AASB Exposure Draft

Tier 2 Supplement to ED 242
September 2013

Leases

Comments to AASB by 15 November 2013

Australian Government
Australian Accounting Standards Board

Invitation to Comment

Comments on this Tier 2 Supplement to AASB Exposure Draft ED 242 are requested by 15 November 2013.

Comments should be addressed to:

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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 ED 242 is available on the AASB website: www.aasb.gov.au. Alternatively, printed copies of this Exposure Draft are available by contacting:

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ISSN 1030-5882

Background

In May 2013, the IASB published ED/2013/6 *Leases*. ED/2013/6 contains proposals to require recognition of assets and liabilities arising from a lease. ED/2013/6 contains revised proposals first exposed by the IASB in August 2010 in ED/2010/9 *Leases*.

Consistent with its policy of adopting International Financial Reporting Standards (IFRSs), in June 2013 the AASB published ED 242 *Leases* (for comment to the AASB by 14 August 2013), which incorporates IASB ED/2013/6 (for comment to the IASB by 13 September 2013). The AASB's response to IASB ED/2013/6 is available on the AASB website under Work in Progress/Submissions from AASB.

This Exposure Draft sets out the disclosures proposed in ED 242 from which it is proposed entities applying Tier 2 reporting requirements should be exempt. It supersedes the Tier 2 Supplement to AASB ED 202R issued by the AASB in November 2010. The proposals in this Exposure Draft should not be seen as any indication of AASB support or otherwise for the IASB's proposals in IASB ED/2013/6. That will be determined through the ED 242 due process.

ANALYSIS OF PROPOSED DISCLOSURES

The AASB's conclusions in relation to proposed Tier 2 disclosure requirements in this Exposure Draft have been reached after applying the AASB's usual approach to the analysis of the disclosures proposed in ED 242 compared with disclosures set out in the IASB's *IFRS for SMEs* and application of the AASB's 'Tier 2 Disclosure Principles'. Those principles and that analysis are available on the AASB website under Work in Progress/Reduced Disclosure Requirements.

A summary of the comparison between ED 242 and *IFRS for SMEs* Section 20 *Leases* in terms of the recognition and measurement accounting policies for the purpose of applying Tier 2 Disclosure Principles are outlined in the Appendix to this Exposure Draft.

AASB Specific Matters for Comment

The purpose of this Tier 2 Supplement to ED 242 is to seek comment on the proposed disclosure requirements that should apply to Tier 2 entities.

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.

The AASB would particularly value comments on the following:

1. whether you agree with the AASB disclosure proposals to exclude paragraphs 61, 62, 64, 65, the second sentence of paragraph 67, the words 'in a tabular format' of paragraph 101, paragraphs 101(a), 103-105, the second sentence of paragraph 106, and paragraph 107 of ED 242 for Tier 2 entities, as set out in the Proposed Reduced Disclosure Requirements section below;

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

   (a) not-for-profit entities; and

   (b) public sector entities;

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

4. whether these 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.

Proposed Reduced Disclosure Requirements

Under the proposals in this Tier 2 Supplement to ED 242, Tier 2 entities would be exempt from making the disclosures proposed in paragraphs 61, 62, 64, 65, the second sentence of paragraph 67, the words 'in a tabular format' of paragraph 101, paragraphs 101(a), 103-105, the second sentence of paragraph 106, and paragraph 107 of ED 242.

The disclosures proposed in ED 242 are provided below. Entities applying Tier 2 requirements are proposed to be exempted from applying disclosure requirements shown as shaded text.

PROPOSED REDUCED DISCLOSURE REQUIREMENTS: AASB ED 242

Presentation

54 A lessee shall either present in the statement of financial position or disclose in the notes all of the following:

- (a) right-of-use assets separately from other assets;
- (b) lease liabilities separately from other liabilities;
- (c) right-of-use assets arising from Type A leases separately from right-of-use assets arising from Type B leases and right-of-use assets measured at revalued amounts; and
- (d) lease liabilities arising from Type A leases separately from lease liabilities arising from Type B leases.

55 If a lessee does not present right-of-use assets and lease liabilities separately in the statement of financial position, the lessee shall do both of the following:

- (a) present right-of-use assets within the same line item as the corresponding underlying assets would be presented if they were owned; and
- (b) disclose which line items in the statement of financial position include right-of-use assets and lease liabilities.

