Australian Government

Department of Finance and Deregulation

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Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
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Dear Mr Stevenson

AASB Exposure Draft 202R *Leases*

The Australian Government Department of Finance and Deregulation (Finance) welcomes the opportunity to provide comments on the Australian Accounting Standards Board Exposure Draft 202R *Leases* (ED). Finance has provided input to the submission made by the Heads of Treasuries' Accounting and Reporting Advisory Committee (HoTARAC). However, as some of Finance's views diverge from those of the majority of HoTARAC, Finance has elected to submit its own comments.

Finance acknowledges that the ED addresses many of the concerns raised in its submission on the IASB Discussion Paper 2009/1 *Leases – Preliminary views*. However, Finance still believes that the proposals, in their current form, are not appropriate and go beyond the scope of the project. This is due to both conceptual and practical issues, as outlined below.

Conceptual issues

Finance does not consider that assets and liabilities exist under all lease agreements. In our view some of the rights and obligations would not meet the definitions under the *Framework* as some of these rights and obligations are dependent on future events. There is some question as to whether this approach would therefore undermine the conceptual framework.

Finance notes that "future" rights and obligations under many lease agreements are similar to executory contracts. While we appreciate that the IASB chose not to adopt the executory contract model, we do not think their approach is appropriate and further, results in inconsistencies with other standards where the executory contract model is either inherent or explicit (e.g. employee entitlements, inventory, property under construction)

Finally, the inherent assumption in the paper is that all leases are a means of financing an acquisition. In practice, not all lessees want to acquire the asset; rather they want to just use it for a period, sometimes for a very short period. The current proposals do not adequately reflect the economic substance of these lease transactions.

The Government Finance Statistics system, which is focussed on economic substance, currently has no plans to alter its treatment of leases (which aligns with the current AASB117).

Practical issues

In addition to the conceptual concerns discussed above, the proposals may have a significant impact on preparers of financial statements. Finance strongly believes that the cost of implementing and maintaining the standard will exceed the benefits to be obtained from improved disclosures.

As a consequence, if the IASB proceeds with the proposals, Finance recommends that the IASB be approached to provide for a longer lead time for mandatory application of the Standard due to the expected significant costs, implementation issues and time consuming process to implement the proposals (such as a review of all current lease contracts, and system changes).

While the ED seems to have scoped out investment properties for arrangements where the Commonwealth is a lessor and the property is an investment property measured at fair value, the Commonwealth nevertheless would have a very large number of lease agreements, including those for premises (as lessee), motor vehicles, information technology equipment and office machines.

Different approaches for lessors and lessees

Finance notes that accounting standard setters place great emphasis on consistency between entities.

Finance notes that the exposure draft provides for different treatment of leases by lessors and lessees, and potentially different calculations even using the same treatment, through different assumptions about contingent rentals, expected lease terms etc. This issue has both conceptual and practical elements. It could result in a mismatch where a single entity is both lessor and lessee in respect of the same underlying asset; and could result in inconsistent results in corporate groups where one entity acts as lessor to other entities in the group, considerably complicating the consolidation process.

Alternative Approach

The IASB, in issuing the exposure draft, has stated that the main purpose in changing the standard is to provide financial statement users with information about the potential cash flows associated with lease agreements, and we agree this information could be useful to some users.

If this is the objective, Finance's view is that this would be much better addressed for operating leases by requiring disclosure of the information sought - the projected cash flows. This could be done through a form of enhanced commitments disclosure. This might have greater granularity between years and could also include separate disclosure of contingent rentals etc. If desired, this could be accompanied by a tightening of the rules for classification of a lease as either a finance or an operating lease.

As this information would not be incorporated in the primary statements but in the notes, it would be less objectionable to disclose amounts such as contingent rentals and to provide information about the expected lease term, because it reduces the subjectivity in the primary financial statements. In particular it does not require adjustments in the operating statement that have little meaning, but which result from changes to expected contingent rentals, expected lease terms etc. Issues arising with discount rates disappear since expected cash flows are reported without discount (users may impute their own discount rates if they wish to undertake discounted cash flow analysis).

