



15 December 2010

Sir David Tweedie  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

*Submitted electronically via IASB website*

Dear Sir David

### **Exposure Draft ED/2010/9: Leases**

Thank you for the opportunity to comment on the Exposure Draft (ED). Australia and New Zealand Banking Group Limited (ANZ) is listed on the Australian Securities Exchange and remains one of a select group of banks who continue to be AA rated. Our operations are predominately based in Australia, New Zealand and Asia and our most recent annual results reported profits before tax of A\$6.6 billion and total assets of A\$532 billion.

#### Summary

ANZ will be significantly impacted by this ED both as a lessee and as a lessor. As a regulated entity we are concerned by the capital implications of the proposals which could be a significant cost to our business. We also note that given the number of leases we are involved in, and the complexity of some of our structured lending leases, the cost of implementing the proposals will be significant at a time when we already have to spend a significant amount of time and resource on the implementation of IFRS 9. We would encourage the IASB to critically evaluate the results of the field testing and to reconsider the costs and benefits of the leases proposals, because at this stage we would query whether the benefits outweigh the costs of implementation and ongoing application.

We have a number of concerns with the proposals themselves and these are outlined below and are discussed in detail in the Appendix to this letter.

#### Performance obligation approach

We do not support the performance obligation approach and believe the derecognition approach should be adopted as the single model for lessor accounting. The two approaches do not represent a single model for lessor accounting. Whilst the derecognition approach is consistent with the approach applied to lessee accounting, the performance obligation approach, in our opinion, grosses up the balance sheet and creates an "intangible liability" not envisaged by the IASB Framework.

When a lessor leases an asset the economic benefits it will bring will be in the form of lease payments and any residual value, and hence it is appropriate to recognise a lease asset being the present value of lease payments. However, there are no remaining economic benefits to support continuing to carry the underlying asset (other than any residual value).

However, whilst we support the derecognition approach, we believe that the residual asset should be determined as the difference between the carrying amount of the underlying asset at inception and the present value of lease payments unless a gain on sale of the asset can be demonstrated (as may be the case for manufacturers).

### Lease term

We do not agree with the proposal to measure a lease assuming the longest possible term that is more likely than not to occur, as we do not believe that the liability that arises for a lessee meets the definition of a liability under the IASB's Conceptual Framework, or that the asset that arises for a lessor meets the definition of an asset. Under the Framework, a liability is a present obligation, the lessee's present obligation under a lease is the minimum lease payments that are due, and whether or not the lease is renewed is at the lessee's option, the lessee is only committed to the extent of the minimum lease payments. An asset is a resource controlled by an entity. It is hard to argue that a lessor has control beyond the minimum lease payments. We are concerned by the wider implications of these proposals which appear to be eroding the fundamental concepts of what constitutes an asset and a liability.

If this proposal is retained we would prefer an approach to determining the lease term based on the most likely outcome as we believe such an approach to be more intuitive. This would only factor in renewal options that have a relatively high degree of certainty. Under the current approach small changes to assumptions can have a significant impact to the liability, as a lease could change from being considered a three year lease, to say a five year lease, this is not ideal given the significant amount of judgement needed to set these assumptions. In addition, it may result in the determination of a lease term that actually has a low probability of eventuating.

### Lease payments

If the ED was proposing a fair value approach we would understand the rationale for the proposals in relation to contingent rentals, expected payments under term option penalties and residual value guarantees. We are concerned, however, that under the ED's proposals that a lessee would recognise a liability if there is a 10% probability of a contingent rental hurdle being triggered (when the lessee will often have control over whether or not the hurdle is triggered), and even more concerned that the lessor will recognise an asset reflecting the expected receipt of the contingent rental (even though the lessor has no control over such an asset). This is another area where we are concerned by the wider implications of these proposals which appear to be eroding the fundamental concepts of what constitutes an asset and a liability.

If this proposal is retained we would prefer an approach to determining lease payments based on the most likely outcome as we believe such an approach to be more intuitive. This would only factor in payments that have a relatively high degree of certainty.

