Kevin Stevenson
Chairman
Australian Accounting Standards Board
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via email: standard@aasb.gov.au

1 February 2011

Dear Kevin

Re: Tier 2 Supplements to ED 198, ED 202, ED 204 and ED 206

We are responding to your request for comment on the Tier 2 Supplements to the following Exposure Drafts (ED):

- ED 198 *Revenue from Contracts with Customers*
- ED 202 *Leases*
- ED 204 *Deferred Tax: Recovery of Underlying Assets (proposed amendments to AASB 112)*
- ED 206 *Severe Hyperinflation (proposed amendment to AASB 1)*

We appreciate the Board's aim to issue complete Australian standards which address the tier 2 requirements as soon as the equivalent international standards are approved. We also understand that to be able to do so, it is necessary to consult with stakeholders as early as possible. However, we question whether this is necessarily the best use of resources for standards such as those on revenue recognition and leases, where it is likely that the final standards will differ from their exposure draft versions. In particular, we are concerned that a second round of consultation may be necessary if the disclosures in the final standards differ significantly from those proposed in the exposure drafts.

In our view, a short delay of three to six months between the issue of a new standard and the finalisation of the reduced disclosures applicable under this new standard would still be acceptable. In our experience, entities reporting under tier 2 of the reduced disclosure regime are less likely to adopt a new standard early and it should therefore be unlikely to be major issue for those companies should there be a short delay.

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Leaving these concerns aside, we have provided specific comments on each of the supplements in Appendix A to this letter.

I would welcome the opportunity to discuss our firm's views at your convenience. Please contact me on (03) 8603 5371 if you would like to discuss our comments further.

Yours sincerely,

Margot Le Bars
Partner, PricewaterhouseCoopers

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Appendix A – Specific matters for comment

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

ED 198 *Revenue from Contracts with Customers*

Presentation of items

We note that the supplement only considers those paragraphs from the ED that are covered under the heading of "Disclosure" (ie paragraphs 69 to 83) and does not discuss any presentation issues such as paragraph 64, which requires separate presentation of contract assets and contract liabilities in the statement of financial position.

Paragraph 9 of the AASB's *Tier 2 Disclosure Principles* acknowledges that sometimes judgement is required as to whether a particular requirement relates to presentation or disclosure. It goes on to say that "Presentation requirements are limited to requirements that specify the broad structure of financial statements including the basis of classification of items. Specifications relation to sub-classifications or line items to be shown on the face of financial statements or in the notes, are treated as matters of disclosure".

For this reason, paragraph 64 should also be considered in the context of tier 2 disclosures. As explained in our submission on ED 202 (see extracts in Appendix B), we believe there is sufficient guidance in AASB 101 *Presentation of Financial Statements* as to what should be disclosed on the face of the primary statements based upon materiality and what should be included in the notes. On that basis, paragraph 64 should be excluded from the tier 2 disclosures.

Other disclosures that should be excluded

As discussed in our submission on ED 198, we found that many of the proposed disclosures appear to duplicate information already required under various existing standards. We also queried the usefulness of certain other disclosures. These comments are even more relevant for tier 2 entities and we have included the relevant responses in Appendix C to this submission.

In addition, we do not believe that the disclosures required in paragraph 83 in relation to determining the transaction price and allocating it to performance obligations would satisfy any of the criteria set out in paragraph 6 of the AASB's *Tier 2 Disclosure Principles*. They should also be excluded on that basis.

ED 202 *Leases*

Presentation

As explained in our comments on the ED 198 supplement above, proposed presentation requirements should also be reviewed for their applicability to tier 2 entities. In the context of the leasing ED, this applies in particular to the following paragraphs:

- Paragraphs 25-27 which require separate presentation of liabilities to make lease payments, rights-of-use assets, amortisation, interest expense and cash payments relating to these items
- Paragraphs 42-45 which prescribe presentations for a lessor applying the performance obligation approach
- Paragraphs 60-63 which prescribe presentations for a lessor applying the derecognition approach

As explained in our submission on ED 202, we believe that the guidance in AASB 101 is sufficient for preparers of financial statements (see the responses to questions 12 to 14 which are reproduced in Appendix B).

Reconciliations – comparative information
We are comfortable with the requirements to disclose various reconciliations in paragraphs 77 and 80. However, we remind the Board that other standards such as AASB 116 *Property, Plant and Equipment* provide a specific exemption for tier 2 entities from the requirement to disclose the reconciliation also for the comparative period. A similar exemption should be included in the future leasing standard.

ED 204 *Deferred Tax: Recovery of Underlying Assets (proposed amendments to AASB 112)* and ED 206 *Severe Hyperinflation (proposed amendment to AASB 1)*

We support the proposals in relation to tier 2 disclosures for these two exposure drafts, which have since been issued as final standards (AASB 2010-8, AASB 2010-9 and AASB 2010-10).