Further, the current proposals do not actually allow users of financial statements to determine the potential cash flows from the accrual information because the mathematical models require extensive information about lease terms, payment arrangements and discount rates for every significant lease (or groups of identical leases). This is clearly impractical.

While this alternative approach would require preparers to undertake additional work and make additional judgements compared to the present standard, this will not be as onerous as the IASB proposals because these judgements more directly relate to the cash flows under lease agreements, and thus avoid the more complicated modelling used to determine accrual figures. Sophisticated users will be able to use this information, and may be able to directly integrate it into their analysis models, as the prevalence of XBRL marked-up financial statements improves.

Comments on the provisions of the exposure draft

While Finance does not support the proposed changes to the Standard, to assist the Board Finance has prepared detailed comments and suggestions on the proposals in Attachment A.

Please contact Peter Gibson on (02) 6215 3551 if you have any questions regarding these comments.

Yours sincerely

Tim Youngberry
First Assistant Secretary
Financial Reporting and Cash Management Division
17 November 2010

The Accounting Model

Question 1: Lessees

a) Do you agree that a lessee should recognise a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

1.1 Disagree. Finance disagrees with the notion that a lessee should **always** recognise a right-of-use asset and a liability to make lease payments.

1.2 The proposed accounting model fails to reflect the economic substance of the arrangement by treating leases with vastly different economic substance in the same way. This reflects an inherent assumption in the proposed model that all leases are a means of financing an acquisition. Finance does not agree with this assumption as not all lessees want to acquire the asset, some just want to use it for a period.

1.3 Finance also considers there are conceptual difficulties in recognising assets and liabilities under all lease agreements (particularly, but not limited to, some cancellable leases). In our view some of the rights and obligations would not meet the definition under the *Framework*. There is some question as to whether the proposed approach would undermine the conceptual framework because the treatment of leases will include rights and obligations that are dependent on future events.

1.4 "Future" rights and obligations under lease agreements are similar to executory contracts. Finance acknowledges the board's rationale for determining lease assets and liabilities arising at the commencement date of the agreement when the lessor provides access to the underlying asset. However, if this principle was applied for other arrangements currently treated as executory contracts, such as employee contracts, this would have significant ramifications (i.e. consistent treatment would require employers to capitalise employee's remuneration over the expected term of the employment contract, particularly for fixed term contracts).

1.5 Finance considers a much better alternative approach would be to retain the distinction between finance and operating leases, but improve disclosure requirements of future cash flows arising from operating leases (i.e. only recognising assets and liabilities for finance leases). This would be consistent with the objective of the project being to provide information about the amounts, timing and uncertainty of cash flows arising from lease contracts, while still recognising the differences in the economic substance of the transactions. Further details are contained in the covering letter and we would be happy to answer any questions about this approach.

Despite our opposition to the proposals in the exposure draft, Finance is providing below detailed comments on the proposals in order to inform the Board:

b) Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative would you propose and why?

1.6 As expressed above, Finance does not consider the current proposals reflect the economic substance of many lease transactions; this is also a concern in recognising amortisation of the right-of-use asset and interest on the liability to make lease payments. Recognising an 'interest expense' may be appropriate when the substance of the arrangement is the provision of finance, however, it is inappropriate when leasing a piece of equipment is an operational decision and not a financing decision. 'Lease rental expense' would better reflect the substance of such transactions.

1.7 Finance notes that if the alternative disclosure approach was adopted there is no issue of amortisation.

Question 2: Lessors

a) Do you agree that a lessor should apply (i) the performance obligation approach if the lessor <u>retains exposure to significant risks or benefits</u> associated with the underlying asset during or after the expected lease term, and (ii) the derecognition approach otherwise? Why or why not? If not, what alterative approach would you propose and why?

2.1 Agree.

2.2 Finance supports the board's position to require the lessor to derecognise the underlying asset when significant risks and benefits are transferred to the lessee as this is consistent with the *Framework* and the economic substance of the transaction the lessor is undertaking.

