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Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

via email: standard@aasb.gov.au

1 October 2013

Dear Kevin

Re: Exposure draft 242 *Leases*

I am enclosing a copy of PricewaterhouseCooopers' response to the International Accounting Standards Board's exposure draft ED/2013/6 *Leases*.

The letter reflects the views of the PricewaterhouseCoopers (PwC) network of firms and as such includes our own comments on the matters raised in the exposure draft. PwC refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

AASB specific matters for comment
We are not aware of any regulatory or other issues that could affect the implementation of the proposals for not-for-profit and public sector entities.

Subject to our concerns about specific matters as expressed in our submissions to the IASB, the proposals would result in financial statements that would be useful to users. Should the proposed amendments be approved by the IASB, we are not aware of anything that would indicate that the proposals are not in the best interests of the Australian economy.

I would welcome the opportunity to discuss our firm's views at your convenience. Please contact me on (02) 8266 4664 if you would like to discuss our comments further.

Yours sincerely,

Paul Brunner
Partner, PricewaterhouseCoopers

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12 September 2013

Dear Sir/Madam

Exposure draft: Leases

We are responding to the invitation from the IASB and the FASB ('the boards') to comment on the revised exposure draft 'Leases' (the 'exposure draft' or 'proposed standard'). Following consultation with members of the PwC network of firms, this response summarises the views of those member firms that commented on the exposure draft. 'PwC' refers to the network of firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We recognise the significant efforts that the boards have made to address the concerns raised by constituents on the previous exposure draft issued in 2010. Accounting for leases is an important topic given their pervasiveness and their significance to businesses across multiple industries. Therefore, we support the boards' efforts to develop an accounting standard that will meet the boards' objectives to increase transparency and provide a more faithful representation of the rights and obligations arising from leasing transactions.

We continue to support the boards' core principle that an entity should recognise assets and liabilities arising from a lease. We acknowledge that the current model for lessees has long been criticised for failing to meet the needs of users of financial statements. We agree that a lessee should recognise an asset representing the right to use an underlying asset during the lease term (the right-of-use asset) and a liability to make lease payments. For lessees, we believe that the proposed standard is consistent with the boards' respective conceptual frameworks and, thus, provides a better foundation for a new accounting model than the current model, which requires recognition of an asset and liability in more limited circumstances.

Notwithstanding the above, we agree with the boards that the economic characteristics of leases take a variety of forms. We also agree that a single 'right-of-use' model for all leases might be complex to apply in some circumstances and will, in practice, reduce the income statement's usefulness to many users. For this reason, we agree with the boards that different types of leases should be treated differently. However, we find the boards' decision to classify leases based on the principle of consumption to be lessor-focused and typically not relevant or intuitive for many lessees. We also do

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not find the presumptions applicable to 'property' and 'other than property' to be sufficiently neutral or decision-useful for many users.

In considering the theoretical merits and costs of the proposed change, we believe the proposed classification model would not substantively improve upon the current distinctions in IAS 17. Accordingly, we recommend incorporating IAS 17's classification criteria into the proposed standard, instead of the consumption principle. We believe operational concerns would be significantly lessened if the current 'dividing line' in IAS 17 (as articulated in paragraphs 10 to 15A) for distinguishing between finance and operating leases was retained for the purpose of income statement classification. This would not be very different from the proposed model for property leases (as the criteria for rebutting the Type B presumption resemble those for identifying finance leases under IAS 17). It would also address many of the difficulties relating to non-property leases with economics similar to property leases, without sacrificing the boards' principal objective of balance sheet recognition. For example, it would require Type A lease treatment for the majority of arrangements in which the lessee clearly consumes the underlying asset. We believe this recommendation would be supported by many constituents, given the familiarity of IAS 17's classification criteria, ease implementation for preparers, and reduce complexity, all while enhancing the usefulness of information to users.

There are a number of other matters that we would like to raise for the boards' consideration, including where the concepts in the exposure draft could be more clearly articulated, where its current proposals might be challenging to apply, and where the guidance may not appear to produce benefits that compensate for their expected costs. In the appendix to this letter we highlight these matters in our responses to the boards' questions in the exposure draft.