### Short term leases

We believe the final leases standard should provide simplified requirements for short-term leases, but believe the current proposals do not go far enough for lessees.

We would propose that for short-term leases the final standard should allow lessees to account for such leases off balance sheet, consistent with the current operating lease requirements. We believe this would provide significant relief to lessees, is consistent with the concession for lessors, and, together with adequate disclosure of lease commitments, would provide useful information to users.

We also believe that such an approach would mitigate the differences in treatment between short term contracts that will be accounted for as service contracts and those that will be accounted for as leases. For a short-term lease we do not see the distinction between lease and service contracts as relevant to the user. Under the new proposals this distinction is likely to be an area of significant accounting arbitrage, given the differences in accounting treatment.

### Intangible assets

We support the current scope exclusion for intangible assets but are concerned about the certainty of treatment in the medium term. We would be concerned if the accounting for intangible assets is changed again in the near future such that entities would have to apply three different measurement approaches to leases of intangible assets over a relatively short period of time: current requirements, the ED's proposed requirements and future amendments. We would regard this as a very poor outcome.

We would also note that the final standard should provide greater clarity of how the intangible asset components of a lease would be unbundled.

### Disclosure

We support the more principles-based approach of the disclosure principles proposed in the ED but are concerned that the specific disclosure requirements do not always adhere to these principles and in many cases require disclosures that go beyond the users' needs.

If disclosure is to be more principles-based the final standard should articulate the principles clearly and provide guidance about the specific disclosures that might be required in some cases and the minimum disclosures that will be required in all cases. In many cases the ED proposes separate disclosure of lease assets and liabilities. We do not support separate disclosure in all cases. We believe that disclosure should be driven by the disclosure principles and the general requirements of IAS 1, under which disclosure is driven by presentation of information that is relevant to an understanding of an entity's financial position. We support separate disclosure in the notes only where lease assets and liabilities are different in nature to other financial liabilities and tangible assets. We do not agree that presentation should be driven by the way in which an asset is funded, but should be driven by the nature of the asset.

### Transition

Given that all of the approaches to transition have significant difficulties, an approach that grandfathers existing leases should be given further consideration by the IASB.

Given the scale of the leasing changes proposed none of the transition approaches are ideal. We would generally not support full retrospective application and we agree with the board that full retrospective application costs would be excessive and the benefits would not outweigh the costs. However, we are also concerned with the simplified retrospective approach under the current proposals which will have a significant one-off impact because all leases are recognised at the same point, hence all gains or losses arising under the derecognition approach will be recognised at the same time, and the profit emergence will not resemble the pattern that would normally be seen under an ongoing portfolio. A full retrospective application approach would not have this disadvantage.

Another alternative would be a prospective approach that allows existing leases to run-off under the old approach whilst new leases are accounted for under the new model. This does create issues of comparability for a period of time; however, we believe this concern could be mitigated by, for example, allowing prospective application for all leases that have a minimum lease period of say three years or less. Whilst the results under a prospective approach will require careful presentation in the early years, the approach would require a less intensive use of resources and provide for a more manageable implementation process.

Detailed comments on the questions raised in the ED are attached as an Appendix to this letter. Should you have any queries on our comments, please contact me at [Rob.Goss@anz.com](mailto:Rob.Goss@anz.com).

Yours sincerely

Rob Goss  
Head of Accounting Policy, Governance and Compliance

Copy: Chairman, Australian Accounting Standards Board (AASB)

## Appendix

The exposure draft proposes a new accounting model for leases in which:

- (a) a lessee would recognise an asset (the right-of-use asset) representing its right to use an underlying asset during the lease term, and a liability to make lease payments (paragraphs 10 and BC5–BC12). The lessee would amortise the right-of-use asset over the expected lease term or the useful life of the underlying asset if shorter. The lessee would incur interest expense on the liability to make lease payments.
- (b) a lessor would apply either a performance obligation approach or a derecognition approach to account for the assets and liabilities arising from a lease depending on whether the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected term of the lease (paragraphs 28, 29 and BC23–BC27).