2.3 Finance notes that the approach taken for lessors is significantly different conceptually than the approach for lessees. BC25 indicates that the Board considers that a single approach would be inappropriate for lessor accounting because of the differences in the economics of the business models for different lessors. However, the same is true for lessees – some enter into a lease as a source of finance, while others enter in a lease to obtain use of an asset for a limited period of time, and thus in business terms cannot justify a purchase arrangement (either outright purchase or finance lease).

b) Do you agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

2.4 Agree.

Question 3: Short-term leases

a) At the date of inception of a lease, a <u>lessee</u> that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the <u>undiscounted amount of the lease payments</u> and

(ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognise lease payments in profit or loss over the lease term (paragraph 64).

b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognise assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payment in profit or loss over the lease term (paragraph 65).

Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

3.1 Partially agree. While Finance agrees with the proposed simplified requirements for lessors, Finance does not consider the proposed simplified requirements go far enough for lessees. Finance believes the requirements for lessors should be extended to lessees.

3.2 While Finance agrees that short-term leases should be included in the scope of the standard, Finance is of the view that the simplified requirements do not reduce the administrative burden of identifying and tracking short-term leases for lessees. The relief for lessees only removes the effect of discounting; however, given the effect of discounting would be considered minimal over a period less than 12 months, this will provide little to no relief from the administrative burden for lessees. Lessees will still be required to recognise and measure a right-of-use asset and lease liability for short-term leases and collect the information to support the asset and liability recognition. As expressed above, Finance considers the relief provided to lessors should be extended to lessees; that is, to recognise lease payments in profit or loss over the lease term.

3.3 Furthermore, Finance believes very short-term (i.e. one day to one month hire) cancellable leases should not be included in the scope of the standard as the cost would exceed the benefits provided. Alternatively the board could require that lessees and lessors only recognise expense or income in the statement of comprehensive income as incurred.

Question 4: Definition of a lease

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

4.1 Agree. The definition appears to be appropriately defined and retains the principle in the definition of a lease in AASB 117 *Leases*.

b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?

4.2 While Finance agrees with the criteria in paragraphs B9 and B10, Finance considers additional indicators in B10 addressing the risks and benefits associated with the underlying asset would be useful.

4.3 Additional guidance on how to measure 'trivial' risks would also be useful.

c) Do you think that the guidance in paragraphs B1-B4 for <u>distinguishing leases from service contracts</u> is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

4.4 The guidance for distinguishing leases from service contracts appears to be sufficient and consistent with ED 198 *Revenue from Contracts with Customers.*

Scope

Question 5: Scope exclusions

The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33–BC46).

Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and why?

5.1 Partially agree.

5.2 Finance agrees that leases of biological assets and leases for or use minerals, oil, natural gas and similar non-regenerative resources are more appropriately covered by other IFRSs and therefore should be excluded from the scope.

5.3 However, Finance is concerned that excluding leases of intangible assets could result in leases involving intangible assets being treated differently without adequate justification (i.e. differences in revenue recognition under ED 198 *Revenue from Contracts with Customers* from what it would be under the ED 202R *Leases* proposals). This could be an issue when dealing with IT contracts which contain hardware which will be accounted for under ED 202R *Leases* and software which will be accounted for under ED 198 *Revenue from Contracts with Customers*. In addition, the IASB have acknowledged that there is no conceptual reason to exclude intangible assets (BC36). Finance also acknowledges that it may be difficult to apply the proposed concepts to leases of certain types of intangible assets. Nevertheless, Finance urges the IASB to reconsider the treatment of leases of intangible assets.

5.4 Alternatively, the Board could propose to include leases of intangible assets in another standard (or potentially amend AASB 138 *Intangible Assets*). If this approach is taken, it should be explicitly identified and prioritised as part of the work to complete this standard

Question 6: Contracts that contain service components and lease components

The exposure draft proposes that lessees and lessors should apply the proposals in *Revenue from Contracts with Customers* to a <u>distinct service component of a contract that contains service components and lease components</u> (paragraphs 6, B5–B8 and

BC47–BC54). If the service component in a contract that contains service components and lease components is not distinct:

(a) the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.