If you have any questions about our letter, please do not hesitate to contact John Hitchins, PwC Global Chief Accountant (+44 20 7804 2497), Paul Kepple, PwC US Chief Accountant (+1 973 236 5293), Peter Hogarth (+44 20 7213 1654), Chad Soares (+1 973 236 4569), or Marc Jerusalem (+1 973 236 4714).

Yours faithfully

PricewaterhouseCoopers International Ltd

PricewaterhouseCoopers International Limited

Appendix

Responses to detailed questions in the exposure draft

Question 1

Do you agree with the definition of a lease and the proposed requirements in paragraphs 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.

We support the boards' proposed definition for a lease. When an arrangement involves nothing more than conveyance of the right to use a specific asset for a period of time, determining whether the arrangement contains a lease is usually straightforward. In our view, the difficulty arises when the right to use an asset is conveyed in some other manner, involving the delivery of other goods and services in a multiple element arrangement. We believe the new guidance for distinguishing a lease from a service contract addresses many of the known application issues of IFRIC 4/EITF 01-8 that were raised in our comment letter on the 2010 exposure draft. We also believe that the greater alignment of the concept of the right to control the use of the identified asset with IFRS 10 and the revenue recognition proposals improves the guidance. However, we have identified a few remaining areas of concern regarding some of the proposed guidance and examples.

The guidance on substitution rights (including, as set out in example 1, cases where the vendor may acquire a substitute asset in the future) does not sufficiently consider all of the commercial conditions motivating the parties to an arrangement. We expect that arrangements in which the vendor has substantive substitution rights would be atypical in practice (particularly when the asset is located at the customer's premises and is operated by the customer, in which case we would expect the arrangement to contain a lease or series of leases). This is due to the prohibitive costs and operational barriers that may arise from substitution; yet, the examples give little insight into how to weigh costs and benefits and appear to downplay the economic costs of substitution in assessing whether an asset is identifiable. For example, the proposed guidance is supplier-focused and overlooks the potential disruption to the customer's business that could be caused by substitution. It also fails to consider how substitution rights might benefit the supplier so that the supplier would be economically motivated to substitute the asset; if there were sound business objectives for including substitution rights in an arrangement, it should be expected that substitution would have occurred in similar arrangements in the past. We believe that these factors are important and should be included in the final standard.

Also, there appears to be a presumption in example 1(c) that the purchaser/lessee will have visibility of the supplier/lessor's access to additional assets and finance, which in reality is unlikely to be the case. We recommend that the assessment focuses on the substance of the contractual terms and information readily available to the purchaser rather than on the supplier's financial position or its access to assets.

In relation to example 2, we believe that if a lessee has the ability to control an asset, the contract is a lease. The determination should not depend on whether the consumables can only be supplied by the supplier. In examples 2 and 3, there seems to be little economic difference in the purchaser's ability to exercise control; in the former case it is restricted by practicality and in the latter by contract. In both cases the equipment is physically operated by the purchaser. We understand how, from a seller/lessor's perspective, the distinction is important given the need to be consistent with guidance in the revenue exposure draft (that is, a performance obligation is distinct if the entity regularly sells the good or service separately or the customer can benefit from it on its own or together with other resources that are readily available). However, we are not convinced that the distinction as illustrated in these examples is meaningful from the perspective of the purchaser.

In our view, a more clear-cut example of equipment that is incidental to the delivery of a service could be drafted in respect of an arrangement involving a set-top box for provision of cable or satellite television services. It is important for the boards to illustrate clearly when a purchaser does and does not control the right to use an asset and articulate the key factors that drive the conclusion. We believe that entities in some industries (for example, shipping) may find it challenging to apply the proposed guidance by reference to the examples in the exposure draft in their particular circumstances.