### **Question 1: Lessees**

- (a) 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?
- (b) 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?

- (a) If it is accepted that all leases should be brought on balance sheet for lessees (and we understand that the IASB now regard this as non-negotiable) we agree that a lessee should recognise a right-of-use asset and a liability to make lease payments. We believe such an approach is intuitive and easy for users to understand. However, we note that this will have significant implications for Tier 1 capital that needs to be addressed, as the fundamentals of the balance sheet will not have changed and yet our capital may be potentially reduced.

The ED requires the lessee to measure the lease liability using its incremental borrowing rate, or, if it can be readily determined the rate the lessor charges the lessee. This drafting could be read as implying that the incremental borrowing rate should be used unless the actual rate can be determined. We believe the emphasis should change such that the lessee uses the actual rate charged by the lessor unless it cannot be readily determined, in which case the incremental borrowing rate should be used.

- (b) The current proposals will have a financial impact that does not reflect the economics of certain leases currently classified as operating leases and we do not support such an outcome. Whilst we agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments to reflect these costs in the profit and loss, we do not agree with the way in which the interest costs are recognised in the profit and loss in cases where the economics of the arrangement is such that the costs accrue evenly over the lease term. Under the ED, the expense is front-end loaded, as a result of the application of the effective interest rate method. Under the current requirements the operating lease expense is even over the period of the lease, in many cases reflecting the economics of the arrangement and matching the delivery of benefits under the lease. For a lease that is akin to a financing arrangement the proposed treatment is more logical.

We also note that under the current proposals the asset and liability will not run-off consistently, leading to an accounting mismatch. We also note that for foreign currency

leases, existing hedges may be compromised as the cash flows will no longer be matched. We believe the final standard should give careful consideration to these issues.

### **Question 2: Lessors**

- (a) 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?
- (b) 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?

We do not support the performance obligation approach and believe the derecognition approach should be adopted as the single model for lessor accounting. However, we believe that the residual asset should be determined as the difference between the carrying amount of the underlying asset at inception and the present value of lease payments unless a gain on sale of the asset can be demonstrated.

We do not agree with the two different approaches to lease accounting by lessors depending upon whether or not the lessor retains exposure to significant risks/benefits associated with the underlying asset for the following reasons:

1. The two approaches do not represent a single model for lessor accounting: the performance obligation approach and derecognition approach are different conceptual approaches and give rise to very different accounting results. The ED states that one approach to lessor accounting would not be appropriate for all leases due to the differences in the economics of the transactions. We do not understand why this is a concern for lessors but not for lessees.
2. Whilst the derecognition approach is consistent with the approach applied to lessee accounting, the performance obligation approach, in our opinion, grosses up the balance sheet and creates an "intangible liability" not envisaged by the IASB Framework.
3. The use of one approach will reduce the opportunities for accounting arbitrage, one of the concerns with the current distinction between operating and finance leases.

We do not support the performance obligation approach as we believe that recognising both the underlying asset and a lease asset is double counting the economic value the underlying asset will bring to the lessor. Under IAS 16 an asset is recognised if it is probable that future economic benefits associated with the item will flow to the entity. When a lessor leases an asset the economic benefits it will bring will be in the form of lease payments and any residual value, and hence it is appropriate to recognise a lease asset being the present value of lease payments. However, there are no remaining economic benefits to support continuing to carry the underlying asset (other than any residual value).