2.Are there any regulatory issues or other issues arising in the Australian environment, particularly any issues relating to (a) not-for-profit entities, and (b) public sector entities?

We do not believe that there are any regulatory or other issues that would affect implementation of the proposals in Australia.

(c) Overall, would the proposals result in financial statements that would be useful to users?

Subject to our specific comments above, we believe that the proposals would result in financial statements that are useful to users.

(d) Are the proposals in the best interests of the Australian economy?

The introduction of the reduced disclosure regime has significantly reduced the regulatory burden for those entities that are eligible to report under tier 2 of the new regime. It is therefore in the best interests of the Australian economy if new standards provide consistent disclosure relief for tier 2 entities on a timely basis. However, as explained on page 1 of this submission, we do question whether tier 2 requirements have to be finalised at the same as a new standard is issued.

Appendix B – Extract from our comment letter on ED 202 *Leases*

Question 12

(a) Do you agree that a lessee 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?

We agree that an entity should present the obligation to make lease payments separately from other financial liabilities and the right-of-use asset separately from owned property, plant and equipment. In many respects, the right-of-use asset is treated as an intangible asset (for example, guidance with respect to amortisation and impairment), but many users and preparers believe these are more closely akin to property, plant and equipment in most cases. We therefore agree that right-of-use assets should be presented as if they were tangible assets within property, plant and equipment in the statement of financial position.

However, with respect to reflecting the lease liabilities and right-of-use assets separately, we believe for IFRS reporters there is sufficient guidance in IAS 1, 'Presentation of financial statements', as to what should be disclosed on the face of the primary statements based upon materiality and what should be included in the notes. We do not therefore support including any further guidance within the proposed leasing standard. We acknowledge that there is no direct equivalent to IAS 1 in US GAAP, but believe that the same principles as contained in IAS 1 should be applied, and would naturally be applied in practice if allowed.

(b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net 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?

As more fully explained in our response to question 2, we do not support a 'hybrid' approach for lessors.

However, if the boards were to continue with the 'hybrid approach', we would agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability.

In addition, we believe that the boards should also clarify the manner in which the net asset/liability under this approach should be presented in the current or non-current section of a classified statement of financial position.

Similar to our response to question 12(a), we believe there is sufficient guidance in IAS 1 for IFRS preparers. We believe that an entity should decide whether separate presentation is necessary in the primary statements or whether it is adequate to provide the information in the notes based upon materiality. We acknowledge that there is no direct equivalent to IAS 1 in US GAAP, but believe that the same principles as contained in IAS 1 should be applied.

(c) Do you agree that a lessor applying the derecognition approach 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?

As explained in our response to question 2, we do not support the 'hybrid' approach for lessors. However, if the boards go ahead with derecognition accounting for lessors then, similar to our response to question 12(a), we believe there is sufficient guidance in IAS 1 for IFRS preparers. We believe that an entity should decide whether the separate presentation is necessary in the primary statements or whether it is adequate to provide the information in the notes based upon materiality. We acknowledge that there is no direct equivalent to IAS 1 in US GAAP, but believe that the same principles as contained in IAS 1 should be applied.

(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease 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?

As explained in our response to question 2, we do not support a 'hybrid' approach for lessors. However, if the boards continue with the proposed lessor accounting guidance provided in the exposure draft, we observe that most sub-leases are likely to be reflected under the performance obligation approach (except where the terms and amounts of the lease in nearly match those of the lease out, in which case the derecognition approach might be appropriate).

With respect to whether the intermediate lessor should separately distinguish assets and liabilities arising from the sub-lease in the statement of financial position, similar to our response to question 12(a), we believe there is sufficient guidance in IAS 1 for IFRS preparers. We believe that an entity should decide whether separate presentation is necessary in the primary statements or whether it is adequate to provide the information in the notes based upon materiality. We acknowledge that there is no direct equivalent to IAS 1 in US GAAP, but believe that the same principles as contained in IAS 1 should be applied.

Question 13

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?

Similar to our response to question 12(a), we believe there is sufficient guidance in IAS 1 for IFRS preparers. We believe that an entity should decide whether separate presentation is necessary in the primary statements or whether it is adequate to provide the information in the notes based upon materiality. We acknowledge that there is no direct equivalent to IAS 1 in US GAAP, but believe that the same principles as contained in IAS 1 should be applied.

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Question 14

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?