We recommend that the fact pattern in example 5 is improved to clarify the key factors that influenced the conclusion in order to make the example useful for other scenarios. We understand that there are various activities involved in power purchase agreements (for example, design, dispatch, fuel supply, operations, and maintenance), which are not always carried out solely by the purchaser or the supplier. The example does not clearly illustrate how to assess control when key activities are shared between the purchaser and the supplier. To illustrate our point, consider the case of a purchaser of electricity that was involved in the design of a wind facility, but not involved in its operation and maintenance. Does this demonstrate sufficient 'control' by the purchaser to consider the contract a lease? Furthermore, it is not clear to us what 'involvement' in design means, as there could be differing levels of involvement ranging from passive interest to outright control, particularly in the case of renewable energy facilities. We believe it would be useful if the boards explained how the current consolidation rules in IFRS 10 are aligned with the points above, in order to help preparers to apply the example to other scenarios. In our view, the proposed guidance may be interpreted differently from paragraph B51 of IFRS 10, which states that being involved in the design alone is not sufficient to give an investor control.

Although the exposure draft contains guidance on linked transactions in respect of sale and leaseback transactions, we recommend that it also includes general guidance for the purpose of identifying whether a series of arrangements together represent a lease (or leases). Such guidance is proposed in the revenue exposure draft (paragraphs 16-17) and, for IFRS reporters, paragraph IG B6 of IFRS 9. We believe that similar guidance in the proposed standard would assist in the analysis of sale and leaseback transactions, but would more widely be of use to preparers when analysing other contracts such as 'lease-in lease-out' transactions and others currently contemplated in SIC-27.

Question 2

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?

We agree that the economic characteristics of leases take a variety of forms (notwithstanding that they all contain an element of financing) and that distinguishing between different leases is appropriate. However, we have concerns with respect to the proposed basis for classifying leases. We discuss these concerns and our proposed alternative in greater detail in our response to question 4.

The proposed presentation in the cash flow statement for Type A and Type B leases seems appropriate.

Question 3

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?

In our response to the 2010 exposure draft, we disagreed with the boards' proposals for lessor accounting. We did not believe that the 'hybrid approach' was a demonstrative improvement of current lessor accounting in accordance with IAS 17/ASC 840. We therefore proposed that lessor accounting should not be amended at that time but that it should be revisited in the future.

Now that the boards propose that both lessors and lessees would apply a consistent dual model, one of our significant concerns from 2010 no longer applies. The proposals for lessors are now little different from current accounting, except that the dividing line is in a different place. We therefore support the notion that lessees and lessors use symmetrical approaches, subject to our comments on lease classification, which are set out in our response to question 4.

Question 4

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 paragraphs 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?

As noted in our cover letter, we find the boards' decision to classify leases based on the principle of consumption to be lessor-focused and typically not relevant or intuitive for many lessees. We also do not find the presumptions applicable to 'property' and 'other than property' to be sufficiently neutral or decision-useful for many users.

In considering the theoretical merits and costs of the proposed change, we believe the proposed classification model would not substantively improve upon the current distinctions in IAS 17. Accordingly, we recommend incorporating IAS 17's classification criteria into the proposed standard, instead of the consumption principle. We believe operational concerns would be significantly lessened if the current 'dividing line' in IAS 17 (as articulated in paragraphs 10 to 15A) for distinguishing between finance and operating leases was retained for the purpose of income statement classification. This would not be very different from the proposed model for property leases (as the criteria for rebutting the Type B presumption resemble those for identifying finance leases under IAS 17). It would also address many of the difficulties relating to non-property leases with economics similar to property leases without sacrificing the boards' principal objective of balance sheet recognition. For example, it would require Type A lease treatment for the majority of arrangements in which the lessee clearly consumes the underlying asset. We believe this recommendation would be supported by many constituents, given the familiarity with IAS 17's classification criteria, ease implementation for preparers, and reduce complexity, all while enhancing the usefulness of information to users.

