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Sir David Tweedie
Chairman
International Accounting Standards Board
1st Floor
30 Cannon Street
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UNITED KINGDOM

Dear David

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

The Australian Accounting Standards Board (AASB) is pleased to submit its comments on the abovenamed Discussion Paper. In formulating these comments, the AASB sought and considered the views of Australian constituents. The comment letters received are published on the AASB's website.

In summary, the AASB supports the overall proposal to remove the distinction between operating and finance leases and concurs with the conceptual justification for recognising an asset and a liability arising in a lease contract. However we note concerns have been raised by constituents regarding the cost burden the proposals would create for entities with a large volume of small leases. Some constituents argue the benefits of the proposed approach would not exceed the costs and, therefore, although the AASB supports the main thrust of the project, we suggest that the IASB give further consideration to the approaches that might be applied in practice to operationalise the proposals.

Although in overall support of the Discussion Paper, the AASB has a number of major concerns.

- (a) The proposal to include the impact of all leases on balance sheet will place more emphasis on the identification of leases, and there will be a need to greatly strengthen the requirements and guidance on the definition of a lease. In particular, guidance is required to assist in making the distinction between a service/executory contract and a lease, and between a purchase and a lease of an asset.
- (b) The Boards should consider providing additional guidance as to whether in all situations an agreement granting a 'right-of-use' of an asset (tangible or otherwise) would constitute a lease.

- (c) Some of the preliminary views of the FASB and IASB differ. The AASB continues to be supportive of the convergence efforts and would much prefer that the FASB and IASB reach consensus on these proposals.
- (d) Ideally the IASB should address lessor accounting at the same time as lessee accounting. However, given the global financial crisis and the pressure from various quarters, including the G20, the AASB acknowledges the most immediate issue is to address off-balance sheet accounting. Therefore, the AASB views the Discussion Paper as a medium-term update of IAS 17 *Leases*, and considers that there is a need for a fundamental review of lessor accounting.
- (e) Consideration needs to be given to consistency with the requirements of other IFRSs, such as with IAS 39 *Financial Instruments: Recognition and Measurement* in respect of the initial and subsequent measurement of the lease liability.

The AASB's comments on the questions in the Invitation to Comment are in the attached submission.

If you require further information regarding any matters in this submission, please contact Jessica Lion (jlion@asb.gov.au) or me.

Yours sincerely

A handwritten signature in black ink that reads "Regards" on the first line and "Kevin" on the second line.

Kevin Stevenson
Chairman

AASB's Specific Comments on IASB Discussion Paper DP/2009/1 *Leases – Preliminary Views*

The AASB's views on the questions in the Invitation to Comments are as follows:

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.

The AASB does not agree that the scope of the new lease accounting standard should be based entirely on the scope of the existing lease accounting standard (IAS 17 *Leases*). The IASB should reconsider what constitutes a lease for the following reasons.

- (a) There is often uncertainty in practice between what constitutes a lease and what constitutes a service or executory contract. Given the new proposals to recognise all leases on balance sheet the question 'what constitutes a lease?' and hence the definition of a lease will come under more scrutiny. The Boards should ensure that all contracts that they believe should be treated as leases are captured within the scope of the new standard.
- (b) Given that interpretations have been issued on the question of 'what is a lease?' (IFRIC Interpretation 4 *Determining whether an Arrangement contains a Lease* and EITF Issue No. 01-8 *Determining Whether an Arrangement contains a Lease*) the Boards should use this opportunity to revisit their guidance, and the clarity of these interpretations, and incorporate these into the new standard.
- (c) The current IAS 17 definition of the lease term includes the words 'non-cancellable period' and hence current practice assumes cancellable leases are scoped out of IAS 17. However, the Discussion Paper comments on including termination payments/periods (Chapter 6) and does not make it clear whether the new leasing standard should also apply only to 'non-cancellable' leases or whether the Boards' intention is to include cancellable leases in the scope of the new standard. Although the AASB presumes the distinction between cancellable and non-cancellable leases would be redundant due to the manner in which the lease term is determined, it would still be helpful for the Boards to make this point clear.
- (d) Given the Boards propose to apply a new concept of the 'right-of-use' of an asset, the Boards should consider providing additional guidance whether in all situations the granting of a 'right-of-use' of an asset would constitute a lease. For example, if a franchisee pays a fee to be able to use the franchisor's brand name is it the Boards' intention this constitutes a lease within the scope of the new leasing standard? Similar

issues arise in respect of many rights to use intangible assets and with royalty agreements.