(b) the IASB proposes that:

(i) a lessee should apply the lease accounting requirements to the combined contract.
(ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.
(iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements, and the service component in accordance with the proposals in *Revenue from Contracts with Customers*.

Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

6.1 Agree.

6.2 If the ED proposals go ahead, Finance considers that the lease and service components of a contract need to be distinguished and accounted for separately but acknowledges that sometimes this will not be possible.

6.3 Finance considers that a lessor should usually be able to separate the lease and service components of a contract but that a lessee may have difficulty in doing so. In such circumstances, a practical solution might also be to permit the lessee to account for the contract based on its dominant component rather than requiring lease accounting in all circumstances.

6.4 Finance prefers the IASB proposal to the FASB because the IASB requires a lessor, when applying the derecognition approach, to account separately for the lease and service components of a contract rather than combining them.

6.5 Further, the FASB approach could lead to inappropriate treatment of contracts that are substantially for provision of services with a small leasing component.

Question 7: Purchase options

The exposure draft proposes that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) <u>when the purchase option is exercised</u> (paragraphs 8, BC63 and BC64).

Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?

7.1 Agree. Finance agrees that the exercise of a purchase option terminates a lease and creates a sale and purchase agreement.

Measurement

Question 8: Lease term

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

8.1 Disagree. For similar reasons as expressed in AV2, Finance considers options to extend the lease should not be taken into account in determining the lease term. Specifically, the inclusion of options to extend the lease may be inconsistent with the *Framework* as there would be no <u>unconditional obligation</u> for lessees to pay, or no <u>unconditional right</u> for lessors to receive, lease payments if the options are not exercised.

8.2 Further, determining the longest possible lease term that is more likely than not to occur will require a significant amount of judgement and subjectivity, especially for long-term leases. If the Board proceeds with the proposals, Finance believes that the lease term should be the minimum lease term, unless an extension of the term is **reasonably certain.** This view is consistent with Board members in BC119 which would prefer a higher threshold than 'more likely than not', such as 'reasonably assured'.

8.3 Finance also notes that lessors may not have information available to them on the likelihood of lessees to exercise such options.

8.4 Finance further notes that use of its alternative option (greater disclosure) overcomes issue 8.1.

Question 9: Lease payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease <u>using an expected outcome technique</u>? Why or why not? If not, <u>how do you propose</u> that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?

Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be <u>measured reliably</u>? Why or why not?

<u>Contingent rentals / Residual value guarantees</u>

9.1 Finance conceptually agrees that contingent rentals and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities for lessees and lessors, as long as they are contractually committed in such a way that the lessee has an unconditional obligation to pay. For example, and consistent with 8.1, Finance would not support inclusion of such amounts that might fall due during a future option period.

9.2 Finance suggests that lessors and lessees should determine the contingent rentals and residual value guarantees on the same basis. This ensures that there is a consistent recognition and measurement approach especially if the lessee also acts as a lessor, or is part of a consolidated group.

9.3 Finance notes that contingent rentals are often a significant and integral part of lease payments (although not fixed in amount) and not including these may understate assets and liabilities and potentially lead to manipulation (i.e. low fixed payments and high contingent rentals). In addition, Finance believes contingent rentals and residual value guarantees meet the definition of an unconditional obligation but should only be recognised if able to be reliably measured.

9.4 It may prove difficult for management to reliably estimate future contingent rentals in respect to very long term leases and contingent rentals that are not based on indices/rates publicly available, or are subject to future events (e.g. future sales turnover). Guidance could assist preparers on how these should be treated.

9.5 Finance accepts that it may be difficult for a lessor to estimate contingent rentals that depend on the actions of the lessee (e.g. retail leases based on lessee turnover). Finance notes that this could lead to the lessor and lessee having different expectations in relation to the same economic event, and thus, recognising different amounts.

