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Ref: DAH

15 December 2010

The Technical Director
International Accounting Standards Board

By email to: commentletters@ifrs.org

Exposure Draft ED/2010/9: Leases

Our comments and recommendations regarding ED/2010/9 are provided in this submission. Responses to the specific questions as requested by the IASB are provided in the attachment on pages 3-7.

Pitcher Partners is an association of independent firms operating from all major cities in Australia. Our clients come from a wide range of industries and include listed and non-listed disclosing entities, large private businesses, family groups, government entities and small to medium sized enterprises.

In summary, we hold the following views which are described further in the attachment:

- The introduction to the invitation to comment states that needs of users are not met under the current leasing standard because the models used do not provide a faithful representation of leasing transactions, and consequently users adjust amounts presented in the statement of financial position to reflect the assets and liabilities arising from operating leases.
 - We have never observed this happening in practice.
 - Given the significant additional cost of preparation that the proposals are likely to require, and the relative ease with which the IASB could direct research, we consider that it is unreasonable that these assertions are made without supporting empirical evidence. We consider that the IASB should have supported this assertion with empirical evidence obtained through independent research studies.

- We are concerned that financial statements prepared in accordance with IFRS are losing their relevance to users, as the financial information provided is increasingly more theoretically based in order to explain economic performance.
 - We consider that users of financial statements are more interested in understanding the commercial arrangements that drive cash flows, rather than economic performance per se.
 - Unless there is careful scrutiny of note disclosures it is difficult to understand the commercial substance of transactions, as presented in contractual arrangements.
 - We recommend that the IASB should direct independent research to ascertain the relevance and usefulness of financial information prepared under IFRS, and in particular to determine whether economic measures of performance are considered more useful than reporting commercial reality.
- We consider that the level of detail in the nature and extent of information to be provided to users in the proposed disclosure requirements will result in “information overload” and consequently is unlikely to be useful.
 - We do not believe that increased complexity in financial statements is in the best interests of the Australian or New Zealand economies.

Please do not hesitate to contact me if you wish to discuss further any matters arising from this submission.

Yours sincerely



S. DIANNE AZOOR HUGHES
Partner

cc: Kevin Stevenson, Chairman, Australian Accounting Standards Board

IASB Questions for Respondents

Question 1: Lessees

- (a) We consider that the proposal to introduce a right-of-use asset and a liability to make lease payments introduce an unnecessary layer of complexity which clouds the faithful presentation of commercial arrangements and disguises the associated cash flows. As the financial statements become increasingly complex we consider that users are more interested in actual cash flows rather than the estimates of economic financial performance and economic financial position.
- (b) If a right-to-use asset is introduced, then amortisation over the period the right-to-use-asset is consumed in the course of business would be necessary. However, given the extensive use of accounting estimates needed to recognise a right-of-use asset, the liability to make lease payments, and amortisation over the period of use, we question whether the impact on profit or loss would be significantly different to the operating lease rentals charged. Prior to requiring this accounting overlay, the IASB should present the empirical evidence to demonstrate that the differences are significant and meaningful to users.

Recommendation: We consider that financial reporting should reflect the commercial reality as presented in contractual agreements. Users are more interested in the cash flows associated with operating leases rather than the right-of-use asset and lease liability. Consequently we consider that the expensing of operating lease rentals provides more useful information to users.

Question 2: Lessors

The proposals for lessors are broadly consistent with current reporting requirements for finance and operating leases, which are well understood in practice. However, these proposals are inconsistent with the recognition of a right-to-use asset by lessees, which does not refer to risks and rewards in the same manner.

Question 3: Short-term leases

We concur with the proposed accounting for short-term leases. However, we consider that the definition of short-term leases should be extended to include a longer period (say 3-5 years).

Recommendation: We consider that the proposed onerous reporting requirements should not be applied to assets where technology changes are likely to prompt regular replacement (e.g. laptop computers, printers, copiers) and the nature of the lease is more faithfully represented as rental rather than financing.

Question 4: Definition of a lease

We consider that the proposed reporting requirements will prompt the development of new products and contractual arrangements that provide access to and use of assets without meeting the definition of a lease.

Question 5: Scope exclusions

We note that the proposed standard explicitly excludes leases of intangible assets. However, we consider that the principles for recognising all types of leasing/rental arrangements are inconsistent with current practice prohibiting the recognition of human capital, which is often an entity's most important asset. Employment contracts provide access to the intellectual capital of a workforce, and therefore should be considered as contracts that provide access to the use and control of human assets over a specified period. The application guidance in Appendix B could equally be applied to human capital.

The proposed accounting for leases introduces a high level of subjectivity into the recognition and measurement of right-to-use assets and associated liabilities. Nonetheless it requires reporting of the economic impact of these arrangements in contrast to a faithful representation of the commercial transaction. If these proposals are deemed important and necessary, then the recognition of employment contracts is a glaring omission and needs urgent consideration.

Recommendation: Empirical evidence should be obtained and presented by the IASB to clearly demonstrate that users need to measure the economic impact of operating leases beyond accounting for the cash flows. We consider that in a post-global financial crisis era, entities should not be required to deploy time and resources to onerous reporting obligations. If the results of research support the recognition of right-to-use assets and associated liabilities, then accounting for human intellectual capital under contractual arrangements needs urgent attention.

