31 January 2011.

AASB Specific Matters for Comment

The AASB would particularly value comments on the following:

1. whether you agree with the AASB disclosure proposals under Tier 2 as set out in the attached analysis;

2. whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

   (a) not-for-profit entities; and

   (b) public sector entities;

3. whether, overall, the proposals would result in financial statements that would be useful to users;

4. whether the proposals are in the best interests of the Australian economy; and

5. unless already provided in response to specific matters for comment 1 – 4 above, the costs and benefits of the proposals, whether quantitative (financial or non-financial) or qualitative.

Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue.

ANALYSIS OF PROPOSED DISCLOSURES

The purpose of this Tier 2 Supplement to ED 202R is to propose whether Tier 2 entities should be exempted from making certain disclosures proposed in ED 202R in their general purpose financial statements.

Determining Tier 2 Disclosure

In determining the proposed reduced disclosure requirements, consideration has been given to the principles that were applied in analysing full International Financial Reporting Standards (IFRSs) as adopted in Australia when the reduced disclosure requirements were first established for Tier 2 entities. The principles for determining Tier 2 disclosure requirements ('Tier 2 Disclosure Principles') are as follows:

(a) drawing directly on the *International Financial Reporting Standard for Small and Medium-Sized Entities (IFRS for SMEs)* when the Tier 2 recognition and measurement requirements are the same as those under the *IFRS for SMEs*; and

(b) using the 'user need' and 'cost-benefit' principles applied by the IASB in developing its *IFRS for SMEs* when the Tier 2 recognition and measurement requirements are not the same as those available under the *IFRS for SMEs*.

Further explanation of the above principles is provided on the AASB website[1]. Because the distinction between principles (a) and (b) above depends on whether there are differences in recognition and measurement requirements under Tier 2 and the *IFRS for SMEs*, the differences pertinent to this exposure draft are identified below.

Comparison of ED 202R and Section 20 of the *IFRS for SMEs*

Section 20 of the *IFRS for SMEs* applies to all leases, with a number of key exemptions where the lease would be covered by another Standard (for example, AASB 140 *Investment Property* or AASB 141 *Agriculture*). AASB ED 202R similarly applies to leases, but has further scope exemptions, beyond those under *IFRS for SMEs*, for leases of intangible assets and contracts that represent a purchase or sale of the underlying asset.

Recognition, Measurement or Presentation Requirements

Section 20 *Leases* of the *IFRS for SMEs* differs from AASB ED 202R in relation to the recognition of leases from the perspective of lessees in a number of ways, given major changes proposed to the classification of leases in AASB ED 202R. The *IFRS for SMEs* classifies leases as either finance or operating leases based on the extent to which the risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee. Rights of use and obligations under finance leases are recognised as assets and liabilities in the lessee's statement of financial position but not under an operating lease. AASB ED 202R proposes to remove the distinction between operating and finance leases, and would require a right-of-use asset and a liability to make lease payments to be recognised in the statement of financial position at the commencement of all leases covered by the proposed revised Standard.

There are also proposals in AASB ED 202R to change the recognition of leases from the perspective of lessors, including replacing the finance or operating lease classification with the performance obligation or derecognition approaches based on whether the lessor retains exposure to significant risks or benefits associated with the underlying asset either during or after the expected term of the lease. This classification determines whether the lease is recognised on a lessor's statement of financial position.

1 See www.aasb.gov.au/Work-In-Progress/Reduced-Disclosure-Requirements/Tier-2-Disclosure-Principles.aspx.

Tier 2 Disclosure Proposals

It is proposed to exempt Tier 2 entities from the proposed disclosure requirements in paragraphs 70, 71, 72, 73(a)(iii) second sentence, 73(a)(v), 73(a)(vii), 73(b), 78, 79, 80(b), 81, 82, 84 and partially paragraph 76 of AASB ED 202R.

An analysis of the proposed disclosure requirements is available on the AASB website[2]. The full text of the proposed reduced disclosure requirements, with shading to identify the proposed exemptions for Tier 2 entities, where relevant, is provided below.

2 See www.aasb.gov.au/Work-In-Progress/Reduced-Disclosure-Requirements/Analysis-of-Disclosure-Requirements.aspx.

Proposed Reduced Disclosure Requirements

The following are the disclosure requirements proposed in ED 202R *Leases* (August 2010), showing, where relevant, requirements from which it is proposed entities applying Tier 2 requirements should be exempt as shaded text.