- (e) The Boards should also consider clearly identifying what is not within scope of the leasing standard, by examining the definition of a lease. For example, consider the distinction between a lease and a purchase of an asset. If an entity purchases an asset with deferred payment terms, not taking legal ownership until the final payment, would the Boards consider this a lease or a purchase? This situation can be contrasted with a lease arrangement with a bargain purchase option. There is a fundamental difference between these arrangements and the accounting for them and the Boards should clarify if a purchase of an asset with deferred payment terms is within the scope of these proposals. Similarly if the lease contract includes a purchase option that management intends to exercise, would the Boards consider this a purchase of the underlying asset on deferred terms or a 'right-of-use' asset?

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.

The AASB agrees with the Boards' decision not to exclude non-core and short-term leases from the scope for the reasons outlined in the Discussion Paper.

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.

The AASB agrees with the Boards' analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract. However some concerns are as follows.

- (a) The lessee may have 'make good' obligations at the end of the lease. The AASB considers these to be obligations arising from entering into the lease contract and using the asset and therefore the accounting for them should be reconsidered by the Boards in the context of their preliminary views in the Discussion Paper.
- (b) Some have expressed the view that as the lessee does not have a 'present obligation' to pay rentals for option periods/purchase options which can be exercised at the lessee's discretion, and accordingly payments for option periods should not be included in the lease obligation as they do not represent a valid liability. The AASB believes that these are fundamentally different from contingent rents and residual value guarantees, where the lessee has a present obligation but the amount is uncertain. Although the AASB agrees with the Boards' approach to recognising only a single obligation with regard to obligations arising in the lease contract, it believes

that the Boards should clarify how payments arising in future option periods can conceptually be included in the liability in the Basis for Conclusions.

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.

The AASB supports the Boards' approach to lessee accounting set out in Question 4, as conceptually it believes it an appropriate conclusion to reach when applying the accounting framework to a lease contract. However the AASB has some concerns whether it is conceptually correct to recognise a **single** liability for all obligations and options arising in a lease contract, which is discussed in the next section.

We note that the impact on the income statement of this approach is not addressed anywhere in the Discussion Paper. For entities that currently have operating leases and are straight-lining their rentals, the impact of the above accounting will bring increased expenses early in the lease term, with reduced expenses towards the end. This is due to the impact of the financing element causing increased interest expense early in the lease term compared to the later stages. The AASB is concerned some entities and users have not assessed the impact of the Discussion Paper proposals on their income statement and had they done so it would influence their views about the proposals. The Boards should include comment about the impact in the Basis for Conclusions to any forthcoming exposure draft to ensure that the effect on the income statement can be fully understood by constituents.

The Discussion Paper does not address the nature of the accounting that would apply to 'right-of-use' assets that are presently treated as property, plant and equipment under the finance lease requirements of IAS 17. For example, would a components approach to depreciation continue to apply, given that the 'right-of-use' is a 'whole-of-asset' notion? The Boards should make reference to the 'unit-of-account' to which the proposed accounting should apply. There is also a need for the Boards to justify a gross presentation in the balance sheet, given that they are currently considering the presentation of assets and liabilities arising under insurance contracts on a net basis.

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?

The AASB supports the Boards' tentative decisions to recognise a single right-of-use asset and a single obligation. Some constituents supported the proposal on the basis of its simplicity. The AASB has some concerns about the lack of consistency between recent proposals, for example recognising a single obligation is not consistent with the concepts in the Discussion Paper on Revenue Recognition in Contracts with Customers, where the proposal is to identify the performance obligations in a contract for financial reporting purposes.

The AASB presumes from the proposal that there is a need to distinguish between lease payments and service payments, which can arise under a single agreement and hence a single payment. The AASB suggests that any forthcoming exposure draft should make this clear and should include guidance on how to separate service payments from the lease payments.

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.

