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Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
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Dear Mr Stevenson

ED 202R *LEASES*

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to respond to the Australian Accounting Standards Board's Exposure Draft ED 202R *Leases* (the ED).

HoTARAC is an intergovernmental committee that advises Australian Heads of Treasuries on accounting and reporting issues. The committee comprises senior accounting policy representatives from all Australian States and Territories and the Australian Government.

HoTARAC acknowledges that the existing lease accounting model is problematic and therefore supports the overall objectives of this project. A majority of HoTARAC members support:

- recognising all assets and liabilities arising from lease contracts
- adopting a standard that applies to both lessees and lessors
- distinguishing leases from sales or purchases
- distinguishing a contract's lease component from its service component; and
- adopting simplified requirements for short-term leases.

HoTARAC notes that the ED addresses many of the issues raised by respondents to the Boards' 2009 discussion paper, *Leases: Preliminary Views*, particularly the need to consider lessor accounting simultaneously. However, HoTARAC has concerns with some key aspects of the ED and offers detailed comments and suggestions in the Attachments. These concerns primarily relate to:

- clarifying the lessor accounting approaches [ED Question 2]
- applying the proposals to long-term leases of land [Question 2]
- adopting simplified requirements for short-term leases [Question 3]
- clarifying definitions and distinctions [Question 4]
- distinguishing sales from derecognition-approach leases [Question 4]
- clarifying whether service concession arrangements are within scope [Question 5]
- determining and measuring the more-likely-than-not lease term [Question 8]

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- recognising contingent lease payments [Question 9]
- justifying the benefits of the proposals [Question 17]; and
- applying the proposals to cancellable leases [Question 18].

A minority of HoTARAC members reject the proposed models for lessee or lessor accounting, for the following additional reasons:

- The costs of implementing and applying the proposal are unlikely to exceed the benefits obtained from any improved disclosures
- Despite the proposal's inherent assumption that all leases are a means of financing an acquisition, in practice, not all lessees want to acquire the underlying asset. Some lessees just want to use the leased asset for a, sometimes, very short period.
- Having two lessor accounting models will create inconsistency between entities and between leases and, in some cases, cause confusion over which model to apply.

HoTARAC recommends that the Boards allow a substantial period for implementation in view of the likely impact of the proposal on accounting systems and processes.

Please contact David Laidley on 02 9228 4759 or Robert Williams on 02 9228 3019 from New South Wales Treasury if you would like to discuss any of the matters raised by HoTARAC.

Yours sincerely

Grant Hehir

CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

17 November 2010

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ATTACHMENT 1

DETAILED COMMENTS ON EXPOSURE DRAFT ED 202R *LEASES*

HoTARAC offers the following comments and suggestions in response to the questions in the ED and related matters. The issues of greatest concern are asterisked (★).

The accounting model

Q1. Lessees

> Question 1. The exposure draft proposes a new accounting model for leases in which 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.
>
> (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?

HoTARAC agrees in principle with the proposed new accounting model for lessees. The present leasing model, based on a somewhat arbitrary distinction between finance and operating leases, is flawed, is open to abuse and fails to recognise the assets and liabilities arising under operating leases.

See also response to Question 17.

Q2. Lessors

Question 2. The exposure draft proposes a new accounting model for leases in which 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).

(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?

A majority of HoTARAC members broadly agree with the proposals for lessor accounting. However, HoTARAC has concerns with some of the detailed proposals as discussed below.

★ *Lessor accounting approaches*

A lessor would apply the performance obligation approach if the lessor retained exposure to significant risks or benefits associated with an underlying asset and would apply the derecognition approach if the lessor did not retain exposure to significant risks or benefits associated with the underlying asset [paragraph 29]. Under the derecognition approach, the lessor would derecognise part of the underlying asset and reclassify the remainder as a residual asset [paragraph 46].

HoTARAC observes that, because of the use of the word ***or*** in the two conditions in paragraph 29, they are not mutually exclusive and therefore do not unambiguously determine when to apply each of the two alternative approaches. In cases where one party has exposure to significant risks and the other party enjoys significant benefits associated with the underlying asset, the lessor would be required to apply both approaches. Such cases could arise where the contracting parties have unequal bargaining power.

This ambiguity could be remedied by requiring one approach to be applied in the circumstances as proposed and the other approach to apply ***in other cases***. For example:

- If the lessor does not retain significant risks or significant benefits associated with the underlying asset, it applies the derecognition approach
- In any other case the lessor applies the performance obligation approach.

This would increase the applicability of the performance obligation approach.

Alternatively, the word ***and*** could be substituted for ***or*** in the two conditions in paragraph 29. This would increase the applicability of the derecognition approach.

Moreover, despite the ambiguity, the tenor of paragraphs 28 and 29 seems to be that a lessor would apply the performance obligation approach if it retains either significant risks or significant benefits (or both) during or after the lease term. If this is so, a lessor would only apply the derecognition approach if it retains no significant risks and no significant benefits at any time during or after the lease term. However, this would conflict with the derecognition approach requiring the lessor to recognise a residual asset representing the retained rights in the underlying asset. It is difficult to see what rights a lessor retains if it has no significant risks and no significant benefits associated with the underlying asset.

HoTARAC recommends that the boards clarify the intent of paragraphs 28 and 29.

★ *Lessor accounting for a long-term lease of land*

The ED proposes that a long-term lease of land should be regarded as a lease and not a sale. Among other reasons, the title to the land retained by the lessor is likely to have a significant value at the end of the lease term [paragraph BC38].