56 In the statement of profit or loss and other comprehensive income, a lessee shall present both of the following:

- (a) for Type A leases, the unwinding of the discount on the lease liability separately from the amortisation of the right-of-use asset.
- (b) for Type B leases, the unwinding of the discount on the lease liability together with the amortisation of the right-of-use asset.

Disclosure

58 The objective of the disclosure requirements is to enable users of financial statements to understand the amount, timing and uncertainty of cash flows arising from leases. To achieve that objective, a lessee shall disclose qualitative and quantitative information about all of the following:

- **(a) its leases (as described in paragraphs 60(a) and 60(b));**
- **(b) the significant judgements made in applying the [draft] Standard to those leases (as described in paragraph 60(c)); and**
- **(c) the amounts recognised in the financial statements relating to those leases (as described in paragraphs 61-67).**

59 A lessee shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. A lessee shall aggregate or disaggregate disclosures so that useful information is not obscured by including a large amount of insignificant detail or by aggregating items that have different characteristics.

60 A lessee shall disclose the following:

(a) information about the nature of its leases, including:

(i) a general description of those leases;

(ii) the basis, and terms and conditions, on which variable lease payments are determined;

(iii) the existence, and terms and conditions, of options to extend or terminate the lease. A lessee shall provide narrative disclosure about the options that are recognised as part of the right-of-use asset and lease liability and those that are not;

(iv) the existence, and terms and conditions, of residual value guarantees provided by the lessee; and

(v) the restrictions or covenants imposed by leases, for example those relating to dividends or incurring additional financial obligations.

A lessee shall identify the information relating to subleases included in the disclosures provided above.

(b) information about leases that have not yet commenced but that create significant rights and obligations for the lessee.

(c) information about significant assumptions and judgements made in applying the [draft] Standard, which may include the following:

(i) the determination of whether a contract contains a lease (as described in paragraphs 6-19);

(ii) the allocation of the consideration in a contract between lease and non-lease components (as described in paragraphs 23-24); and

(iii) the determination of the discount rate (as described in paragraphs B7-B9).

61 A lessee shall disclose a reconciliation of opening and closing balances of right-of-use assets by class of underlying asset separately for Type A leases, Type B leases and right-of-use assets measured at revalued amounts. Those reconciliations shall include items that are useful in understanding the change in the carrying amount of right-of-use assets, for example, the following:

(a) additions due to leases commencing or being extended;

(b) reclassifications when a lessee exercises a purchase option;

(c) reductions due to leases being terminated;

(d) remeasurements relating to a change in an index or a rate used to determine lease payments;

(e) amortisation;

(f) effects of business combinations; and

(g) impairment.

62 A lessee that measures its right-of-use assets arising from leased investment property in accordance with the fair value model in IAS 40 (as described in paragraph 52) may elect not to provide the disclosure required by paragraph 61 for those right-of-use assets.

63 If a lessee measures right-of-use assets at revalued amounts, the lessee shall disclose:

(a) the effective date of the revaluation; and

(b) the amount of the revaluation surplus that relates to right-of-use assets at the start and end of the reporting period, indicating the changes during the period and any restrictions on the distribution of the balance to shareholders.

64 A lessee shall disclose a reconciliation of opening and closing balances of the lease liability separately for Type A leases and Type B leases. Those reconciliations shall include the periodic unwinding of the discount on the lease liability and other items that are useful in understanding the change in the carrying amount of the lease liability, for example, the following:

(a) liabilities created due to leases commencing or being extended;

(b) liabilities extinguished due to leases being terminated;

(c) remeasurements relating to a change in an index or a rate used to determine lease payments;

(d) cash paid;

(e) foreign currency exchange differences; and

(f) effects of business combinations.

65 A lessee shall disclose costs that are recognised in the period relating to variable lease payments not included in the lease liability.

66 A lessee shall disclose information about the acquisition of right-of-use assets in exchange for lease liabilities, arising from both Type A leases and Type B leases, as a supplemental non-cash transaction disclosure (see IAS 7).

67 In place of the maturity analysis required by paragraphs 39(a) and 39(b) of IFRS 7 *Financial Instruments: Disclosures*, a lessee shall disclose a maturity analysis of the lease liability, showing the undiscounted cash flows on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessee shall reconcile the undiscounted cash flows to the lease liability recognised in the statement of financial position.

Presentation

88 A lessor shall present lease assets (ie the sum of the carrying amounts of lease receivables and residual assets) separately from other assets in the statement of financial position.

89 A lessor shall also either present in the statement of financial position or disclose in the notes the carrying amount of lease receivables and the carrying amount of residual assets.