9.6 Finance further notes that use of its alternative option (greater disclosure) overcomes issues 9.4 and 9.5.

Option term penalties

9.7 Disagree. Option term penalties should not be included in the measurement of assets and liabilities as they are conditional obligations and therefore do not meet the definition of a liability/asset; rather, they are contingent assets/liabilities.

Question 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

Lease term

10.1 As stated above, Finance does not support the inclusion of options to extend the lease. However, if the IASB does proceed with the proposals, Finance offers the following comments.

10.2 Finance acknowledges the board's decision that a detailed examination of every lease is not required unless there has been a change in facts or circumstances that would indicate that there is a significant change in the lease asset or lease liability.

10.3 Identifying whether a change in the amounts payable under contingent rentals and residual value guarantees relates to **prior or future periods** may not always be straightforward.

10.4 Finance agrees that the discount rate used at initial recognition should not be revised subsequent to initial recognition.

10.5 Finance requests the board clarify the meaning of 'significant' and provide guidance to ensure it is consistently applied (e.g. dollar, nature, business model or if the omissions of the item would influence the economic decision that the user makes on the basis of the financial statements). Without such guidance there is the potential for inconsistency between different preparers.

Sale and leaseback

Question 11

Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?

11.1 Agree.

Presentation

The exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25–27, 42–45, 60–63 and BC142–BC159).

Question 12: Statement of financial position

(a) Do you agree that a <u>lessee</u> should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment or investment property as appropriate, but separately from assets that the lessee does not lease (paragraphs 25 and BC143–BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?

12.1 Agree. Lessees should present liabilities to make lease payments separately from other financial liabilities due to the significant level of management judgement in measuring the liability; it needs to be clearly identifiable in the financial statements.

12.2 Lessees should present right-of-use assets as if they were tangible assets within property, plant and equipment but separately from assets that the lessee does not lease. If recognised as intangible assets it effectively undermines the IASB argument that all leases constitute financing of assets. However, Finance notes that this creates an additional conceptual problem since the right-of-use asset is recorded at neither cost nor fair value unlike PPE or intangibles. Finance also notes that the proposed presentation will result in an increase in the number of line items in a lessee's statement of financial position.

12.3 However, Finance notes that the IASB will need to consider proposed disclosures in conjunction with its project on financial statement presentation, as there is the potential for the statement of financial position to become too "cluttered".

(b) Do you agree that a <u>lessor applying the performance obligation approach</u> should present underlying assets, rights to receive lease payments and lease liabilities <u>gross</u> in the statement of financial position, totalling to a <u>net</u> lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

12.4 Disagree. Finance considers that the lessor applying the performance obligation approach should present the net position in the statement of financial position and the gross amount in the notes. By presenting the gross amount in the statement of financial position it could become too unwieldy depending on the amount of sub asset classes within each asset class reported in the statement of financial position. The notes to the statement of financial position would provide the required information to the users in a more informative manner.

(c) Do you agree that a <u>lessor applying the derecognition approach</u> should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

12.5 Overall agree. Finance agrees that a lessor applying the derecognition approach should present the right to receive lease payments separately from other financial assets and residual assets separately within property, plant and equipment. However, Finance considers the total residual assets should be reported in the statement of financial position with a breakdown of this amount by class of assets in the notes. Otherwise, the information provided could become too unwieldy. Notes disclosure would be more useful to users.

(d) Do you agree that <u>lessors should distinguish assets and liabilities</u> that arise under a <u>sublease</u> in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

12.6 Disagree. Finance considers that the intermediate lessor should disclose this information in the notes.

Question 13: Statement of comprehensive income

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss (paragraphs 26, 44, 61, 62,

BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

13.1 Agree. The proposed presentation provides useful information.

13.2 However, Finance notes that the IASB will need to consider proposed disclosures in conjunction with its project on financial statement presentation, as there is the potential for the statement of comprehensive income to become too "cluttered".

Question 14: Statement of cash flows

Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

14.1 Agree. The proposed presentation provides useful information and aligns with the ED objectives. Also, refer to our suggested alternative of providing future cash flow commitment disclosure and a clearer principle for distinguishing between finance and operating leases rather than requiring the recognition of liabilities and assets for all leases.

