

14 December 2010

International Accounting Standards Board  
30 Cannon Street  
London  
EC4M6XH  
United Kingdom

Dear Sir/Madam

IASB/FASB Leases Exposure Draft

I appreciate the opportunity to comment on the exposure draft "Leases".

Your specific questions are addressed on the pages that follow but I would like to make the following general comments:

My overriding view is that the proposed accounting for leases is simply too complex and we cannot justify the changes on a cost/benefit basis, nor do we believe that the board has done so in the ED. I have a real concern that the proposals will simply make leasing "too hard" and customers (who have choices in this regard) will adopt forms of finance that are simpler to account for. This in-turn will negatively impact independent (i.e non-bank owned) lessors significantly.

In the Australian context in particular we hold grave concerns for the impact on Novated Leasing, a form of employee benefits which would be inadvertently trapped under these proposals and effectively force employers to capitalize future salary costs onto their balance sheets. This could act as a real disincentive to what is currently a prolific form of vehicle finance in Australia which in-turn would adversely impact the automotive sector which is indeed a most important employer in the Australian economy.

Answers to your specific questions are as follows:

#### *Question 1*

*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?*

*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 model would you propose and why?*

#### *Response*

I have no fundamental objection to requiring a lessee to recognize a right-of-use asset and a liability to make lease payments, however we disagree strongly (as explained below) with the way in which the ED requires lessees to calculate this.

#### *Question 2*

*Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits 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 alternative approach would you propose and why?*

*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?*

#### *Response*

Our view is that the Performance Obligation approach is fundamentally inconsistent with the right of use model and should not be included as an option in the final standard.

We also believe that the derecognition approach proposed in the ED is flawed in that it does not allow lessors to earn income on the outstanding residual during the life of the lease. This proposal would lower the income over the life of the lease and create an artificial profit on the eventual realization of the residual asset. This is fundamentally inconsistent with the way in which the majority of lessors in our industry operate which is to set residuals to break even at the end of the lease.

#### *Question 3*

*The exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is twelve months or less:*

*At the date of inception of a lease, a lessee 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 undiscounted amount of the lease payments 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).*

*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 payments 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?*

*Response*

We believe that this proposal does not provide any real benefit. We would propose that short term leases be treated as operating leases are currently treated. Moreover we would propose that "basic" leases, defined as leases that contain no renewal options, no residual value guarantees, no purchase options and which are not for the majority of the economic life of the asset be treated as operating leases are currently treated.

*Question 4*

*Do you agree that a lease is defined appropriately? Why or why not?*

*If not, what alternative definition would you propose and why?*

*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?*

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

*Response*

We agree with the definition.

*Question 5*

*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?*

*Response*

We believe that the final standard should include intangible assets even if this means delaying the release of the standard because not doing so would lead to absurd results. For example a server costing \$5,000.00 per month on lease would need to be capitalized, but the software leased for \$25,000.00 per month running on the server would not need to be capitalized. If the final standard is to have any credibility then intangible assets need to be included.

Secondly, in Australia, Novated Leases are a prevalent form of providing benefits to employees.

Under a Novated Lease and employee leases a vehicle from a Lessor and then Novates the lease to the employee's employer. The employer assumes the lease obligations of the employee other than payment of the RVG for as long as the employee is employed by the employer. The employer reduces the salary of the employee by the amount of the lease payment, which includes service and fuel components. In effect, Novated Leasing allows employees to pay for a vehicle and its running costs out of pre-tax dollars, and allows employers to offer greater benefits to employees without a commensurate increase in costs.

Under the ED, a novated lease would need to be accounted for on the balance sheet of the employer as a head-lease and a sub-lease which would be an absurd outcome since it is in effect nothing more than a salary payment. We would propose that Novated Leasing arrangements of this nature be excluded from scope of the standard.

#### *Question 6*

*The exposure draft proposes that lessees and lessors should apply the proposals in Revenue from Contracts with Customers to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B5-B8 and BC47-BC54). If the service component in a contract that contains service components and lease components is not distinct:*

*the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.*

*the IASB proposes that:*

*a lessee should apply the lease accounting requirements to the combined contract.*

*a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.*

*a lessor that applies the de recognition 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?*

#### *Response*

We believe that Lessee's should be able to make a reasonable estimate of the service components if they do not have a detailed breakdown of these components. They should not be required to capitalize the entire lease rental.