90 A lessor shall either present in the statement of profit or loss and other comprehensive income or disclose in the notes income arising from leases. If a lessor does not present lease income in the statement of profit or loss and other comprehensive income, the lessor shall disclose which line items include the income in the statement of profit or loss and other comprehensive income.

91 A lessor shall present any profit or loss on the lease recognised at the commencement date in a manner that best reflects the lessor's business model(s). Examples of presentation include the following:

(a) if a lessor uses leases as an alternative means of realising value from the goods that it would otherwise sell, the lessor shall present revenue and cost of goods sold relating to its leasing activities in separate line items so that income and expenses from sold and leased items are presented consistently.

(b) if a lessor uses leases for the purposes of providing finance, the lessor shall present the profit or loss in a single line item.

Disclosure

98 The objective of the disclosure requirements is to enable users of financial statements to understand the amount, timing and uncertainty of cash flows arising from leases. To achieve that objective, a lessor shall disclose qualitative and quantitative information about all of the following:

(a) its leases (as described in paragraph 100(a));

(b) the significant judgements made in applying the [draft] Standard to those leases (as described in paragraph 100(b)); and

(c) the amounts recognised in the financial statements relating to those leases (as described in paragraphs 101-109).

99 A lessor shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. A lessor shall aggregate or disaggregate disclosures so that useful information is not obscured by including a large amount of insignificant detail or by aggregating items that have different characteristics.

100 A lessor shall disclose the following:

(a) information about the nature of its leases, including:

(i) a general description of those leases;

(ii) the basis, and terms and conditions, on which variable lease payments are determined;

(iii) the existence, and terms and conditions, of options to extend or terminate the lease; and

(iv) the existence, and terms and conditions, of options for a lessee to purchase the underlying asset.

(b) information about significant assumptions and judgements made in applying the [draft] Standard, which may include the following:

(i) the determination of whether a contract contains a lease (as described in paragraphs 6-19);

(ii) the allocation of the consideration in a contract between lease and non-lease components (as described in paragraph 22); and

(iii) the initial measurement of the residual asset (as described in paragraph 71).

101 A lessor shall disclose lease income recognised in the reporting period, in a tabular format, to include the following:

(a) for Type A leases:

(i) profit or loss recognised at commencement date (gross or net, consistently with paragraph 91);

(ii) the unwinding of the discount on the lease receivable; and

(iii) the unwinding of the discount on the gross residual asset;

(b) for Type B leases, lease income relating to lease payments;

(c) lease income relating to variable lease payments not included in the measurement of the lease receivable; and

(d) short-term lease income.

Disclosures relating to Type A leases

102 In addition to the disclosures required by paragraphs 100-101, a lessor shall also provide the disclosures in paragraphs 103-107 for Type A leases.

103 A lessor shall disclose a reconciliation of the opening and closing balances of the lease receivable. The reconciliation shall include items that are useful in understanding the change in the carrying amount of the lease receivable, for example, the following:

(a) additions due to leases commencing or being extended;

(b) receivables derecognised due to leases being terminated;

(c) cash received;

(d) the unwinding of the discount on the lease receivable;

(e) foreign currency exchange differences;

(f) effects of business combinations; and

(g) changes to the loss allowance.

104 A lessor shall disclose a reconciliation of the opening and closing balances of the residual asset. The reconciliation shall include items that are useful in understanding the change in the carrying amount of the residual asset, for example, the following:

(a) additions due to leases commencing;

(b) reductions due to leases being extended;

(c) reclassifications at expiry or termination of a lease;

(d) the unwinding of the discount on the gross residual asset;

(e) effects of business combinations; and

(f) impairment.

105 Except as described in paragraph 106, a lessor shall disclose information relating to risks arising from leases required by paragraphs 31-42H of IFRS 7.

106 In place of the maturity analyses required by paragraph 37(a) of IFRS 7, a lessor shall disclose a maturity analysis of the lease receivable, showing the undiscounted cash flows to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessor shall reconcile the undiscounted cash flows to the lease receivable recognised in the statement of financial position.

107 A lessor shall disclose information about how it manages its risk associated with residual assets. In particular, a lessor shall disclose all of the following:

(a) its risk management strategy for residual assets;

(b) the carrying amount of residual assets covered by residual value guarantees (excluding guarantees considered to be lease payments for the lessor, as described in paragraph 70(d)); and

(c) any other means by which the lessor reduces its residual asset risk (for example, buy-back agreements or variable lease payments for use in excess of specified limits).