We also are concerned that a model based solely on the type of asset (that is, property/other than property) would not adequately address the significant number of leases that are priced similarly to property leases, even when considering the proposed practical expedients. For example, certain assets, such as some aircraft, rail cars, and ships, have comparable economic lives to property and are often priced in a manner similar to property leases. However, most of these assets would be treated as Type A leases by both lessors and lessees solely because they are not 'property'. We believe that accounting for some of these types of leases as Type A leases could prove as complex as the boards acknowledge it would be for property leases. Similarly, the fact that land could be a Type A lease under the proposed standard appears to be inconsistent with the notion of consumption. If the boards decide to continue to use a consumption principle, we recommend providing guidance similar to paragraph 15A of IAS 17 such that, in determining whether land is a Type A or Type B lease, an important consideration is that land normally has an indefinite economic life.

In light of recent discussions by the IFRS Interpretations Committee about the definition of 'property' (land or a building, or part of a building, or both), we believe there will likely be mixed views on what 'property' represents. We think that the accounting should be neutral and determined by the substance of the transaction rather than the nature of the underlying asset.

The narrow definition of property raises further practical difficulties, particularly when determining the primary asset in a multiple element arrangement. For example, while the primary asset in a power station may be the power generating equipment, we believe that the building and the land on which it is built should not be disregarded. The location of the asset (inherent in the land) may significantly affect the pricing of the lease or the decision to execute an arrangement in the first place; to ignore that aspect would be inconsistent with the underlying economics of the arrangement. If the boards decide to retain the proposed guidance with respect to the classification of leases, we recommend that the boards provide additional guidance on how integral equipment (as currently contemplated under US GAAP) should be accounted for.

Question 5

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?

We agree that a lease term should include options to extend a lease or not to terminate a lease only when the definition of a liability (for a lessee) and asset (for a lessor) is met. We believe that by raising the hurdle of which extension periods are included in the lease term (as compared to the guidance in the 2010 exposure draft), the proposed guidance will better conform with these definitions and reduce operational complexity when considering the reassessment requirements applicable to lessors and lessees.

We note in paragraph 140 of the Basis for Conclusions that "applying the concept of 'significant economic incentive' would provide a threshold that is similar to the concepts of 'reasonably assured' and 'reasonably certain' in existing US GAAP and IFRS". To avoid ambiguity, we suggest that the proposed standard uses the words 'reasonably certain' instead of 'significant economic incentive' in assessing whether extension options should be included in the lease term, both in terms of the classification of the lease as well as in the measurement of the lease liability.

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If the boards retain the term 'significant economic incentive' in a new leasing standard, it should be noted that the concept is also relevant in the boards' proposed guidance for put options in a revenue transaction (paragraphs B43-B44/IG43-IG44 in the revenue exposure draft). It is implicit in that proposed guidance that the assessment of whether a customer has a significant economic incentive to exercise a put option is performed only at contract inception. If such an incentive exists, the arrangement is treated as a lease. It is not clear what an entity should do if, under the proposed guidance for reassessing lease transactions, it is subsequently concluded that the incentive no longer exists. In our view, once a transaction has been determined to be a lease, it should be treated as such unless there is a contract modification as described in paragraph 36 of the leases exposure draft. We recommend the boards make this clear.

Both the leases and revenue exposure drafts acknowledge that various factors need to be considered when determining whether a significant economic incentive to exercise an option exists. However, we note that the exposure drafts contain different approaches to option prices. The revenue exposure draft states that "if the repurchase price is expected to significantly exceed the market value of the asset, the customer has an economic incentive to exercise the put option". There is no such explicit statement in the leases exposure draft. We do not believe it is helpful for the proposed revenue standard to include a statement that singles out one possible factor, as this could cause readers to perceive that this factor is more important than any other. We believe that determination of whether a customer/lessee has a significant economic incentive to exercise an option requires consideration of various factors, one of which will be the option price relative to market prices. Given that the proposals provide guidance to determine when a revenue arrangement contains a lease, we believe that consistent principles and terminology should be applied. For the reasons set out above, we believe that the phrase 'significant economic incentive' should be replaced by 'reasonably certain' in both future standards. Moreover, the criteria should be described similarly in both standards.

We agree with the requirement to reassess the lease term by considering changes in relevant factors, as it provides users with more relevant information about the lease payments and greater certainty over the amount and timing of cash flows.