Question 6: Contracts that contain service components and lease components

We consider that the arrangements for rental and service as contained in operating leases are reported appropriately under current reporting requirements, which faithfully present the commercial arrangements in place.

Recommendation: We consider that the risk and reward approach contained in current reporting requirements provides a more faithful representation of the commercial arrangements in place. The proposed accounting is unnecessarily complex in repackaging these commercial arrangements and reports them in a convoluted manner.

Question 7: Purchase option

We consider that termination when an option to purchase is exercised is inconsistent with other measurement criteria which relates to the best estimates of *intention* (ie. the longest possible lease term likely to occur). We question why intention at the start of the contract is not considered as criteria for whether or not the substance of an "operating lease" indicates that it should be accounted for as a finance lease.

We consider that the exercise of an option to purchase should result in the reclassification of assets ie. the derecognition of a right-to-use asset and the recognition of an owned asset.

Question 8: Lease term

We concur with the view that the lease term should be the longest possible term that is more likely than not to occur, *IF* the premise that the recognition of lease-related assets and liabilities were to be considered valid. However, we do NOT consider that this premise is valid. In the normal course of business leases are structured so that there can be a reasonable degree of flexibility in the way a business uses assets, thus allowing businesses to take advantage of opportunities as they become available.

We question the premise underlying this exposure draft which prompts the need to recognise lease-related assets and liability, and requires a high degree of subjectivity to make accounting estimates that relate to scenarios which are inconsistent with the commercial reasons for entering into leasing arrangements.

Recommendation: We consider that the expensing of lease rentals and enhanced disclosures about the nature and extent of leasing commitments would provide users of the financial statements with more relevant understandable information.

Question 9:

As for question 8 we do not support the premise under which contingent rentals require consideration. Contingent rentals represent opportunities or penalties that directly relate to the commercial arrangements; thus we consider that incorporating expected outcomes has little meaning in relation to the commercial reality of the transaction.

If the premise were to be accepted, we concur with the proposed treatment of contingent rentals and expected payments, although we have serious concerns as to whether the resulting calculations have any intrinsic meaning.

Question 10: Reassessment

We consider that the nature of leasing arrangements requires that options providing flexibility are considered prior to each renewal date, to obtain optimal access to assets for use in the business. Consequently this review would also be necessary for financial reporting purposes so that the reporting process captures the decisions made. However, this requirement is both onerous and costly, and introduces a level of accounting overlay with only minimal limited benefit if any.

Question 11: Sale and leaseback

No comment

Question 12: Statement of financial position

- (a) We consider that the presentation of right-of-use assets where there is no ownership interest, with other tangible assets within property, plant and equipment will contribute to significant misunderstanding by users. We consider that showing aggregated information on the face of the financial statements would be misleading; we consider that disclosure of separate line items on the face of the financial statements will cause confusion; we consider

that complex detailed notes are not conducive to promoting useability of the financial information.

- (b) We consider that the representation of a net lease asset or net lease liability does not readily reflect the commercial arrangements in place. The estimation process required to compile this information is not consistent with the reasons for which an entity might choose to provide short-term leasing arrangements and may be an inconsistent representation of the business model in place.

Question 13: Statement of comprehensive income

We consider that the statement of comprehensive income already contains too much detailed information and an inappropriate mix of realised and unrealised income and expense items. The manipulation of leasing payments, receipts, interest and amortisation expenses is too complex to be relevant or understandable. We consider that users are more interested in the cash flows that are generated through these arrangements and we have no experience of users seeking the type of information anticipated by the exposure draft. We believe that the IASB should obtain empirical evidence to support their assertions that users would find this type of information useful.

Question 14: Statement of cash flows

We consider that operating lease rentals incorporated as part of the outflows in the ordinary course of business are well understood. If information is manipulated as anticipated by this exposure draft, significantly more information about the actual cash flows should be presented in the notes. However, we consider that the statement of cash flows will become cluttered if additional individual lines items, such as lease payments, are disclosed separately.

Question 15: Disclosures

- (a) We consider that the provisions of an increasing volume of disclosures in the notes to the financial statements will not benefit users and will only contribute to information overload. Further we believe that a majority of users do not read the notes to the financial statements. In contrast, given the high level of subjectivity proposed in the measurement and recognition criteria in this exposure draft, this information has no context unless detailed notes are provided. Consequently we consider that the significant additional costs to implement the proposals in this exposure draft are not supported by anticipated user benefits.

Question 16: Transition

We consider that retrospective application is onerous and impracticable. Considerable work would be needed to with minimal benefit to preparers or users.

Recommendation: The draft standard should require prospective application only.

Question 17: Benefits and costs

We consider that the proposals in the exposure draft require significant cost for implementation and will provide information that is neither relevant nor useful to users. Consequently it is our view that anticipated costs to implement these proposals will exceed any perceived benefits.

We consider that it is unreasonable that the IASB should make assertions regarding user needs for financial information that are NOT supported by empirical evidence.

Recommendation: We consider that the IASB should direct independent research to provide empirical evidence to clearly demonstrate that there is demand for the type of information anticipated in this exposure draft.

Question 18: Other Comments

We strongly urge the IASB to conduct empirical research into the relevance and useability of financial information produced in accordance with IFRS. There is increasing concern that financial information prepared in accordance with IFRS has limited relevance in decision-making processes.