

15 December 2010

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC 4M 6XH
UNITED KINGDOM

Dear Sir David

ED/2010/9 LEASES

Myer Holdings Limited is a listed department store retailer in Australia with turnover in excess of A\$3 billion from our portfolio of 67 stores, and market capitalization in excess of A\$2 billion. We are pleased to provide comments on the Exposure Draft.

Whilst we understand the objectives of the IASB in proposing the changes set out in the Exposure Draft, we do not support them. The implications for some sectors, in particular the retail sector, will be significant and costly. Our view is that the changes will result in financial reports that are less relevant and reliable than those produced under the current leasing pronouncements. We believe that a more appropriate approach is to retain the existing measurement framework for leases and, implement a more detailed disclosure regime in relation to lease terms, renewal options, and contingent rentals.

The main issues we see in the implementation of the proposed standard are as follows:

- The proposed model for recognition of an asset and liability on balance sheet for all leases will create a financial reporting outcome for some companies that is so far away from the economic reality of business operations to render the income statement and balance sheet irrelevant. The major shift of expense in relation to long term property leases to the early years of the lease (where right of use asset amortisation and interest on the liability is well in excess of cash rent payments) creates an outcome that is at odds with the economics of opening retail stores, and therefore misleading to users.

For retailers such as ourselves whose business model requires large footprint stores with long lease terms, renewal options and contingent rentals, this change will result in a significant change in the way our financial statements are presented. This will in turn require significant additional time, cost, and effort to explain our results to the market, as well as for users in comprehending financial reports.

These outcomes do not appear to be in line with the stated objectives of the Board.

- As noted in the basis for conclusions accompanying the ED, credit providers, ratings agencies, and capital market participants in general use various ratios and measures to assess the financial position and performance of companies. To allow for the impact of differing financing structures, these users calculate 'lease adjusted' measures using information disclosed in the notes to the accounts. Whilst this appears to be a justification for the change in standard, this ignores the fact that the vast majority of market analysts primarily use profit and loss and cash flow measures such as EBITDA, EBIT, EPS and cash conversion ratios (EBITDA:Operating cash flow) to assess financial performance. EBITDA is particularly important as it is used as a cash flow proxy by the market.

Our view is that these measures will no longer be a useful measure of performance under the proposed changes due to the change to income statement profile, and the variability of earnings that will be introduced as a result of reassessment of assumptions. A company's ability to provide returns to its shareholders will no longer be driven by the outcome of its income statement.

We also note that there is no evidence to suggest that those parties who use 'lease adjusted' measures will not continue to make their own adjustments if the proposal is implemented.

It is our view that the existing approach of note disclosure of lease commitments is far superior to the proposed model of enforcing a blanket 'on-balance sheet' approach.

- The feedback we have received so far from credit providers and the investment community is that they will be looking to strip out the effect of this standard to ensure that they can get to a set of financial information reflective of the underlying structure and economics of the business. Based on this, we believe that the proposed standard would not result in the production of financial results that meet the needs of users.
- It is our view that the current regime of reporting operating lease commitments but showing what is effectively a cash rental expense in the income statement is a far more appropriate method of disclosure of the occupancy costs associated with a retailer's business, and the exposure to future costs that may exist. We would support an enhanced disclosure regime if the Board considers the current situation inadequate.
- The costs associated with implementing and complying with the proposed approach will be significant. Lessees will be required to introduce significantly more monitoring and record-keeping on an ongoing basis for all but short-term leases. In addition, audit costs are likely to increase because of the detailed audit procedures applying to all leases including leases embedded in other contracts. We believe that these additional costs will not outweigh the perceived benefits of the proposed changes.
- The requirement for a lessee to evaluate regularly whether there are new facts or circumstances related to contingent rentals and assumptions about the lease term will provide significant challenges for entities such as Myer who have a large number of significant leases. Although accounting is on a lease-by-lease basis, entities with large portfolios of leases may need to

develop robust processes to ensure compliance and practical application including developing triggers/flags indicating the need to review lease terms etc. Significant systems changes will also be required to allow for the determination and tracking of the lease term effective interest rate and assumptions relating to contingent rentals. Tax implications will also need to be considered.

- The uncertainty and degree of estimation involved in recognizing the impact of contingent rentals and lease rentals in option periods will reduce the reliability of reported financial information.

We believe that due to their nature, contingent rentals should be expensed as incurred as this would match the underlying revenue against which the rentals are incurred. In addition, we do not believe that contingent rentals meet the requirements in the Framework for recognition as a liability as they are avoidable.

We also believe that the inherent nature of option periods are such that they are avoidable. Inclusion of these within the lease liability ignores the flexibility and discretion available to lessees.