Whilst we are supportive of the derecognition approach, we note that under this approach a lessor may often generate a gain on the inception of the lease, where this would not be appropriate (we note that the recognition of a gain is appropriate in certain cases, for example, where the lessor is a manufacturer). We do not support the recognition of a gain in the many cases where this gain is effectively the profit arising from the lease contract; we believe this profit should be earned as the lease service is provided. In structuring a lease contract the

lessor will consider the expected value of the lease contract and the expected residual value. The lessor is likely to add a profit margin to the expected lease payments and be conservative in the estimation of the residual value – in other words in pricing the lease contract the lease payments will be close to a fair value whereas the residual value is more likely to be conservative and less than the fair value. If the residual asset is determined at an allocated amount of the carrying amount of the underlying asset at inception, based on the fair value of rights retained and the rights transferred, a gain may arise on inception because, in structuring the contract, a lessor is conservative in pricing the residual asset (which reflects the uncertainty related to this asset). We would prefer an approach that determines the residual asset as the difference between the carrying amount of the underlying asset at inception and the present value of lease payments unless a gain on sale can be demonstrated. Guidance should make it clear that gains on sale are likely to arise in the case of manufacturers and dealers. Gains may arise on some of ANZ's leases, for example, where we fund the construction of an infrastructure project and the fair value of the constructed asset exceeds the costs of construction.

We are also concerned that the gain on inception is based on a very subjective determination of the fair value of the rights retained and the rights transferred and that no guidance is provided in relation to how the fair value would be determined. Our preferred approach outlined above would eliminate this subjectivity in most cases.

Another observation is that the residual asset value is effectively locked-in after initial recognition and the ED does not address the unwind of the discount rate. We do not believe this approach is appropriate, as the residual asset is effectively the present value of expected cash flows from the subsequent re-lease or the sale of the asset, this amount should change at each reporting period to reflect the passing of time.

### Question 3: Short-term leases

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:

- (a) 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).
- (b) 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). (See also paragraphs BC41–BC46.)

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?

We believe the final leases standard should provide simplified requirements for short-term leases, but believe the current proposals do not go far enough for lessees.

We support any approach that limits the impacts of these proposals for short-term leases as the current requirements will be onerous for entities that are involved in a large number of

low-value lease arrangements, however, we do not believe that the concessions proposed in the ED will provide a significant relief for lessees.

We believe that the lessor proposals for short-term leases provide an appropriate concession and we would support a consistent approach for lessees. As the current proposals stand, for a short-term lease the lessor could choose to continue to reflect the underlying asset on its balance sheet but will not reflect the lease asset. However, the lessee will still be required to recognise the right of use asset. We would propose that for short-term leases the final standard should allow lessees to account for such leases off balance sheet, consistent with the current operating lease requirements. We believe this would provide significant relief to lessees, is consistent with the concession for lessors, and, together with adequate disclosure of lease commitments, would provide useful information to users.

We also believe that such an approach would eliminate the differences in treatment between short term contracts that will be accounted for as service contracts and those that will be accounted for as leases. For a short-term lease we do not see the distinction between lease and service contracts as relevant to the user. Under the new proposals this distinction is likely to be an area of significant accounting arbitrage given the differences in accounting treatment between contracts that will be considered service contracts and those that will be considered leases.

#### Definition of a lease

The exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1–B4 and BC29–BC32). The exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59–BC62) and on distinguishing a lease from a service contract (paragraphs B1–B4 and BC29–BC32).

#### Question 4

- (a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?
- (b) 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?
- (c) 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?

In our opinion the distinction between a service contract and a lease in the ED proposals is sufficiently unclear as to provide fertile grounds for accounting arbitrage, which would seriously undermine the comparability and the key objectives of the ED. We believe that increasing the term of a lease that can be classified as short term would mitigate this risk. Refer to our response to question 3.

## Scope

### **Question 5: Scope exclusions**

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?

We support the current scope exclusion for intangible assets but are concerned about the certainty of treatment in the medium term. We would be concerned if the accounting for intangible assets is changed again in the near future such that entities would have to apply three different measurement approaches to leases of intangible assets over a relatively short period of time: current requirements, proposed requirements and future amendments. We would regard this as a very poor outcome.

We would also note that the final standard should provide greater clarity of how the intangible asset components of a lease would be unbundled. ANZ has lease contracts that include both a hardware and software component. In the banking industry it is common for banks to lease automatic teller machines; the most significant component of such a lease is software. It is not clear whether in such circumstances the lease would be unbundled or whether the contract could be classified as a lease if the hardware constitutes the majority of the lease. The accounting treatment of service components suggests an unbundling approach would be applied.

