13 September 2013

Hans Hoogervorst, Chairman International Accounting Standard Board 30 Canon Street London EC 4M 6XH United Kingdom

Dear Mr. Hoogervorst

ED/2013/6 Leases

We are pleased to provide our comments in relation to the Exposure Draft (ED) on Leases. We believe the current approach to accounting for leases and current disclosure requirements are understood by preparers and users and provide sufficient information to enable an assessment of the impact of leasing transactions on the financial position and operations of an entity. However, if it is inevitable that the final standard will bring all lease transactions onto the balance sheet then we believe the current ED is overly complex and lacking in specific areas to satisfy this intention.

Our main concerns with the proposed ED are set out below:

- We believe there is a lack of specific guidance in the proposed standard in respect to commercial arrangements that effectively sell the underlying asset to a customer, but do not transfer legal ownership, in exchange for consideration over a period of time. That is, it is unclear in the ED as to when there is a lease versus an outright sale of an asset, in situations where substantially all the remaining benefits of the underlying asset (i.e.: a sale), thus control of its use (i.e.: a lease), are transferred to the end customer. In this instance, would this transaction be accounted for as a lease or an outright sale? The final standard should include guidance to distinguish between the right to control the underlying asset vs. the right to control its use (where that use is substantially all of the benefits from its use);
- Leases of intangible assets are prima facie excluded from the scope of the proposed standard. Lessees can however can elect to apply the standard to intangibles without reciprocal recognition by the lessor. We believe that software can be an 'identified asset' (which is consistent with the current definition of intangibles) and that a lessee would be able to control the use of that asset. By excluding intangibles the proposed standard fails to take into account the technological shift in many industries where the right to control software is more relevant than the right to control a physical piece of equipment;
- We note that the terms 'insignificant', 'significant', 'major' and 'substantially all' are used throughout the proposed standard as key concepts in classifying and measuring Type A and Type B leases and also when control of an asset exists, but are not defined terms. It would be beneficial if the Board provides additional guidance as to the meaning of these terms or what factors an entity should consider when assessing these terms. For example, there is no guidance as to whether these terms are subjective or objective assessments in the minds of either lessors or lessees;
- We believe the requirement to reassess the lease liability by the lessee and the lease receivable and residual asset by the lessor at every reporting date (for any change) is onerous compared to current requirements. In order to implement these proposals, this



would require considerable systems changes and the utilisation of additional resources, resulting in significant costs being incurred, which would far outweigh the benefits of these changes to financial statement users;

- We believe the lessee accounting for Type B leases contains a number of problems and conceptual difficulties, including:
 - Amortisation of the right of use (ROU) asset under a Type B lease is artificial as it simply reflects the number required to achieve the straight line expensing of the lease. It therefore adds no value to users of financial statements;
 - Given the straight line expensing of the Type B lease, there could be an issue with testing for the impairment of the right of use (ROU) asset. This is because there could be situations where the ROU asset is impaired as amortisation does not represent the true use of the asset;
 - The concept of the 'ROU asset' is not sufficiently defined or given due consideration in light of the distinction drawn between Type A and Type B leases. We consider that there are conceptual difficulties with a ROU asset being able to be recognised by a lessee under a Type B lease as the lessor can continue to recognise the underlying asset, but under a Type A lease the lessor must de-recognise that asset. The ROU asset must therefore have different meanings under Type A and Type B; and
- Overly complex calculations are required by lessors for Type A leases concerning residual
 asset measurements and profit / loss measurements, again requiring significant resources
 to comply with, which would far exceed the benefits to users of these proposals;
- The short term lease exemption should be extended to three year lease terms and take
 into consideration the 'significant economic incentive' to exercise purchase options in the
 assessment, to ensure the simplified measurement requirements proposed for short term
 leases would be in line with the commercial realities of short term lease periods and give
 the relief that this proposed concession is intending to provide; and
- The proposed disclosure requirements are overly burdensome given the level of transparency that will be provided by the standard in the financial statements themselves (by bringing all leases "on balance sheet"). Certain disclosures are therefore either repetitive or excessive.

Our detailed responses to the questions raised in the ED are as follows:

Question 1: Identifying a lease

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 do not agree with the proposed definition of a lease. It is unclear in the ED as to when there is a lease versus an outright sale of an asset, in situations where substantially all the remaining benefits of the underlying asset (ie: a sale), thus control of its use (ie: a lease), are transferred to the end customer, without legal ownership transferring, in exchange for consideration over a period of time. In this instance, would this transaction be accounted for as a lease or an outright sale? Should the transaction fall into the proposed lease standard (when in substance it is an outright sale) the entries that would be recorded by the lessor for

the Type A lease are likely to match those for an outright sale. However, as the transaction falls under the proposed leasing standard, additional accounting and disclosures relevant to the proposed leasing standard would be required, creating onerous work for transactions that are really demonstrating a financing arrangement. Therefore, the final standard should include guidance to distinguish between the right to control the underlying asset versus the right to control its use (where that use is substantially all of the benefits from its use).

