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Mr H. Hoogervorst
 Chairman
 International Accounting Standards Board
 30 Cannon Street
 London EC 4M 6Xh
 UNITED KINGDOM

The Group of 100 Incorporated

Level 20, 28 Freshwater Place
 Southbank VIC 3006 AUSTRALIA
 www.group100.com.au

Telephone: (03) 9606 9661
 Facsimile: (03) 9670 8901
 Email: g100@group100.com.au
 ABN: 83 398 391 246

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Dear Mr Hoogervorst

ED/2013/6 'Leases'

The Group of 100 (G100) is an organization of chief financial officers from Australia's largest business enterprises with the purpose of advancing Australia's financial competitiveness. We are pleased to provide comments on this Exposure Draft.

The G100 considers that the current approach to accounting for leases is well understood by preparers and users and provides sufficient information to enable an assessment of the impact of leasing transactions on the financial position and operations of the entity.

We acknowledge the Board's work in addressing the deficiencies and complexity in earlier iterations of the proposed new lease accounting framework, however, in our view:

- i. **the proposals in the ED are complex, will involve undue costs for preparers to implement and those costs outweigh the benefits of the changes;**
- ii. **there is no conceptual basis for key aspects of the proposals, which sets an undesirable precedent in the standard-setting process and will make the ongoing maintenance of the standard difficult;**
- iii. **the proposals will not reduce the propensity for users of the financial statements to make adjustments and therefore the changes cannot be considered more useful to users;**
- iv. **the extensive proposed disclosures, including separate disclosures for Type A and Type B leases are an additional burden and contrary to the G100's previously stated position on the need to rationalise and reduce unnecessary disclosures in financial reporting; and**
- v. **the current approach to accounting for leases is well understood by preparers and users and provides sufficient information to enable an assessment of the impact of leasing transactions on the financial position and operations of an entity.**

For these reasons the G100 does not support the issuance of a final standard based on the proposals in the ED.

Our comments below are provided on the basis that the IASB proceeds with the proposals and should not be interpreted as support for the changes to the lease accounting model.

The current project revisiting the conceptual framework offers the opportunity for the IASB to address issues relating to the rights of use approach to accounting for a range of services and arrangements including supply contracts. In respect of accounting for leases it appears that the approach is moving from the recognition of in-substance purchases of assets to the recognition as what some describe as notional assets.

In principle, the rights of use model if applied consistently would not require a distinction to be made between different types of leases. However, in view of the practical and implementation difficulties associated with such an approach we consider the proposals to identify Type A and Type B leases is a reasonable pragmatic approach to achieve the perceived benefits of changes to accounting for leases. We believe that if the proposals proceed in their current form the IASB should be transparent in its approach and state that the different classifications are made on the basis of practicality in the current environment.

Q1 Identifying a lease: *This revised ED defines a lease as a 'contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration'. An entity would determine whether a contract contains a lease by assessing whether:*

- a. *fulfilment of the contract depends on the use of an identified asset; and*
- b. *the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.*

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.

Do you agree with the definition of a lease and the proposed requirements in paras 6-19 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

The G100 has the following concerns about the definition of a lease:

- a. **the practical difficulties associated with distinguishing between leases and service contracts and, in many instances, where an agreement includes both a lease and a service arrangement. For example, it is likely to be difficult, and in some cases impractical, to seek to separate a service contract and a lease and between different service components embedded in a lease, in the following types of arrangements:**

