



Australian Government

**Australian Accounting
Standards Board**

Level 7, 600 Bourke Street
MELBOURNE VIC 3000

Postal Address
PO Box 204
Collins Street West VIC 8007
Telephone: (03) 9617 7600
Facsimile: (03) 9617 7608

9 May 2011

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear David

Recent tentative decisions on *Leases* project

The Australian Accounting Standards Board (AASB) has been following with interest the progress the IASB is making on the *Leases* project. The AASB would like to bring a number matters to the attention of the IASB for consideration in finalising this important project.

Whilst the AASB continues to be supportive of the decision made by the IASB to proceed with a fundamental review of lease accounting, it believes that some of the tentative decisions reached to date on the project would not result in improved information for users of financial reports when compared to current requirements for lease accounting provided in IAS 17 *Leases*. Specifically, the AASB is concerned that the effects of those decisions brings into finer balance whether benefits will outweigh the costs of implementing the proposals. Accordingly, the AASB asks the IASB to re-consider the following:

(a) Distinction between finance and other-than-finance leases

The AASB is concerned about the tentative decision that there should be two accounting approaches for lessees: finance leases and other-than-finance leases, because it is inconsistent with the 'single approach to lease accounting' objective of the project and introduces unnecessary complexity.

Further, the AASB is of the view that the IASB's tentative decision for lessees to use guidance similar to that in IAS 17 to determine which accounting approach to apply does not present an improvement to the current lessee model outlined in IAS 17. Rather, the AASB considers that such an approach will be likely to result in the creation of 'bright-lines' that encourage structuring between types of leases. The AASB also notes that eliminating structuring opportunities was part of the IASB's objective in undertaking the project.

The AASB continues to support a single model for a lessee reflecting a right-of-use asset and a liability to make lease payments. The AASB considers that the IASB's recent tentative decisions on two models for capitalised leases would not result in improved information for users of financial reports when compared to IAS 17's current requirements for lessee accounting.

(b) Amortisation method for ‘other-than-finance’ leases

The AASB is concerned with the tentative decision made by the IASB to amortise the right-of-use asset in a manner that would result in total lease expense being recognised over the lease term on a straight-line basis, unless another systematic basis is more representative of the time pattern of the total lease expense.

The application of an apparently rule-based method of amortisation that provides an inverse relationship between interest expense and amortisation expense does not appear to be consistent with the *Framework* statement that amortisation be recognised on the basis of systematic and rational allocation procedures. Further, the AASB is of the view that the proposed method of amortisation is inconsistent with the requirements of existing IFRSs, specifically the requirements of IAS 16 *Property, Plant and Equipment*, and IAS 38 *Intangible Assets*. The AASB considers that it would be preferable to have a consistent approach in dealing with similar items across Standards and projects.

The AASB is of the view that this method of amortisation of the right-of-use asset does not have conceptual merit and does not appear to have a justifiable rationale. The AASB recommends the IASB reconsider its tentative decision in relation to this proposed amortisation method for other-than-finance leases. For those who wish to see greater relationship between expenses and cash flows, other disclosures options could be explored. The AASB do not support moving away from clear measurement attributes to arbitrary methods.

(c) Variability in lease payments

The AASB is of the view that the tentative decision made by the IASB that the asset and liability recognised under a lease contract for a lessee should exclude variable lease payments, except for those that are considered disguised minimum lease payments, is a retrograde step and inconsistent with the approach taken for other IASB proposals on similar items. For example, the approach taken in recent redeliberations on the *Revenue from Contracts with Customers* project to include uncertain consideration when determining the transaction price appears to apply quite different criteria to those of the leases project. Further, IFRS 3 *Business Combinations* requires contingent consideration to be included in consideration transferred. The AASB is of the view that projects should, to the extent possible, have a consistent approach in dealing with similar items across Standards and projects.

In addition to the above, the AASB considers that the tentative decision to exclude variable lease payments except for those that are considered disguised minimum lease payments does not reflect the economics of lease arrangements. When contingent rentals are material, capitalising only minimum lease payments is not representationally faithful.

The AASB continues to support the inclusion of contingent rentals in the measurement of assets and liabilities arising from a lease contract, on a basis consistent with other standards, and recommends that the IASB reconsider its tentative decision to exclude such payments from the asset and liability recognised under a lease contract.

(d) Other Issues

In addition to the above issues, the AASB suggests that, if the IASB proceeds with its current approach, it should consider the following issues in relation to the right-of-use asset in other-than-finance-leases in the final Standard on *Leases*:

- the relationship between an arbitrarily amortised asset balance and the revaluation approach for leased assets; and
- the implications of such a balance for testing for impairment.

If you require further information regarding any matters in this letter, please contact me or Nikole Gyles (ngyles@asb.gov.au).

Yours sincerely

A handwritten signature in black ink that reads "K. M. Stevenson". The signature is written in a cursive style with a long, sweeping underline.

Kevin M. Stevenson
Chairman and CEO