### **Question 6: Contracts that contain service components and lease components**

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:

- (a) the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.
- (b) the IASB proposes that:
  - (i) a lessee should apply the lease accounting requirements to the combined contract.
  - (ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.
  - (iii) a lessor that applies the derecognition 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?

Whilst we agree conceptually that service and lease components should be accounted for separately, we do not believe the treatment of service components under the derecognition approach is appropriate and note that the proposals represent a significant change for lessors using the derecognition approach as they will always be required to account for the lease and service component separately even if the service component is not distinct.

FASB do not support separating a non-distinct service component because this is seen as inconsistent with the revenue project. The Basis for Conclusions to the ED notes that under the revenue project, entities account for separate performance obligations only if the promised asset is distinct from other goods or services promised under the contract.

The IASB's approach is driven by the desire to prevent any profit on derecognition arising under the service component of a contract before the service has been provided. We note that this concern would be eliminated by our proposed method of determining the residual asset outlined in our response to question 2 above.

#### **Question 7: Purchase options**

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?

We support the proposed approach to purchase options as we agree that the exercise price of a purchase option is not a lease payment.

#### **Measurement**

The exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that:

- (a) assumes 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 (paragraphs 13, 34, 51, B16–B20 and BC114–BC120).
- (b) includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21 and BC121–BC131). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be measured reliably.
- (c) is updated 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 (paragraphs 17, 39, 56 and BC132–BC135).

#### **Question 8: Lease term**

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?

We do not agree with the proposal to measure a lease assuming the longest possible term that is more likely than not to occur, as we do not believe that the liability that arises for a lessee

meets the definition of a liability under the Framework, or that the asset that arises for a lessor meets the definition of an asset. If this proposal is retained we believe that the most likely outcome would be a more intuitive approach.

In the case of a lessee we do not believe that this approach is consistent with the definition of a liability under the Framework. A liability is a present obligation, the lessee's present obligation under a lease is the minimum lease payments that are due, and whether or not the lease is renewed is at the lessee's option, the lessee is only committed to the extent of the minimum lease payments. An asset is a resource controlled by an entity. It is hard to argue that a lessor has control beyond the minimum lease payments. We are concerned by the wider implications of these proposals which appear to be eroding the fundamental concepts of what constitutes an asset and a liability.

If this proposal is retained we would prefer an approach to determining the lease term based on the most likely outcome as we believe such an approach to be more intuitive. This would only factor in renewal options that have a relatively high degree of certainty.

Under the current approach small changes to assumptions can have a significant impact to the liability, as a lease could change from being considered a three year lease, to say a five year lease, this is not ideal given the significant amount of judgement needed to set these assumptions. In addition, it may result in the determination of a lease term that actually has a low probability of eventuating.

#### **Question 9: Lease payments**

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?

If the ED was proposing a fair value approach we would understand the rationale for the proposals in relation to contingent rentals, expected payments under term option penalties and residual value guarantees. We are concerned, however, that under the ED's proposals that a lessee would recognise a liability if there is a 10% probability of a contingent rental hurdle being triggered (when the lessee will often have control over whether or not the hurdle is triggered), and even more concerned that the lessor will recognise an asset reflecting the expected receipt of the contingent rental (even though the lessor has no control over such an asset). This is another area where we are concerned by the wider implications of these proposals which appear to be eroding the fundamental concepts of what constitutes an asset and a liability.

If this proposal is retained we would prefer an approach to determining lease payments based on the most likely outcome as we believe such an approach to be more intuitive. This would only factor in payments that have a relatively high degree of certainty.

If the final standard retains these proposals we would note that this is going to be onerous and costly for many lessees and lessors and that some contingent rentals and expected payments under term option penalties and residual value guarantees may not be reliably measurable.