70 An entity shall disclose quantitative and qualitative financial 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.

71 An entity shall consider the level of detail necessary to satisfy the disclosure requirements in paragraphs 73–86 and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics.

72 If the disclosures required by this and other IFRSs do not meet the objectives in paragraph 70, an entity shall disclose the additional information necessary to meet the objectives.

Information that identifies and explains the amounts in the financial statements

73 An entity shall disclose:

(a) the nature of its lease arrangements, including:

(i) a general description of those lease arrangements.

(ii) the basis and terms on which contingent rentals are determined.

(iii) the existence and terms of options, including for renewal and termination. A lessee shall provide narrative disclosure about the options that were recognised as part of the right-of-use asset and those that were not.

(iv) the existence and principal terms of any options for the lessee to purchase the underlying asset.

(v) information about assumptions and judgements relating to amortisation methods and changes to those assumptions and judgements.

(vi) the existence and terms of residual value guarantees.

(vii) initial direct costs incurred during the reporting period and included in the measurement of the right-of-use asset or right to receive lease payments.

(viii) the restrictions imposed by lease arrangements, such as those relating to dividends, additional debt and further leasing.

(b) information about the principal terms of any lease that has not yet commenced if the lease creates significant rights and obligations for the entity.

74 An entity shall identify the nature and amount of significant subleases included in the disclosures provided in accordance with paragraph 73.

75 An entity that accounts for short-term leases in accordance with paragraphs 64 and 65 shall disclose that fact and, for lessees, the amount recognised in the statement of financial position for such short-term leases.

76 A lessee that enters into a sale and leaseback transaction shall disclose that fact, disclose the terms and conditions for that transaction and identify any gains or losses arising from such transactions separately from gains or losses on other disposals of assets.

77 A lessee shall disclose a reconciliation of opening and closing balances of right-of-use assets and liabilities to make lease payments, disaggregated by class of underlying asset. The reconciliation shall show separately the total cash lease payments paid during the period.

78 A lessor shall disclose the information about its exposure to the risks or benefits associated with the underlying asset that it used in determining whether to apply the performance obligation approach or the derecognition approach.

79 A lessor shall disclose impairment losses arising from leases to which it applies the performance obligation approach separately from those to which it applies the derecognition approach.

80 A lessor shall disclose a reconciliation of the opening and closing balances for each of the following:

(a) rights to receive lease payments.

(b) lease liabilities arising from leases to which it applies the performance obligation approach.

(c) residual assets arising from leases to which it applies the derecognition approach.

81 A lessor shall disclose information about the nature and amount of each class of residual asset arising from leases to which it applies the derecognition approach.

82 A lessor shall disclose information about the nature of significant service obligations related to its leases.

Information about the amount, timing and uncertainty of cash flows arising from leases

83 An entity shall disclose information about significant assumptions and judgements and any changes in assumptions and judgements relating to renewal options, contingent rentals, term option penalties, residual value guarantees and the discount rate used when determining the present value of lease payments.

84 Except as described in paragraphs 85 and 86, an entity shall disclose information relating to risks arising from a lease required by paragraphs 31–42 of IFRS 7 *Financial Instruments: Disclosures*.

85 In place of the maturity analyses required by paragraph 39(a) and (b) of IFRS 7, a lessee shall disclose a maturity analysis of the liabilities to make lease payments showing the undiscounted cash flows on an annual basis for the first five years and a total of the amounts for the remaining years. The maturity analysis shall distinguish the minimum obligations specified in the lease (i.e. excluding contingent rentals and expected payments under term option penalties and residual value guarantees) and the amounts recognised in the statement of financial position.

86 In place of the maturity analyses required by paragraph 37(a) of IFRS 7, a lessor shall disclose a maturity analysis of the right to receive lease payments showing the undiscounted cash flows on an annual basis for the first five years and a total of the amounts for the remaining years. The maturity analysis shall distinguish the cash flows attributable to the minimum amounts receivable specified in the lease (i.e. excluding contingent rentals and expected payments from the lessee under term option penalties and residual value guarantees) and the amounts recognised in the statement of financial position.