The Boards should clarify the measurement objective they want to achieve for the obligation to pay rentals in the Basis for Conclusions to any forthcoming exposure draft. Discounting cash flows is a way of achieving a measurement objective not an objective in its own right. If discounting is being used to approximate fair value, then the Boards should consider the initial measurement accounting in IAS 39 for financial liabilities, which is fair value plus transaction costs that are directly attributable to the acquisition of the liability. Furthermore, the AASB is concerned that the proposals are inconsistent with IAS 39, when in concept lease liabilities are a type of financial liability.

The AASB supports the Boards' tentative decision to discount the lessee's obligation to pay rentals using the lessee's incremental borrowing rate and notes that, where all cash flows are known, the incremental borrowing rate may equal the interest rate implicit in the lease. The

AASB suggests that the Boards consider making this point explicitly in the Basis for Conclusions to any forthcoming exposure draft.

If the Boards proceed with their decision to use the lessee's incremental borrowing rate, the AASB suggests adding guidance on how to determine the incremental rate in respect of:

- (a) subsidiaries, when the parent undertakes the financing for the group;
- (b) entities that are not able to further increase their level of borrowing; and
- (c) arrangements where part of the asset is leased not the asset in its entirety.

The Boards should also make the definition of 'incremental borrowing rate' consistent between IFRS and US GAAP.

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.

The AASB supports the Boards' tentative decision to initially measure the lessee's right-of-use asset at cost. The Boards should clarify whether initial direct costs should be included in the right-of-use asset.

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.

The AASB tentatively supports the Boards' preliminary view to adopt an amortised cost-based approach to subsequent measurement of both the obligation to pay rentals and 'right-of-use' asset. However, the AASB believes that it would be consistent with the overall approach in the Discussion Paper for subsequent measurement of the right-of-use asset to be in accordance with the measurement requirements of IAS 38 *Intangible Assets*, because it is the AASB's view that the 'right-of-use' asset is an intangible asset. The AASB also notes that IAS 38 in its current form may not be sufficiently robust to deal with the complexities that will arise from the proposals in the Discussion Paper and would therefore need to be reviewed.

The AASB further notes that it may be more useful to users of information about leased assets if the relevant IFRSs were to apply for the purposes of subsequent measurement, such

as IAS 16 *Property, Plant and Equipment* in respect of a right-of-use relating to property, plant and equipment.

The AASB notes that the accounting for assets under IAS 16 and IAS 38 is fundamentally different with regard to revaluation. Both permit revaluation to fair value, but under different circumstances, which contrasts with the measurement approach proposed for assets in the Discussion Paper. The AASB considers that the subsequent measurement issue needs to be addressed to achieve consistency between lease accounting and other standards.

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.

The AASB supports permitting a lessee to elect to measure its obligation at fair value to be consistent with the measurement methods permitted in IAS 39. Furthermore, a leases standard could mandate requirements for initial recognition of assets and liabilities in lease arrangements, but then cross reference to IAS 39 for subsequent measurement of the lease obligation. See also the comments raised in Question 8, regarding subsequent measurement of the right-of-use asset.

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 AASB does not support remeasurement of the obligation based on changes in the incremental borrowing rate. The AASB agrees with the disadvantages of reassessing the incremental borrowing rate noted in paragraph 5.23 of the Discussion Paper (that is, not being consistent with the way non-derivative financial instruments are subsequently measured, being costly and complex for preparers and being inconsistent with an amortised cost-based approach). The AASB considers a lease with fixed or determinable payments to be similar in concept to a fixed rate borrowing.

Australian constituents consulted in the process of formulating this response noted that reassessment of the rate would not reflect the underlying nature of the obligation which is fixed at commencement and would be costly to implement. The users among those constituents considered that it would distort an entity's financing costs.

Therefore the AASB suggests that a revised incremental borrowing rate should only be applied to the lease obligation when there is a change in cash flows that would necessitate revision of the obligation (i.e. the lease term is renegotiated). If the proposals proceed the Boards should include guidance on determining an incremental borrowing rate when there is a change in the lease term.

The AASB also notes the view that the Boards should be clear as to the principle they are applying to the liability with regard to subsequent revisions of the liability and consider the need for consistency in accounting for changes that arise from movements in the borrowing rate and changes in cash flows. For example, the liability can be considered to be akin to a fixed rate borrowing under IAS 39, or akin to a liability under IAS 37 and hence reviewed and potentially adjusted at each balance sheet date.