Disclosure

Question 15

Do you agree that lessees and lessors should disclose quantitative and qualitative information that:

(a) identifies and explains the amounts recognised in the financial statements arising from leases; and

15.1 Agree, this is particularly important for a principle-based Standard. However, it is Finance's view that the proposed note disclosures are rules-based. Where there is a large quantity of leases, the information requirements describing the lease term options, residual value guarantees, restrictions and additional costs would be onerous and too detailed to provide useful information. A general policy outline would be more appropriate. Some of the disclosure requirements could also breach business confidentiality arrangements and security requirements by disclosing some of the more sensitive arrangements.

15.2 The board should more clearly state that the disclosures are not mandatory in all situations, and require that the entities provide relevant information to explain significant amounts in the financial statements.

15.3 Finance notes that its proposed alternative approach would provide information directly about potential cash flows and most of the additional disclosure requirements proposed would be unnecessary.

(b) describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows (paragraphs 70–86 and BC168–BC183)? Why or why not? If not, how would you amend the objectives and why?

15.4 Agree. However, where this is a large quantity of leases, a general policy outline would be more appropriate.

15.5 Under Finance's alternative proposal, the expected impact of leases on future cash flows would be directly disclosed. There may still be some benefit in general, high level, summary, disclosures about the risks and major judgements identified in projecting the cash flows

Transition

Question 16

(a) The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186– BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?

16.1 Agree. The proposed simplified retrospective approach provides some relief during the implementation period.

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

16.2 No. The full retrospective application would be onerous and should not be provided as an option for comparability purposes.

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

16.3 Finance would support a relatively long lead time due to the implementation issues and time-consuming process to implement the proposals (such as review of all outstanding leases and system changes). In addition, a longer lead time would allow for lessees and lessors to assess as soon as possible the effect of application of the proposals on their key financial ratios, debt covenants and KPIs .

Benefits and costs

Question 17

Paragraphs BC200–BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?

17.1 The ED's proposals provide for extensive lease reporting and disclosure requirements for both lessees and lessors that affect their financial statements, accounting policies and information systems. The proposed transition requirements impact particularly longer-term lease contracts as new rules would have to be applied as of the beginning of the first comparative period presented in the financial statements. Finance does not consider that the perceived benefits outweigh the costs of the proposals. Finance considers the objective of the ED could be satisfied at a lower cost, by retaining the current standard and merely expanding the disclosure requirements to include more detailed operating lease cash flow and providing a clearer principle for distinguishing between finance and operating leases, as proposed in the covering letter.

Other comments

Question 18

Do you have any other comments on the proposals?

Finance considers the following items need to be addressed:

- The following specific guidance has been withdrawn and not replaced:
    a. Lease incentives; and
    b. Derecognition of lease assets for the lessee and liabilities for both lessee and lessor.
- Proposals do not integrate well with 'make-good' provisions.
- The treatment of leases with 'indefinite' lease terms.
- Relationship with relevant interpretations including:
    a. IFRIC 4 *Determining whether an Arrangement contains a Lease*;
    b. IFRIC 5 *Rights to Interest arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*;
    c. IFRIC 12 *Service Concession Arrangements*;
    d. SIC-15 *Operating Leases – Incentives*;
    e. SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*; and
    f. SIC-29 *Service Concession Arrangements: Disclosures*.
- Arrangements that involve the construction of leased assets.

GAAP/GFS Harmonisation

- Finance has discussed the proposals with the Australian Bureau of Statistics (ABS). They have indicated that there are not currently any proposals to change the treatment of leases in Government Finance Statistics (GFS) and, in any event, would have to emanate from international statistical bodies. The current GFS treatment is aligned with the current AASB117.
- If this situation continues, not only will there be a harmonisation difference between the two systems, impacting on harmonised reporting under AASB 1049 etc.
- Further, all entities (including those in the private sector), will need to continue to provide sufficient information to enable the ABS to compile its own statistics, including national accounts.