- ~ capacity arrangements such as occurs with transmission by pipelines where participants have a right to specified capacity as occurs in the oil and gas industry;
 - ~ outsourcing arrangements where the entity has not specified the particular assets to be used as occurs in the waste removal industry and information processing. For example, in respect of waste removal an entity may contract for the removal of waste but does not specify the trucks to be used although all the capacity of the trucks is used;
 - ~ the construction of accommodation at mining sites and detention facilities by a third party who provides a complete portfolio of services subject to meeting specified performance criteria;
 - ~ medical suppliers often provide a machine to a medical facility for an insignificant or no charge provided the medical facility purchases a minimum number of consumables which can only be used on that machine. Similar arrangements also occur in the beverage and printing industries;
 - ~ take or pay arrangements in the mining industry where a railroad is built and independently managed by a third party, to a remote location, say, to provide access to a port or loading facility;
 - ~ property leasing arrangements where the lessee's use of the property such as retail space in a shopping centre is significantly dependent on the provision of a wide range of services by the lessor and, without these services, would not expect to be liable for the lease payments; and
 - ~ head leases that set out overall parameters covering large numbers of small value assets (eg personal computers) that are also subject to individual agreements (mainly for security and asset tracking purposes). These agreements may not allow the lessor to reclaim the asset at any time but for the lessee the costs of breaking the lease are not large enough to deter the lessee from returning one or more of the assets before the end of the lease.
- b. as all Type A leases except short-term leases, will be recognised on the balance sheet there will be more focus on identifying the components particularly where an agreement includes an embedded operating lease. Under current requirements there is little to be gained in the separation because operating leases and service contracts are accounted for on a similar basis. The allocation of consideration between the various components will become more significant. While lessors are likely to have such information, lessees may not have reliable information to do so.
- c. the application of the notion of control (where the lessee has the right to control the use of an asset) may involve the exercise of judgment compared to current practice in several industries where take-or-pay contracts and certain power purchase arrangements are common. For example, an entity may enter a contract to provide water to a customer via a network of pipelines and supply points. The network of pipes is not easily interchangeable and no other assets may feasibly be used to deliver the service.

Under the contract, the customer may be given the ability to use 50% of the pipeline whenever it requires it. Under IFRIC 4, this would likely be considered a lease because it is likely that this contract would give the customer 'the right to direct others to operate the asset in a manner it determines while obtaining more than an insignificant portion of its outputs'. There would be some judgment involved in determining whether the contract falls within the scope of the proposed draft standard.

Q2 Lessee accounting: *Do you agree that the recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?*

In principle, as mentioned above, application of the right of use approach should not distinguish between leases of different types of assets. However, the G100 accepts that accounting for different classes/types of leases depending on whether the lessee is expected to consume the majority of the economic benefits of an asset is a practical compromise. We believe that the current accounting and distinction between finance leases and operating leases is appropriate and that if the proposals proceed in their current form different opportunities for structuring transactions are created.

If the proposals proceed the G100 considers that the relief in relation to short-term leases is of little benefit to preparers and users and is unlikely to provide significant relief in practice.

We believe the maximum possible terms of twelve months is too short to include anything but incidental leases in respect of office equipment, telecommunications, cars, hotel rooms etc. It would appear that the major concerns about existing lessee accounting relate to the lack of recognition of significant operating assets. As such, we believe that short-term leases be defined as having a maximum possible term of 3 years with related extension options only being included in that threshold if there is an economic incentive to exercise those options.

Q3 Lessor accounting: *Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?*

Yes. The G100 considers that the current approach to lessor accounting in IAS 17 'Leases' is appropriate. We believe that the concerns and issues raised about accounting for leases have been raised in respect of lessee accounting and not the approach adopted by lessors.

The existing lessor accounting model is well understood by users, preparers, auditors and regulators and provides appropriate information to users of financial statements as it reflects the underlying economic substance of the different types of lessor transactions.

Q4 Classification of leases: *Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paras 28-34, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?*

The G100 supports the principle that the lessee's expected consumption of the economic benefits embedded in an asset should determine its classification and suggests that such an approach underlies the present finance lease/operating lease basis of classification. While there is no basis in principle for treating property differently we consider that the distinction is made on pragmatic grounds.

Q5 Lease term: *Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?*

The G100 acknowledges that the current proposals are more operational and less complex than those in ED 2010/9 and closer to the current treatment of renewal options (periods).

However, the practical distinction between 'reasonably certain' of being exercised and 'significant economic incentive' and the reasons for the change in terminology is not clear when it appears they are seeking to achieve the same outcome.

Currently when entities assess the 'reasonably certain' criteria under IAS 17 they include in the assessment a range of economic incentives such as comparisons with current market rates, the relative costs of continuing with the lease and its replacement and the ongoing significance of the lease item to the entity's operations.

If the proposals proceed the G100 considers that the relief in relation to short-term leases is of little benefit to preparers and users and is unlikely to provide significant relief in practice. We believe the maximum possible term of twelve months is too short to include anything but incidental leases in respect of office equipment, telecommunications, cars, hotel rooms etc.