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.

As the AASB supports the decision made to recognise a single obligation to pay rentals (Question 5), the AASB supports the boards' decision to specify the required accounting. However, the AASB suggests the Boards include justification in the Basis for Conclusions of any forthcoming exposure draft why they propose accounting for lease obligations differently from other financial liabilities.

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.

To be consistent with the classification of the 'right-of-use' asset as an intangible asset, amortisation would seem to be appropriate. The AASB does not believe that the expense should be characterised as 'rental expense'. However, please also note the AASB's comments on Question 8.

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, 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.

The AASB supports the view that the determination of the lease term is a recognition issue, not a measurement issue. Identifying the lease term is part of the determination of the asset the entity has acquired, rather than the measuring of its value. The AASB believes the determination of the lease term should be the most likely lease term. The AASB considers this to be most relevant in identifying whether options to extend leases are likely to be exercised and hence more useful to users of the financial statements.

If the Boards proceed with their proposal, they should make it clear whether the 'most likely' lease term could extend beyond the contractual term if, for example management, intended to purchase the item, or historically management have always been able to extend the lease past the contractual term and have the intention to do so. Questions arise regarding the lease term as it is not currently defined in the Discussion Paper. Therefore the Boards should include a definition of 'lease term' and make reference to contractual terms if it is the Boards' intention to include contractual periods only. The Boards should also consider including guidance when all outcomes are 'equally likely'.

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.

The AASB supports the proposed approach to reassess the lease term at each reporting date. The AASB also supports the proposed approach that any changes arising from reassessment should be recognised as an adjustment to the right-of-use asset as the increase/decrease in lease term relates to an increase/decrease of economic benefit expected to be enjoyed. In the case of changes arising from remeasurement of the liability that do not relate to an increase/decrease of expected economic benefits, the change should be recognised in profit or loss. Accordingly, the Boards should include a principle that if a change in the liability causes an increase/decrease of the economic benefit being obtained from the right-of-use asset, the change should be taken as an adjustment against the right-of-use asset. All other changes should be taken to the income statement.

The AASB does not agree with the Boards' proposal to limit factors considered in determining the lease term to contractual, non-contractual and business factors. All factors should be considered.

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.

The AASB supports the Boards' approach as it believes that these options have similar characteristics and therefore should be accounted for in a similar manner. However, the AASB notes that a lease with a bargain purchase option may not be economically different from a purchase of an asset with deferred payment terms. This reinforces the need for the Boards to re-examine the definition of a lease.

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?

The AASB supports the proposed approach to include amounts payable under contingent rental arrangements in the lessee's obligation. Users consulted in the process of formulating these comments noted that the proposal would help to ensure consistency between amounts reported by lessees with leases that are structured differently. For example, leases with low minimum lease payments and large contingent rents, versus leases with high minimum lease payments and low contingent rents. However, the AASB notes that in practice contingent rentals will often be difficult to estimate reliably. The AASB suggests that the Boards include guidance for cases where contingent rentals can not be measured reliably, and require disclosure of assumptions for estimating contingent rentals.

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.

The AASB appreciates the advantages and disadvantages to using the probability-weighted estimate of contingent rentals payable and the most likely approach. However, the AASB thinks that the approach to measuring uncertain contingent rental payments should be consistent with the outcomes of the current Liabilities project as regards measuring uncertainty. The AASB also thinks that the Boards need to reach consensus on this matter to ensure US GAAP/IFRS convergence.

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.

The AASB does not support this approach. The lease rentals should include management's best estimates of the future obligation and hence if the information is available and can be measured reliably, forward rates should be used and reassessed.

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.

The AASB supports this proposed approach. The AASB suggests requiring remeasurement at each reporting date.

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.

As noted in relation to comments on Question 14, the AASB believes that the Boards should include a principle that if a change in the liability represents an increase/decrease of the economic benefit being obtained from the right-of-use asset it should be taken as an adjustment against the right-of-use asset. All other changes should be taken to profit or loss.

The AASB notes that the approach it proposes is a hybrid of the approaches above. An alternative principle is that the Boards should be consistent with regard to whether they adopt a value model or a cost model for the 'right-of-use' asset, with changes recognised in the profit or loss or against the asset respectively.