#### *Question 7*

*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) when the purchase option is exercised (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?*

*Response*

We believe that options to purchase as well as options to extend a lease should only be accounted for when the option has actually been exercised.

*Question 8*

*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?*

*Response*

See question 9.

*Question 9*

*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 using an expected outcome technique? Why or why not? If not, how do you propose 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 measured reliably? Why or why not?*

*Response*

We disagree in the strongest possible terms with the proposals in questions 8 and 9. The estimation of the lease term on this basis is not an accurate representation of the lease term. The lease term over which the rental cash flows should be discounted should be the minimum non-cancellable lease term as set out in the lease agreement.

Our view is that only contractually committed cash flows should be capitalized and that they should be capitalised over a contractually committed lease term. Extension and early termination options and contingent rentals should be completely excluded from the analysis. Requiring a lessee to guess the amounts that may possibly become payable in the event that they possibly exercise an early termination option at some point during the life of the lease is not conducive to the production of reliable financial information. In our view, the degree of subjectivity involved in the application of these standards would hinder rather than help the users of financial statements. In addition the comparison of financial statements of similar entities would be very difficult as a result.

*Question 10*

*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?*

*Response*

As stated above our view is that only contractual commitments should be capitalized. Reassessment should only be required for impairment testing purposes. Requiring annual reassessments of contingent rentals and option periods is overly onerous on the preparers of financial information and will lead to unnecessary volatility in financial statements.

*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?*

*Response*

We agree with the classification criteria but as mentioned above believe the performance obligation approach is fundamentally inconsistent with the right of use model.

*Question 12*

*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?*

*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?*

*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?*

*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?*

*Response*

Subject to what we have said elsewhere in this document, we agree with this proposal.

*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?*

*Response*

We agree with this proposal.

*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?*

*Response*

We agree with this proposal.

### Question 15

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

*identifies and explains the amounts recognised in the financial statements arising from leases; and*

*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?*

### Response

We disagree fundamentally with the proposals in the ED relating to contingent rentals and option periods and as such believe that the above disclosure flowing from this would be too onerous. We believe that if the final standard addresses these deficiencies then the disclosure will inevitably become more simplified.

### Question 16

*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?*

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

*Are there any additional transitional issues the boards need to consider?*

*If yes, which ones and why?*

### Response

Our view is that lessees and lessors should have the option of adopting the full retrospective approach to minimize the negative impact of these proposals.

### 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?*

### Response

We strongly disagree with the assessment that the benefits of the proposals would outweigh the costs. In our view the board has failed to demonstrate the "significant need" for the proposed changes and have failed to identify all of the costs of implementing the changes. We do not consider the proposed standard to be an improvement on the existing IAS17. The annual administration burden on lessees and lessors of complying with this ED will be material, not to mention the cost of readjusting covenants in all lending documents to the artificially inflated gearing levels that this ED will produce.

Given the wide ranging impact of these proposals, in our view the board needs to revisit the

cost/benefit analysis in full and disclose sufficient details of this exercise to justify changing from the current IAS17.

*Question 18*

*Do you have any other comments on the proposals?*

The ED envisages that the assessments required will take place on a lease by lease basis. In our opinion this is totally impractical given the volume of leases that lessor's and some lessees are a party to. The final standard should contemplate a portfolio approach.

In our view the proposals in the ED relating to lessors appear to be a rushed compromise which has produced obscure results such as the inability to accrete income from the residual asset over the life of the lease. A possible solution would be to exclude lessors from the scope of this standard until such time as lessor accounting can be adequately considered.

I believe that these proposals will result in significant damage to the operating lease/contract hire industry. This industry satisfies a very real and required service for its customers by assuming real risk on their behalf. It is our fear that the cost/benefit equation of making use of this product will be significantly diminished by the very onerous burden of accounting for these transactions, particularly on an asset by asset basis.

Yours faithfully