Question 6

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?

We agree with the proposal to exclude performance and usage driven variable lease payments from the lease liability. We also agree with including in the measurement variable lease payments that are in-substance fixed payments, as the lessee has no ability to avoid making payment. We believe, however, that the examples contained in the exposure draft could be improved. In both examples, the lessee cannot avoid a minimum payment regardless of the outcome of the contingency; hence the payments are contractually fixed, not fixed 'in-substance'. Accordingly, we recommend that the boards provide clear guidance on whether, and under what circumstances, 'in-substance fixed payments' include payments that are contractually variable.

We agree that it is appropriate for entities to re-measure lease assets (lessor) and liabilities (lessee) for variable lease payments based on an index or a rate. However, we do not agree that such re-measurement should be required at every reporting date, absent a contractual change in the cash flows. It seems an unnecessary burden for preparers to have to adjust lease balances repeatedly when the quantum of such adjustments, for example, on a quarterly basis, is likely to be minimal. We recommend that lease assets and liabilities be adjusted only when the contractual cash flows change (for example, on an annual basis if the contract stipulates that the lease payments are adjusted based on the index at the anniversary date).

We note that the boards appear to propose that lessors and lessees account for 'lease payments structured as a residual value guarantee' differently. When entities enter into a contract in which any difference between a specified amount and the market value of an underlying asset at the end of the lease term is paid to, or received from, the lessee, the lessor would include that stipulated amount in the measurement of its lease receivable. However, it does not appear that a lessee would include the stipulated amount in the measurement of its lease liability because the lessee only includes amounts expected to be payable. We recommend that lessees apply a symmetrical approach for such residual value guarantees that are economically similar to a fixed lease payment, and include the guaranteed amount in the measurement of their lease liability and right-of-use asset.

In an arrangement where a lessee guarantees that the value of an underlying asset will be at least a specified amount (that is, an indemnification against a loss) but does not guarantee that the lessor receive a fixed payment as described above, we agree with the boards' proposal that lessees and lessors should apply a symmetrical approach and include only the amounts that they expect to pay/receive in the measurement of lease assets and lease liabilities. For lease classification purposes, however, we recommend that lessors and lessees consider the maximum amount payable under residual value guarantees in determining the 'significance' of the present value of the lease payments relative to the fair value of the underlying asset. We believe that when the lessee takes on virtually all of the risks of ownership, it is indicative of a financed purchase and, thus, the lease should be accounted for as a Type A lease.

Question 7

Paragraphs 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?

We support the proposal to permit companies to apply all of the requirements of the proposed standard retrospectively. However, it is not clear in the transition guidance whether this would be applied by class of lease (that is, Type A or Type B) or on an 'all-or-nothing' basis. We encourage the boards to seek views from users and preparers regarding which approach would be preferable.

We agree that there needs to be a modified retrospective approach, as the cost of a full retrospective approach would be likely to outweigh the benefits in many cases. However, the modified retrospective approach could be made simpler.

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Under the proposed modified retrospective approach, we agree with the method used to measure a lease liability. However, we believe that the method for measuring a right-of-use asset is unduly complex. In our view, given the changes the boards have made to their proposals for lease term and variable payments, which reduce the impact of the front-loading effect for lessees, the modified retrospective approach should be as proposed for Type B leases in all cases where leases were not previously recognised on-balance sheet (that is, the lease liability and right-of-use asset should be measured at equal amounts at transition), subject to adjustments for prepaid, accrued and impaired amounts.

The proposed modified retrospective approach also does not envisage a situation where an operating lease was previously considered onerous. For such existing lease contracts, a provision would already be recorded on the balance sheet by the lessee. However, the proposed standard suggests that a lessee would record a right-of-use asset at an amount equal to the lease liability. Applying the proposed impairment guidance subsequently would result in a loss being recognised for a second time. We recommend that the modified retrospective approach allows for the fact that the right-of-use asset's value might be impaired at the date of transition. A simple way to address this could be to adjust the right-of-use asset by the amount of any provision previously recorded for the onerous lease.