The estimation of contingent rentals and option renewals for department store retailers is subjective, and will result in unnecessary earnings volatility as these assumptions are revised over time.

- For property leases, it is common for outgoings (rates, shared services, etc) to be included within the overall lease rental. We believe that the proposal as it currently stands would potentially see these items included in the measurement of the lease asset and liability, which we believe is not appropriate as these costs should be considered as service/executory costs. If a company were to purchase a property rather than lease it, these types of costs would be expensed as incurred. We request that greater guidance is provided in this area.
- The transitional rules for the proposed standard are such that companies that lease properties will be at a disadvantage to those that own them. This is on the basis that lessee companies will be required to bring an asset and liability on balance sheet at what would effectively amount to the market value of the underlying property, whereas existing property owners will be able to hold their existing properties at their historical cost with no adjustments required. This will result in higher earnings for property owning companies compared to lessees, which does not appear to be an appropriate outcome.

Responses to specific questions raised in the Exposure Draft are set out below. Each response has been drafted on the basis that the general principles of the standard proceed as proposed, notwithstanding our overall objection to the new proposals.

Q1: LESSEES

a. Do you agree that a lessee should recognize 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?

We do not agree with the proposed approach, and believe the current approach to accounting for leases, with enhanced disclosures, is more appropriate. Refer reasons noted above.

b. Do you agree that a lessee should recognize amortization 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?

If the right-of-use approach is adopted it is appropriate to recognize amortization of the asset and the interest component of lease payments. However, due to the large negative impact on NPAT in the early years of a lease, it may be more appropriate to allow an amortization profile for the lease right asset that would offset the front-ended profile of interest expense on the lease liability, or alternatively allow the straight-lining of the interest charge on the lease liability over the term of the lease.

In addition, we believe that the change in Income Statement profile will result in a lack of comparability in the results of companies. Analysis of operating results will become challenging for users due to the exclusion of a significant operating expense (lease rentals) from EBITDA and other commonly used performance measures.

Q2: LESSORS

We do not have any specific comments to make on the questions in relation to lessor accounting, other than that we do not see the proposals as an improvement on the existing model and therefore do not support them.

Q3: SHORT-TERM LEASES

The ED 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 recognize lease payments in profit or loss over the lease term (para 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 recognize assets and liabilities arising from a short-term lease in the statement of financial position, or derecognize any portion of the underlying asset. Such lessors would continue to recognize the underlying asset in accordance with other IFRSs and would recognize lease payments in profit or loss over the lease term (para 65). (See also paras BC41-BC46)

Do you agree that a lessee or a lessor should account for short-term leases on a lease-by-lease basis on the basis of undiscounted cash payments plus initial direct

costs? Why or why not? If not, what alternative approach would you propose and why?

While acknowledged as a means of reducing the compliance burden, we do not believe that this concession will provide significant relief in practice. We believe that a maximum possible term of twelve months is too short to include any but the incidental leases in respect of office equipment, telecommunications, cars, hotel rooms etc, and even some of these items will likely fall outside the 12 month time period.

Q4: DEFINITION OF A LEASE

a. Do you agree that a lease (defined 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) 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 paras 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 paras B1-B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary why?

We consider that given the different accounting requirements it is important that there is clarity in the distinction of leases and service contracts. It is not clear why the physical control of an asset is emphasized in the criteria when the essence of the right-of-use approach should be on control of the rights-of-use.

Q5: SCOPE OF EXCLUSIONS

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?

If the requirements of the standard were implemented as proposed, we believe that it should apply to all lease agreements to ensure consistency of treatment. We also believe that leases of intangible assets should be within the scope of the standard as is presently the case with IAS 17 'Leases'. It is incongruous to base the approach to leases on a rights-of-use approach when similar rights in respect of leases of intangible assets are excluded. The inclusion of intangible assets within the scope would avoid inconsistencies with the proposals in respect of revenue recognition.

Q6: CONTRACTS THAT CONTAIN SERVICE COMPONENTS AND LEASE COMPONENTS

Do you agree with either the IASB or the FASB 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?

We consider that where a contract includes both a lease and a service contract the method of accounting should reflect the predominant component of the contract. In many instances, for example, telecommunications, an asset

provided under the contract is merely the means through which the customer is provided with the service which is the reason for entering the contract.

Q7: PURCHASE OPTIONS

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?

Yes. We believe that assuming the exercise of options which is based on the occurrence of a future event is not consistent with the definition of a liability. We also believe that the inherent nature of option periods are such that they are avoidable. Inclusion of these within the lease liability ignores the flexibility and discretion available to lessees. We agree that if a purchase option is exercised it is then appropriate to account for the acquisition of a physical asset.