Further, per paragraph 11, a capacity portion of an asset cannot be an identified asset as it is not physically distinct from the remaining capacity of the asset. Whilst we agree that a capacity contract should not be accounted for as a lease, we do not agree with this assessment in so far as using "physical substance" to determine whether an asset can be an identified asset. This also contradicts the current definition of an intangible asset, which is an "identifiable... asset without physical substance". We believe that software can be an 'identified asset' and that a lessee would be able to control the use of that asset. Therefore, we also believe that intangibles should be included in the proposed standard in order to take into account the technological shift in many industries where the right to control software is more relevant than the right to control a physical piece of equipment

Per paragraph 19, we believe that further guidance is required on the meaning of 'incidental' in the context of assets being measured as incidental to a 'service'. It is unclear whether qualitative and/or quantitative factors should be taken into account. An example or parameters in which to assess would be helpful in this regard. For example, if the asset is less than 10% of the service contract.

Question 2: lessee accounting

Do you agree that the recognition, measurement and presentation of expenses and cash flow 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 no, what alternative approach would you propose and why?

We agree in principle that the accounting treatment of a lessee should differ depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset.

However, we disagree that the starting point in the lessee accounting treatment should be whether the asset is 'property' or not. We propose that the final standard should apply the broader principle of whether a lessee is consuming more than an insignificant portion of an underlying asset when considering the asset's economic life and present value to fair value comparisons. If the lessee is consuming more than an insignificant portion then it should follow the accounting treatment of a Type A lease proposed in the ED and if an insignificant portion is consumed then it should follow the accounting treatment of a Type B lease.

If the Board does not revise the definition of Type A and Type B leases then at the very least there needs to be additional guidance on the definition of 'property' and further guidance on a number of other critical key terms used in the ED such as what is considered 'insignificant' and what 'major' and 'substantially all' are intended to mean. It would be helpful if the Board could provide at the very least qualitative factors for the finance community to consider when making this assessment of how to account for a particular transaction.

We agree in principal with the proposed lessee accounting for Type A leases with the recognition of a 'right of use (ROU) asset' and 'lease liability' at inception and subsequent amortisation and discount unwinding throughout the lease period. This would achieve the objective of bringing the substance of those leases onto the balance sheet.



The proposed lessee accounting for Type B leases, however, raises concerns around costs of implementation versus value added for financial statement users. The steps requiring the 'straight line' expensing of a Type B lease but also requiring the calculation of the unwinding of the discount of the lease liability, adds little if any value to users when assessing the impact of Type B leases. Given that the sum of the unwinding of the lease liability and amortisation of the ROU asset must equal the straight line expensing of the lease, the accounting does not provide any meaningful assessment of the carrying value of the ROU asset (this number is simply the difference required to be added to the liability unwinding to get to the straight line expense value). Therefore, the balance sheet is simply grossed up and wound down providing no further value to financial statement users than current operating lease accounting does. While not providing any further value to users, these requirements will however mean significant costs of implementation for financial statement preparers.

Further, given the straight line expensing of the Type B lease, there could be an issue with testing for the impairment of the right of use (ROU) asset. This is because there could be situations where the ROU asset is impaired as amortisation does not represent the true use of the asset.

Per paragraph 51 a lessee shall determine whether the right of use asset is impaired and shall recognise an impairment loss in accordance with IAS 36 Impairment of Assets. As outlined above we propose that the classification of a Type B lease should be based on whether the lessee is consuming an insignificant portion of the underlying asset. Under this classification we believe a lessee should be exempted from testing a Type B ROU asset for impairment. However, if the Board does not alter the definition of Type A and Type B leases we would ask for further guidance in relation to application of IAS 36 in relation to testing for impairment of ROU assets. For example further guidance is sought on how an entity should allocate ROU assets, particularly assets such as property and laptops across cash generating units.