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?

Consistent with the AASB's comments on question 17 in relation to measuring contingent rentals, the AASB considers that the approach to measuring uncertain residual value guarantees should be consistent with the outcomes of the current Liabilities project. The AASB also notes that in practice residual value guarantees will often be difficult to estimate reliably. The AASB suggests that the Boards include guidance for cases where residual value guarantees cannot be measured reliably.

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?

The AASB does not support requiring the lessee's obligation to pay rentals being presented separately in the statement of financial position. The AASB considers that the entity should be required to present the obligation either separately in the notes to the financial statements or on the face of the statement of financial position.

We note that some users of the accounts in our constituency felt that disclosure of the average incremental borrowing rate across all leased assets would be useful.

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?

Consistent with the AASB comments on Question 8, the right-of-use asset could be accounted for in accordance with IAS 38 *Intangible Assets* and hence presentation of the 'right-of-use' asset would be as an intangible asset. Alternatively, it may provide more relevant information if right-of-use were presented based on the underlying nature of the leased asset, such as property, plant and equipment or biological assets, in accordance with other IFRS. The AASB supports requiring leased assets and owned assets to be separately disclosed in the notes.

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.

In addition to comments made throughout this submission on issues that should be addressed, the AASB notes that the following issues should also be considered:

- Lease modifications
- Splitting contracts that have both lease and services elements
- Initial direct costs on arranging a lease
- Make good provisions for returning a leased asset
- Providing more sophisticated examples in an appendix (the examples used are very simple and don't reflect the complex nature of most leases in existence)
- Construction contracts where a lessee has control of a leased asset before the lease term as it has been built to the lessee's specific requirements
- Transitional arrangements –as some entities will see material liabilities come onto balance sheet the IASB could consider a longer than normal time lag between releasing any new requirements and their mandatory application date to ensure that entities have time to renegotiate current funding arrangements.
- Distinguishing between leases and service contracts and distinguishing between leases and deferred purchase arrangements.
- How to revise the incremental borrowing rate when there is a change in the lease term.
- Whether it is the Boards' intention that the scope of the proposals include cancellable leases.

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.

The AASB supports the lessor recognising a right to receive rentals as an asset. The Boards will need to consider whether the lessor has an asset if the lease is cancellable (i.e. includes termination options/possibilities in 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.

The AASB finds it difficult to reach a conclusion on this question until the Boards identify the recognition, measurement and presentation methods they plan to adopt for each approach. The AASB notes that any conclusion reached by the Boards should be consistent with conclusions reached on their proposals for derecognition of financial instruments. The AASB acknowledges the view in favour of (a) that recognising the actual asset and a right to receive cash flows may be viewed as inherently incorrect as it could involve double-counting the economic benefits of the asset. However, the AASB tentatively supports approach (b) on the basis that it seems consistent with viewing a lease as a right-of-use asset from the lessee standpoint. That is, the lease is a right to use an asset for a period, such that one physical asset can be viewed as a bundle of rights of use and the provision of the asset by the lessor can be viewed as meeting performance obligations over the lease term. In addition, approach (b) is consistent with the proposals in the Discussion Paper on Revenue Recognition in Contract with Customers. The AASB suggests that in the context of approach (b), the Boards consider whether a net presentation of the performance obligation and leased asset would be a relevant presentation basis.

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. The AASB proposes that the Boards investigate lessor revenue recognition in light of the proposals in the Discussion Paper on Revenue Recognition in Contracts with Customers.

Question 28

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

The AASB considers that any fundamental revision of IAS 40 *Investment Property* should depend on the outcome of the Leases project for lessor accounting and that investment property need not be included in the scope of the proposals at this stage.

Question 29

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

Ideally the IASB should address lessor accounting at the same time as lessee accounting. However given the global financial crisis and the pressure from various quarters, including the G20, the AASB acknowledges the most immediate issue is to address off-balance sheet financing. The AASB therefore views the Discussion Paper as a medium-term update of IAS 17 *Leases*, and that there is a need for fundamental review of lessor accounting.

If the Boards proceed with lease accounting without consistent changes to lessor accounting, the AASB considers that, as a minimum the Boards would need to address presentation issues associated with sub-leases.