It would appear that the major concerns about existing lessee accounting relate to the lack of recognition of significant operating assets. As such, we believe that short-term leases be defined as having a maximum possible term of 3 years with related extension options only being included in that threshold if there is an economic incentive to exercise those options.

Q6 Variable lease payments: *Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?*

The G100 believes that the current proposals are a reasonable and practicable approach when compared with those in ED 2010/9. However, we believe that the full requirements should be located in the base IFRS and not left to illustration by way of examples such as occurs with the interpretation of 'in substance fixed payments'.

The meaning of 'in substance' is not clear as it would appear that an assessment should be made against a fixed market rental for the same asset and accordingly we consider that, if retained, further guidance is necessary.

Q7 Transition: *Paras C2-C22 state that a lessee and a lessor would recognise and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?*

Are there any additional transition issues the boards should consider? If yes, what are they and why?

While full retrospective application would provide more reliable comparative information, the practicalities and costs of doing so are unlikely to justify the perceived benefits for most types of entities. In the absence of grandfathering existing leases, the modified retrospective approach is a reasonable practical compromise. However, we support an approach where entities can choose to apply either the modified and/or full retrospective approach depending on the circumstances of the entity.

The G100 recommends that the Board considers permitting relief from applying the transition requirements to operating leases that expire within the financial reporting period of adopting the new lease standard. The cost and effort in applying transition requirements to these leases would far outweigh any benefits in information provided to users of financial reports.

When determining the implementation date for the standard, consideration should be given to potential flow-on impact for financial institutions due to, for example, regulatory capital and tax requirements. Financial institutions may be required to hold additional regulatory capital if the right of use assets are not viewed by regulators in conjunction with the associated lease liability. In Australia, current tax legislation distinguishes between operating and finance leases and further clarification and potential amendments will be required to address the concept of Type A and Type B leases. Furthermore, financial institutions will also have to consider the impact of the leasing requirements on customers, such as updating calculations banking covenants to capture changes in the accounting leases and will require sufficient lead time to address these additional areas.

Q8 Disclosure: *Paras 58-67 and 98-109 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments: reconciliation of amounts recognised in the statement of financial position: and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?*

The G100 supports the disclosure objective specified in paras 58 and 98 and recommends that paras 59 and 99 should be given equal prominence otherwise users, auditors and regulators are likely to expect disclosure of all items mentioned irrespective of their materiality and relevance.

The G100 believes that the proposed disclosures represent a virtual shopping list of information that possibly some users may find to be of interest. For example, we believe that given the disclosure objective the standard should specify key disclosures relating to the impact of leasing on the entity, such as, maturity profile of payments, and rely on the judgment of directors as to additional disclosures that are material and relevant to an understanding of the entity's financial performance and position for shareholders and other users.

We believe that the accumulation of disclosures on a topic-by-topic basis and their application to all types of entities fails to address well publicised views on the sources of discontent about the disclosure overload and the relevance and usefulness of many disclosures.

We draw to your attention the recently published AASB Essay 2013-1 "*Rethinking the path from an objective of economic decision making to a disclosure and presentation framework*" which advocates a purpose-driven disclosure and presentation framework which focuses on the economic characteristics of the entity. Such an approach applied to lease disclosures would focus on the economic significance of leasing to the financing and operations of the entity.

Q9 – Q11 Not applicable.

Q12 (IASB-only): Consequential amendments to IAS 40: *The IASB is proposing amendments to other IFRSs as a result of the proposals in this revised ED, including amendments to IAS 40 'Investment Property'. The amendments to IAS 40 propose that a right-of-use asset arising from a lease of property would be within the scope of IAS 40 if the leased property meets the definition of investment property.*

This would represent a change from the current scope of IAS 40, which permits, but does not require, property held under an operating lease to be accounted for as investment property using the fair value model in IAS 40 if it meets the definition of investment property.

Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

The G100 has concerns about the practicality of the proposed requirements for those lessees who sub-lease property but may not have fair value information in respect of the sub-let property.

OTHER ITEMS

The term 'significant' is used extensively in the proposals without explanation as to the meaning and purpose of the description. It would be helpful to preparers if the term were explained as, for example, the meaning of "significant" in relation to "material" and whether "significant" overrides "material".

Yours sincerely
GROUP OF 100 INC



Terry Bowen
President

c.c. K Stevenson – Chairman AASB