Q8: 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 believe that the lease asset and lease liability should be measured on the basis of the minimum contractual liability. This would simplify the transition and reduce the implementation costs significantly given this data is already collected for note disclosure. This approach would also eliminate a lot of the subjectivity and judgment included in the current exposure draft.

The existence of lease options provide the lessee with flexibility to manage risks and respond to changes in business strategy etc and even if they are not exercised they provide value to the lessee. However, measuring the cash flows which would follow from exercising the option does not reflect the inherent value of the option. In addition, any rentals payable in respect of the option period are conditional on the lessee exercising the option which is not certain at the inception of the lease. It is unlikely that such conditional payments would satisfy the definition of a liability.

We believe that the existence of lease options could be more appropriately dealt with via disclosures in the notes.

Q9: 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?

Our primary concern is in relation to contingent rentals. We do not believe that contingent rents should be included in the measurement of lease assets and liabilities, as its measurement over the life of long term leases is very subjective and has the potential to cause significant volatility in earnings and

recognition will no longer coincide with actual cash flows. We believe that to allow the market to fully understand the potential impact of contingent rentals, enhanced disclosure in the notes to the financial statements would be sufficient to achieve this.

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?

Yes. We believe that reliability of measurement should remain a core requirement for the recognition of assets and liabilities.

Q10: 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?

Yes, but only for material leases. We consider that remeasurement for all leases at each reporting date is impractical and would impose significant cost burdens on lessees and lessors. Where reassessment does occur for material leases such as a change in the lease term (either by taking up an option that had not previously been considered most likely or vice versa) the carrying amount of the asset should be adjusted.

We do not believe that annual reassessment of the lease term would, in general, provide useful information to users.

Q11: SALE AND LEASEBACK

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 with the proposals.

Q12: 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 (paras 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?

Yes. We support the proposed approach assuming the proposed requirement for recognition of a right of use asset and lease liability are part of the final standard.

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, totaling to a net lease asset or lease liability (paras 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?

We do not believe that a grossing up of both the lease asset and lease receivable is appropriate and that a linked presentation showing lease receivable and the net lease asset avoids double-counting.

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 (paras 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?

Yes.

d. Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paras 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?

Yes.

Q13: 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 (paras 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 support the proposed approach.

Q14: 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 (paras 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 support the proposed approach.

Q15: DISCLOSURE

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

- a. identifies and explains the amounts recognized 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 (paras 70-86 and BC168-BC183)? Why or why not? If not how would you amend the objectives and why?*

We support the principles behind the disclosure requirements. However, we do not believe that the extensive list of disclosures should be regarded as mandatory. Rather, the proposals should provide guidance that in meeting the disclosure objectives directors and management should exercise their judgment as to which of the items are relevant to users of the company's financial statements. Further, it is our view that an enhanced disclosure framework would alleviate the need to make the primary changes under the proposed standard (ie. bringing operating leases on balance sheet), as users would then have sufficient information to make fully informed decisions about the company's operating and financing structures.

Q16: TRANSITION

- a. The ED proposes that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paras 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?*

Full retrospective application of the proposals would normally be onerous and costly to implement. However, this would depend on the nature of the final proposals, the length of the transition period and whether full retrospectivity only applied to material leases.

We believe that the simplified retrospective approach for material leases should be an option for lessees and that lessees should be permitted to apply full retrospectivity if they consider it to be practicable.

Q17: BENEFITS AND COSTS

Paras BC200-BC205 set out the boards' assessment of the cost 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 believe that the perceived benefits are likely to exceed the cost of implementation and ongoing compliance with the proposals, including the upgrading of information systems, and ongoing monitoring of individual lease agreements. In addition, the process of achieving education and acceptance by preparers and users, including shareholders, analysts, and other stakeholders, is likely to be costly and burdensome.

Q18: OTHER COMMENTS

Do you have any other comments on the proposals?

The exposure draft is currently silent on issues such as leases denominated in a foreign currency, lease incentive arrangements and make good clauses. Given the practical issues surrounding accounting for these areas it may be beneficial to include some guidance in the standard.

As stated in the body of this letter, as a company we are greatly concerned at the impact that the implementation of the proposed standard will have on the relevance and reliability of our financial reports, and the significant cost that will be involved in ongoing compliance. As a result, we request that the IASB reconsider its proposed approach, and look to an enhanced disclosure regime rather than the changes proposed.

Should you have any questions on any of the views expressed in this letter, please contact Chris Lauder, General Manager Corporate Finance, on +61 3 8667 7882.

Yours sincerely



Mark Ashby
Chief Financial Officer