Also, further consideration and guidance should be given to the nature of what type of balance sheet asset a 'ROU asset' is. Arguably, the nature of the ROU asset under a Type A lease is not the same as under a Type B lease given that the classification between the two is dependent on different measurement factors. These factors are concerned with whether the underlying asset is 'property', what the level of consumption of the economic life or fair value of the underlying asset is, and the existence of a significant economic incentive to exercise any option to purchase. Therefore, the nature of the 'ROU asset' between a Type A and Type B lease must differ where these measurement factors differ. It also follows for the same reasons that the nature of the 'lease liability' for the lessee differs between lease types.

Question 3: 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?

We agree that a lessor should apply a different accounting approach to different leases. However under a Type A lease the lessor is required to undertake a residual measurement and a profit or loss measurement at inception of the lease.

Both these measurements require complex calculations with high degrees of subjectivity and therefore are subject to error, inaccuracy and subsequent review (e.g. residual asset measurement of expected variable lease payments to be earned during the lease term). If the final standard were to be introduced these calculations would need to be simplified to assist lessors in implementing the requirements in a more practical and user-friendly way.

Question 4: 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 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?

We refer you to our comments in response to question 2.

Question 5: 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?

We agree with the initial assessment of the lease term. Even though we support the scope exclusion for short term leases, we do not support the proposed definition for short term leases, that being lease contracts with terms of 12 months or less. We believe expanding this timeframe to contracts of three years or less would ensure the simplified measurement requirements proposed for short term leases would be applicable to a broader range of lease arrangements and give the relief that this proposed concession is intending to provide.

Furthermore we believe that the definition of short term lease should not take into account the maximum possible term under the contract. Options to extend should only be taken into account when assessing a lease term for a short term lease where there is a significant economic incentive to exercise the lease term. The perception that without the exclusion of 'significant economic incentive' there would be deliberate structuring of lease arrangements to obtain the benefit of the short term exemption is, in our view, unfounded and does not reflect the commercial reality of how leases are entered into. This change in definition of short term lease would make it consistent with the definition of lease term and therefore consistent with commercial reality and industry practice. The extension of the short term lease period to three years would also remove any perceived incentive to structure leases to artificially short periods to obtain the benefit of the exemption.

We also do not agree with the ongoing 'reassessment' requirements of the lease term. We consider that the cost required to implement such a review process would far out weigh the benefits obtained by financial statement users. Such a review process would be time consuming and would require a level of automated and manual review with input from various levels of management and assessment of difficult concepts such as 'significant economic incentive'. Requiring reassessment adjustments only for significant, but not all, changes ensures both better quality information for users in addition to less compliance costs for preparers.

We also note that while there is a requirement for lessees to reassess the 'lease term' for Type B leases, there is no such requirement for lessors to reassess for Type B leases.

Question 6: 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?



We agree with the treatment of variable lease payments. However, for the same reasons outlined above for question 5, we do not agree with the ongoing 'reassessment' requirements of variable lease payments and also believe reassessment adjustments should be made for significant changes only.

We also note that while there is a requirement for lessees to reassess the 'variable lease payments' for Type B leases, there is no such requirement for lessors to reassess for Type B leases.

Question 7: transition

Paragraphs C2-C22 state that a lessee and a lessor would recognize 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?

We agree with the option of using either a modified retrospective approach or full retrospective approach.

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

We have no further transition issues to consider.

Question 8: disclosure

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 support the disclosure objectives specified in paragraphs 58 and 98 and recommend that paragraphs 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.

We reiterate that the main purpose of this proposed standard is to disclose those significant assets that have been kept off balance sheet. If the proposed standard is implemented then the objectives of recording operating leases on the statement of financial position will be achieved. We therefore think that it is unnecessary to include any further disclosures other then what is already disclosed as part of today's commitment requirements.

Any extra disclosure requirements are placing an unnecessary compliance burden on the preparers of the financial statements without adding any value to users. Furthermore, we believe that extra disclosures could lead to information overload and confuse the users of financial reports.

We believe some of the proposed disclosure requirements are onerous in respect to collecting the information whilst bringing little benefit to the user. In particular, the need to provide a reconciliation of the opening and closing balances for the right of use asset on each class of the underlying asset is excessive. There is little benefit gained in disaggregating each asset class information and it would be more suitable to show this reconciliation disclosure on an aggregate basis only.

Also, we believe the reconciliation for lease liabilities for lessor accounting seems irrelevant, as users can obtain a majority of the information from the rest of the financial statements.

Question 9 (not applicable to Telstra)

Question 10 (not applicable to Telstra)

Question 11 (not applicable to Telstra)

Question 12 (not applicable to Telstra)

If you have any questions regarding this submission please do not hesitate to contact Sanjay Khushu (+613 8649 7923) or Jackie Trajanovski (+613 8649 7911),

Yours sincerely,

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