Disclosures relating to Type B leases

108 In addition to the disclosures required by paragraphs 100-101, a lessor shall also provide the disclosures in paragraph 109 for Type B leases.

109 A lessor shall disclose a maturity analysis of lease payments, showing the undiscounted cash flows to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessor shall present that maturity analysis separately from the maturity analysis required by paragraph 106 for Type A leases.

Disclosures relating to sale and leaseback transactions

116 If a transferor or a transferee enters into a sale and leaseback transaction that is accounted for in accordance with paragraphs 113-114, it shall provide the disclosures required by paragraphs 58-67 or 98-109.

117 In addition to the disclosures required by paragraphs 58-67, a transferor that enters into a sale and leaseback transaction shall disclose both of the following:

(a) the main terms and conditions of that transaction; and

(b) any gains or losses arising from the transaction separately from gains or losses on disposal of other assets.

Appendix – Differences between Recognition and Measurement Accounting Policies underlying ED 242 *Leases* and Section 20 *Leases* of the *IFRS for SMEs*

The core principle of the proposals contained in AASB ED 242 is that an entity should recognise assets and liabilities arising from a lease. The disclosures proposed in ED 242 and the disclosure requirements in Section 20 of the *IFRS for SMEs* have been compared in the Analysis to Tier 2 Supplement to AASB ED 242, which is available on the AASB website under [Work in Progress/Reduced Disclosure Requirements]. That analysis has regard to the differences and similarities in recognition, measurement and presentation requirements proposed in ED 242 and specified by the *IFRS for SMEs* as identified below. Potential differences in lease classification between Section 20 of the *IFRS for SMEs* and ED 242 are not considered for the purposes of the comparison.

Comparison of Recognition, Measurement and Presentation Requirements

The *IFRS for SMEs* classifies leases into two categories, depending on whether a lease transfers substantially all the risks and rewards incidental to ownership. If substantially all of those risks and rewards are transferred the lease is classified as a finance lease, otherwise, the lease is classified as an operating lease. In contrast, ED 242 proposes that leases be classified as either ‘Type A’ or ‘Type B’ leases, depending on whether the consumption of the economic benefits embedded in the underlying asset is significant. If consumption of the economic benefits embedded in the underlying asset is significant the lease is classified as a Type A lease, otherwise the lease is classified as a Type B lease. Both Type A and Type B leases are recognised in the statement of financial position.

Main differences in recognition, measurement and presentation requirements

Type B leases for a lessee:

1. ED 242 would require recognition of a right-of-use asset and a lease liability, initially measured at the present value of minimum lease payments; and

2. *IFRS for SMEs* does not require asset or liability recognition.

Main similarities in recognition, measurement and presentation requirements

1. Leases with a maximum lease term of 12 months:

    (a) ED 242 would permit lessees and lessors to make an accounting policy election by class of asset to not recognise a right-of-use asset and lease liability in the statement of financial position, and recognise the lease payments in profit or loss on a straight-line basis over the lease term.

    (b) *IFRS for SMEs* requires recognition of lease payments under operating leases as an expense on a straight-line basis unless another systematic basis is representative of the time pattern of the user’s benefit, or the payments are structured to increase in line with expected general inflation.

2. Type A leases for a lessee:

    (a) ED 242 would require lessees to recognise a right-of-use asset and a lease liability, initially measured at the present value of lease payments; and

    (b) *IFRS for SMEs* requires a right of use asset and obligation under finance leases to be recognised at amounts equal to the fair value of the leased property or, if lower, the present value of minimum lease payments.

3. Type A leases for a lessor:

   (a) ED 242 would require lessors to derecognise the underlying asset and recognise a right to receive lease payments and a residual asset. Lease payments include amounts expected to be payable by the lessee under residual value guarantees, and are discounted using the rate the lessor charges the lessee; and

   (b) *IFRS for SMEs* requires assets held under a finance lease to be recognised at the aggregate of the minimum lease payments receivable by the lessor and any unguaranteed residual value accruing to the lessor, discounted at the interest rate implicit in the lease.

4. Type B leases for a lessor:

   (a) ED 242 would require the lessor to continue to recognise the underlying asset and recognise lease income over the lease term, typically on a straight-line basis; and

   (b) *IFRS for SMEs* requires lessors of operating leases to present assets subject to operating leases in its statement of financial position according to the nature of the asset, and recognise lease income in profit or loss on a straight-line basis unless another systematic basis is representative of the time pattern of the user's benefit, or the payments are structured to increase in line with expected general inflation.