Similar to our response to question 12(a), we believe there is sufficient guidance in IAS 1, in conjunction with IAS 7, 'Statement of cash flows', for IFRS preparers. We believe that an entity should decide whether separate presentation is necessary in the primary statements or whether it is adequate to provide the information in the notes based upon materiality. We acknowledge that there is no direct equivalent to IAS 1 in US GAAP, but believe that the same principles as contained in IAS 1 should be applied.

We do not believe that lease cash flows should necessarily be classified entirely as financing. In practice entities enter into leases for many reasons, sometimes as an alternative source of finance and sometimes for operational reasons. There has been recognition of this dichotomy in the boards' deliberations concerning financial statement presentation. There is also some variation in current practice. In the US, lessees typically are required to reflect the 'principal' portions of outflow payments on capital leases as part of financing activities, and lessors would typically be required to reflect the 'principal' portion of inflow payments on capital leases as part of investing activities. Meanwhile, under IFRS, following the 2008 improvements to IAS 7 and IAS 16, 'Property, plant and equipment', cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale are cash flows from operating activities. The cash receipts from rents and subsequent sales of such assets are also cash flows from operating activities.

We believe that the model proposed by the boards approaches leases as purchases of assets financed by a specific debt, which may not be how preparers and users view all leases. This may be an issue for the boards to pick up in their project on financial statement presentation; in the meantime, we are willing to accept presentation as financing cash flow as an interim measure.

However, we also believe the interest component (if identified) should be treated in a manner consistent with other interest cash flows. In this regard, we observe that IAS 7 states that interest cash flows may be classified as operating, investing or financing while ASC 230-10-20 indicates that transactions that enter into the determination of net income should be classified as operating activities.

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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

(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?

We agree with the disclosure principles outlined in the exposure draft and believe that they could enhance the information provided to users compared to the current requirements of IAS 17/ASC 840. The list of qualitative and quantitative information required in the exposure draft (paragraph 73-86) is extensive. If it was made mandatory, without regard to the significance of the leases to a particular lessee or lessor, it could result in boilerplate disclosure of information that is not relevant or material to a user of the financial statements. Given this concern we welcome the requirement in the exposure draft (paragraph 71) that an entity should consider the level of disclosure appropriate to satisfy the objectives in paragraph 70. We believe it is important that the overarching requirement is consistent with the boards' objective that an entity provides sufficient disclosure to allow a user to understand the amounts, timing and uncertainty of the cash flows arising from its lease portfolio.

We note that the boards have proposed that entities can 'aggregate or disaggregate' disclosures, presumably to ease the burden of providing extensive disclosure and allow a portfolio approach. We welcome this and believe the boards should be more explicit to avoid confusion. We believe the overarching requirement should be for a preparer to provide sufficient granularity about the lease portfolio to enable a user to understand the significance of the lease transactions to an entity's business and the related amount, timing and uncertainty of cash flows.

Appendix C – Extract from our comment letter on ED 198 *Revenue from Contracts with Customers*

Question 10

The objective of the boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

It is difficult to assess the adequacy of the disclosures required for any item in the financial statements when the disclosure requirements are specified in each standard rather than in accordance with a clear disclosure framework. An overarching framework that specifies the objectives of the disclosures in the financial statements and how these might be achieved would simplify the identification of disclosures in each area. We encourage the boards to develop a disclosure framework as soon as their timetables will allow.

We believe the proposed disclosure requirements will not meet the boards' objectives and will not improve existing disclosures. There is a danger that useful information will be obscured by the volume of detailed information required by the proposed standard.

Many of the proposed disclosures appear to duplicate information already required under various existing standards. For example, the proposed requirement in paragraph 74 to disaggregate revenue might duplicate the entity-wide disclosures required by the segment reporting standards. We suggest that the boards identify and require disclosure of useful information for users that is not provided by existing disclosure requirements.

We do not believe the roll-forward disclosure of contract balances proposed in paragraph 75 is useful and the disclosure objective satisfied by this disclosure is not clear. This will add significantly to the volume of disclosures and may require entities to develop new systems to capture the necessary information. We suggest that the boards reconsider the cost of this proposal compared to its benefit and identify the specific information provided by this reconciliation that is both useful and not required by existing standards.

We suggest that appropriate disclosures might be:

- A description of the principal sources of revenue and the accounting policies applied to each significant revenue stream;
- A description of the significant estimates and judgments made in connection with the recognition and measurement of revenue and the extent to which revenue in the current period is affected by changes to those estimates; and
- A quantitative analysis of the revenue derived from each principal source, disaggregated as we have suggested in our response to Question 12.

Question 11

The boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

We recommend that information about performance obligations that will be satisfied in future periods not be required to be presented in the financial statements. This information may not be decision-useful, and it would be impractical to present this information if it is not already prepared and used to manage the business. In that case, entities would be required to develop systems to capture the information solely for the purpose of this disclosure.