It appears that lessees will be required to use discount rates that will exist as at the effective date of the proposed standard (for example, 1 January 2017) rather than as of the beginning of the earliest comparative period presented (for example, 1 January 2015). Since lessees with large lease portfolios may, from a practical perspective, need to maintain two sets of books during the period before the effective date, it would be preferable to allow them to use the discount rate in effect at the earliest date they would apply the proposed guidance.

For lessors, the guidance on transition of existing finance lease residual assets needs to be clarified. Under the proposed guidance, upon transition a lessor would record a lease receivable equal to the existing carrying amount of the 'net investment in the lease' (including the residual asset). Subsequently, the lessor would account for the lease receivable in accordance with the guidance pertaining to lease receivables, while ignoring guidance pertaining to residual assets. However, when determining whether the lease receivable, including the residual asset, is impaired, the guidance does not allow the lessor to consider the cash flows it expects to derive from the underlying asset at the end of the lease term. This would appear to lead to a lessor recognising an impairment charge when the combined receivable and residual assets are not actually impaired. Furthermore, the proposed standard provides no guidance on accounting for the residual asset at the end of the lease term. We encourage the boards to consider whether lessors should separately recognise the receivable and residual balances of existing finance leases upon transition and subsequently apply the proposed standard.

We note that paragraph C15 of the exposure draft could be interpreted as having only one outcome for previously securitised lease receivables; that is, on transition a lessor must account for them as secured borrowings. We believe that it may not always be appropriate to account for such receivables as secured borrowings, in particular if they could have been derecognised under IAS 39 or FAS 166 had they been recognised on the balance sheet initially. We recommend that the transition guidance is made clearer, so that a lessor applies the relevant derecognition guidance under the applicable accounting standard to determine whether the receivables should be derecognised or accounted for as secured borrowings.

We are concerned that the proposed transition guidance for entities involved in sale and leaseback transactions, where the transaction fails to meet the criteria for a sale under the revenue exposure draft, is not adequate. Specifically, the boards should consider providing transition guidance for buyer-lessors in sale and leaseback transactions (that is, purchase/lease out) that may not meet the proposed sale criteria under the revenue exposure draft due to the seller having an option to repurchase the asset. Under current guidance, notwithstanding whether a seller accounts for the transaction as a 'sale', a buyer typically accounts for the transaction as an asset purchase and subsequent lease. We believe that the proposed guidance, however, would require buyer-lessors to account for these transactions as financing receivables. Lease transactions with financial lessors are commonly structured as sale and leaseback transactions. Given the magnitude of such transactions, we recommend that the boards consider providing buyer-lessors more explicit transition guidance, particularly clarifying whether the asset would be carried forward at its previous carrying amount and subsequently measured under the applicable standards for financial instruments.

If the boards adopt our recommendation to retain IAS 17's lease classification criteria, we would further suggest that the boards permit a simplified transition approach similar to that proposed in the revenue exposure draft. Under that approach, entities would apply the requirements of the proposed standard as of the effective date and recognise the cumulative effect of transition in the opening balance of retained earnings on the effective date. Whilst we acknowledge that there may be a significant impact on the balance sheet, income statement differences between the periods presented would be less pronounced if IAS 17's lease classification criteria were applied, thus reducing the need to restate comparative periods. Furthermore, this approach would reduce the need to consider leases that will end during comparative periods prior to the effective date, and reduce the need to consider changes in discount rates between the earliest period presented and the effective date.

Question 8

Paragraphs 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; reconciliations 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?

We do not agree that there should be a difference in disclosure requirements between US GAAP and IFRS other than in respect of valuation options that are available under IFRS but not US GAAP. We believe that the reconciliation requirement for the right-of-use assets for Type B leases, as it stands, does not provide users with the most useful information as the Type B leases apply a balancing figure for the amortisation charge to achieve an overall straight-line expense. However, we can see value in the reconciliation for Type A right-of-use assets and, on balance, we would support the inclusion of consistent disclosure requirements in this respect under both IFRS and US GAAP.