We 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, and believe that the same requirements should apply lessees. We note that it will not be unusual for certain items to not be reliably measurable and the final standard should provide more guidance in this area. This is likely to be especially the case for long term leases: for example, ANZ holds long term property leases with rentals contingent on future market rentals.

#### **Question 10: Reassessment**

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?

We agree that it is appropriate conceptually to remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability; we are concerned, however, with the interpretation of this requirement that may evolve. We would not expect to see frequent reassessments being necessary and we would prefer it if the final lease standard provided guidance along those lines. We would be concerned if external auditors interpreted this as requiring frequent reassessments.

We note that this requirement could potentially be onerous for entities that enter into a large number of leases.

#### **Sale and leaseback**

The exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents the sale of the underlying asset, the leaseback would also meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66–67, B31 and BC160–BC167).

#### **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?

We agree conceptually with the sale and leaseback proposals and would agree that, in substance, transactions are either sales or financing arrangements. We believe that more guidance should be provided in accounting for these transactions:

- If the transaction is a sale, how would any profit or loss on sale be determined?
- If the transaction is to be treated as a financing, how are such leases accounted for at amortised cost under IAS 39?

We note that the ED does not address the transition requirements for sale and leaseback transactions that are to be treated as financing arrangements under the new standard as such contracts are not within the scope of the new standard.

Sale and leaseback arrangements are often highly structured complex and material transactions and many are denominated in a foreign currency. We do not believe full retrospective application would be appropriate and we would prefer such contracts to be grandfathered on transition.

#### Presentation

The exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25–27, 42–45, 60–63 and BC142–BC159).

#### **Question 12: Statement of financial position**

- (a) 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?
- (b) 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?
- (c) 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?
- (d) 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?

- (a) We do not support separate disclosure by lessees of liabilities to make lease payments and right-of-use assets in all cases. We believe that disclosure should be driven by the disclosure principles and the general requirements of IAS 1, under which disclosure is driven by presentation of information that is relevant to an understanding of an entity's financial position. Where separate disclosure would be useful to users we would support such disclosure, however, in most cases, and in the case of ANZ, we believe it would be more appropriate to disclose this information in the notes. We support separate disclosure in the notes where lease assets and liabilities are different in nature to other financial liabilities and tangible assets. We do not agree that presentation should be driven by the way in which an asset is funded, but should be driven by the nature of the asset.

We are concerned by the impact that the ED's proposals will have on our regulatory capital requirements. The proposals will increase the amount of assets that are reported, these assets will require regulatory capital to be held against them, and will increase our costs. Whilst this outcome has no economic substance in that our economic position has not changed, from experience we do not expect the issue to be resolved quickly. We would encourage the IASB to work closely with regulators over this issue.

- (b) We do not support separate disclosure by lessors of underlying assets, rights to receive lease payments and lease liabilities in all cases. We do not support the performance obligation approach, however, if it is retained in the final standard, it should be presented separately net where this would be useful to users, however, in most cases, and in the case of ANZ, we believe it would be more appropriate to disclose this information in the notes.
- (c) We do not support separate disclosure by lessors using the performance obligation approach of rights to receive lease payments and residual assets in all cases. We believe that disclosure should be driven by the disclosure principles and IAS 1. Where separate disclosure would be useful to users we would support such disclosure, however, in most cases, and in the case of ANZ, we believe it would be more appropriate to disclose this information in the notes. We support separate disclosure in the notes where lease assets are different in nature to other financial assets and tangible assets.
- (d) We do not support separate disclosure of assets and liabilities that arise under a sublease in all cases. We believe that disclosure should be driven by the disclosure principles and IAS 1. Where separate disclosure would be useful to users we would support such disclosure, however, in most cases, and in the case of ANZ, we believe it would be more appropriate to disclose this information in the notes. Presentation should be driven by the nature of the assets.

#### **Question 13: Statement of comprehensive income**

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?