We agree with the other disclosure requirements as suggested by the boards.

Question 9

To strive for a reasonable balance between the costs and benefits of information, the FASB decided to provide the following specified reliefs for nonpublic entities:

(a) To permit a nonpublic entity to make an accounting policy election to use a risk-free discount rate to measure the lease liability. If an entity elects to use a risk-free discount rate, that fact should be disclosed.

(b) To exempt a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability.

Will these specified reliefs for nonpublic entities help reduce the cost of implementing the new lease accounting requirements without unduly sacrificing information necessary for users of their financial statements? If not, what changes do you propose and why?

We do not agree with the proposed relief to allow nonpublic entities to make a policy election to measure lease liabilities using a risk-free rate. Such a policy election would overstate the lease liability reported in balance sheets as the risk-free rate is substantially below most entities' potential borrowing rates. We note that private companies today use their credit-adjusted risk-free rate in other transactions, such as, to measure asset retirement obligations or exit costs, and would be required to continue to do so. We do not see significant benefit provided by the relief.

If nonpublic companies would find it difficult to identify an incremental borrowing rate, we would be supportive of allowing lessees to determine their credit-adjusted risk-free rate using a 'best estimate' approach.

Question 10

Do you agree that it is not necessary to provide different recognition and measurement requirements for related party leases (for example, to require the lease to be accounted for based on the economic substance of the lease rather than the legally enforceable terms and conditions)? If not, what different recognition and measurement requirements do you propose and why?

We note that Topic 850 requires disclosure of transactions between related parties, including those to which no amounts or nominal amounts are ascribed, as related party transactions cannot be presumed to be carried out on an arm's length basis. Accordingly, we agree that it is not necessary to provide different recognition and measurement requirements for related party leases. Arguably, the requirement to account for the lease based on economic substance is necessary under current US GAAP, as lease classification determines whether assets and liabilities are recorded on balance sheet or not. Furthermore, if related parties were required to account for leases based on their economic substance when contractual terms are lacking, the entities would necessarily make highly subjective judgements to impute important provisions such as: the appropriate lease term, the commensurate discount rate, and the balance of fixed vs. variable payments. The resulting balance sheet and income statement amounts may not be more useful to users than the amounts and disclosures required by the proposed standard.

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Question 11

Do you agree that it is not necessary to provide additional disclosures (beyond those required by Topic 850) for related party leases? If not, what additional disclosure requirements would you propose and why?

We agree that additional disclosures are not required for related party leases. Given that related party transactions cannot be presumed to be carried out on an arm's length basis, we agree that disclosure of transactions between related parties, including those to which no amounts or nominal amounts are ascribed, is sufficient.

Question 12

The IASB is proposing amendments to other IFRSs as a result of the proposals in this revised Exposure Draft, 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?

We agree with the boards' proposals to expand the scope of IAS 40 for right-of-use assets.

Whilst the boards have not sought comment on the other consequential amendments, we make the following observations in respect of the proposed amendments to IFRS 3.

We note the proposed amendment to paragraph 17(a) repeats the message of the last sentence of the paragraph after the bullets (which has not been amended and is not shown in the exposure draft). We recommend that the final sentence is removed. Furthermore, we understand that it is the boards' intention that lease classification not be reassessed upon a business combination. However, we believe the phrase "if the contractual terms and conditions of a lease are modified..." in the proposed wording may be ambiguous, as it is possible to interpret this as forward-looking rather than what has happened in the past. We recommend replacing the words 'are modified' with the words 'have been modified'.

Paragraph B45C provides guidance on measuring residual assets on acquisition of a lessor. It appears that it is presumed the fair value of the underlying asset at acquisition will be greater than the carrying amount of the lease receivable at that date. It is unclear what accounting should be applied if this is not the case (that is, if the carrying amount of the lease receivable is greater than the fair value of the underlying asset). We believe in this scenario a liability or 'negative residual asset' would not be recognised, but it would be useful if the boards expand on the guidance for such a situation.