We do not support separate disclosure of lease income and lease expense in all cases. We believe that disclosure should be driven by the disclosure principles and IAS 1. Where separate disclosure would be useful to users we would support such disclosure, however, in most cases, and in the case of ANZ, we believe it would be more appropriate to disclose this information in the notes.

#### **Question 14: Statement of cash flows**

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?

We do not support separate disclosure of cash flows arising from leases in all cases. We believe that disclosure should be driven by the disclosure principles and IAS 1. Where separate

disclosure would be useful to users we would support such disclosure, however, in most cases, and in the case of ANZ, we believe it would be more appropriate to disclose this information in the notes.

Disclosure

**Question 15**

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

- (a) identifies and explains the amounts recognised in the financial statements arising from leases; and
- (b) 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?

We support the more principles-based approach of the disclosure principles but are concerned that the specific disclosure requirements do not always adhere to these principles and require disclosures that are often beyond the users' needs.

If disclosure is to be more principles-based the final standard should articulate the principles clearly and then provide guidance about the specific disclosures that might be required in some cases and the minimum disclosures that will be required in all cases. Many of the disclosures proposed in the ED would go beyond what a user of ANZ's financial statements may need, or may want to see on the face of the income statement and balance sheet.

Transition

**Question 16**

- (a) 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?
- (b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?
- (c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

We believe the IASB should give further consideration to the transition requirements under the final standard and consider an approach that involves grandfathering existing leases.

Given the scale of the leasing changes proposed none of the transition approaches are ideal.

We would generally not support full retrospective application as this would be an enormous task for an organisation like ANZ, especially in the case of long-term leases and we agree with the board that full retrospective application costs would be excessive and the benefits would not outweigh the costs.

However, we are also concerned with the simplified retrospective approach under the current proposals which will have a significant one-off impact because all leases are recognised at the

same point, hence all gains or losses arising under the derecognition approach will be recognised at the same time, and the profit emergence will not resemble the pattern that would normally be seen under an ongoing portfolio. A full retrospective application approach would not have this disadvantage.

Another alternative would be a prospective approach that allows existing leases to run-off under the old approach (existing leases would be effectively grandfathered) and new leases to be accounted for under the new model. As noted by the board this creates issues of comparability for a period of time. We believe this concern could be mitigated by allowing prospective application for all leases that have a minimum lease period of say three years or less.

On balance, given that all of the approaches to transition have significant flaws, an approach that grandfathers existing leases should be given further consideration by the IASB. Whilst the results will require careful presentation in the early years post transition the approach would require a less intensive use of resources and provide for a more manageable implementation process.

Benefits and costs

**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?

We do not agree with the board's assessment of the costs and benefits of the proposed requirements. We note that the costs of implementing the proposals will be very significant and the ongoing costs will also be significantly higher than existing costs. We are not convinced that these costs will be justified by the benefits – we believe the current lessee accounting to be adequate, and note that many users find the current lessee disclosures more than adequate in assessing lease commitments. We also do not support the lessor proposals for leases measured using the performance obligation approach and would see no benefits to such an approach.

Other comments

**Question 18**

Do you have any other comments on the proposals?

We believe the final standard should provide more guidance in areas where the standard refers to other International Financial Reporting Standards:

1. The ED requires a lessor to apply IAS 39 to assess whether the right to receive lease payments is impaired. IAS 36 would apply to the impairment of the underlying asset. However, it is not clear how this will apply in practice. For example, it would probably be more appropriate to assess the net position under the performance obligation approach rather than the individual assets, as the cashflows under the lease payments will support the recoverable amount of the lease receivable and cannot be double-counted in an impairment test for the underlying asset.

2. It is also not clear which cash flows would be included under the IAS 39 impairment tests. IAS 39 is contract based whereas the leasing standard specifically excludes contractual cashflows related to purchase options.
3. Under the ED proposals certain lease contracts will be treated as financing arrangements. It is not necessarily clear how a lease contract will be accounted for under IAS 39.
4. Under the ED proposals certain contracts will be treated as a sale and purchase. It is not clear how any profit or loss on sale might be determined.