While HoTARAC supports the boards' arguments for including long-term leases of land within the scope of the proposal, HoTARAC finds the guidance in the ED to be ambiguous as to whether a lessor in such a lease should apply the performance obligation or the derecognition approach. HoTARAC observes that, when assessing a lessor's exposure to significant risks and benefits associated with land, there is a tension between an assessment approach based on the land's useful life and one based on the land's value. (This tension could affect other underlying assets too).

Prima facie, the proposal appears to require a lessor in a long-term lease of land to apply the performance obligation approach because the lessor retains exposure to significant risks or benefits associated with the land [paragraphs 28 and BC38].

However, the proposed application guidance is ambiguous. It requires a lessor to consider various indicators when determining whether it retains exposure to significant risks or benefits associated with the underlying asset after the expected term of the lease. These indicators include:

(a) the significance of the lease term in relation to the remaining useful life of the underlying asset and

(b) whether a significant change in the present value of the underlying asset at the end of the lease term is expected [paragraph B24].

No indicator is individually conclusive [paragraph B26].

The proposal discusses which accounting approach is appropriate for particular business models [paragraph BC27] but its conclusions are not included in the indicators and so presumably should be disregarded in reaching a decision on risks or benefits. The boards might like to reconsider this.

The ambiguity in the application guidance is illustrated by considering a 99-year lease of land: an underlying asset that has an indefinitely long useful life. The insignificance of the lease term compared with the land's remaining useful life suggests that the lessor should apply the performance obligation approach. On the other hand, the insignificance of the expected change in the present value of the land at the end of the lease term (due to the lease term being beyond the time value of money or due to the land not deteriorating as a result of the lease) suggests that the lessor should apply the derecognition approach.

HoTARAC notes that the accounting for long-term leases of land has given rise to divergent views in recent years. IFRIC and the IASB have both considered the matter. The ambiguity of the proposal will potentially give rise to divergent accounting for similar transactions, depending on the lessor's approach to assessing risks or benefits. HoTARAC recommends that the boards provide specific guidance on lessor accounting for long-term leases of land, particularly where a lease term extends sufficiently far into the future so that the present value of the later cash flows is insignificant.

Meaning of significant and trivial

A lessor's choice of accounting approach would depend on whether or not it retained exposure to significant risks or benefits associated with the underlying asset [paragraphs 28 and 29]. The distinction between a lease and a sale or purchase would depend (partly) on whether the entity transferred all but a trivial amount of the risks and benefits associated with the underlying asset [paragraph 8].

HoTARAC considers that the meanings of ***significant*** and ***trivial*** are unclear and open to subjective interpretation. Do they imply the presence or absence of a material impact on the financial statements?

Although the ED indicates some factors to be considered in assessing a lessor's exposure to significant risks or benefits [paragraph B22 and following], it has little to say on how to assess their significance. This could lead to divergent application of the requirements.

HoTARAC observes that entities and their advisors sometimes apply an arbitrary threshold to operationalise a requirement in an accounting standard. For example, some accounting firms, when considering whether a finance lease exists, apply a threshold of 75 per cent of the net present value of the lease payments for the underlying asset.

HoTARAC recommends that the resulting standard should give explicit guidance on the degree of significance required (eg, more likely than not) so that it can be determined in a principled and consistent manner.

Similarly, HoTARAC recommends that the boards explain, by example or otherwise, what they consider to be trivial in order to improve comparability of risk measurement and related disclosures across diverse entities.

Lessor's initial measurement of residual assets

Under the derecognition approach, a lessor would initially determine the amount to derecognise and the carrying amount of the residual asset based on the fair values of the rights transferred and retained [paragraph 50].

HoTARAC considers that in some long-term leases, particularly land leases, the fair value of the lease payments may exceed the fair value of the underlying asset. It is unclear how the requirements of paragraph 50 would apply in such circumstances. Presumably the derecognition of the underlying asset is limited to its carrying amount. More importantly, HoTARAC considers that, even if the present value of the residual asset is insignificant, the residual asset should be reported at a nominal value, say CU1.

HoTARAC recommends that the boards clarify the requirements for measuring the residual asset in such circumstances.

Lessor's subsequent measurement of residual assets

The ED would prohibit a lessor from remeasuring a residual asset unless the asset becomes impaired or the lessor reassesses the lease term [paragraphs 55 and BC106].

HoTARAC is concerned that the restriction on the revaluation of residual assets will cause inconsistencies for entities, such as governments in Australia, that adopt the revaluation model for property, plant and equipment.

HoTARAC therefore recommends that a lessor be permitted to apply the revaluation model to a residual asset if it applies that model to similar items of property plant and equipment.

Correction of erroneously applied accounting approach

The ED would require a lessor to assess, at the date of inception of the lease, whether to apply the performance obligation approach or the derecognition approach. A lessor would be prohibited from subsequently changing that approach [paragraph 29].

HoTARAC supports the concept that the lessor determines the accounting approach at the inception of the lease, but envisages that a lessor might erroneously select the wrong approach. Alternatively, HoTARAC wonders whether there is potential for facts and circumstances to change during the term of a lease so that subsequent remeasurements differ so significantly from initial expectations that they call into question the approach initially selected. The prohibition on subsequently changing the lessor accounting approach ignores the fact that errors can be made and that these would normally be corrected through the application of IAS 8 or AASB 108 *Accounting Policies, Changes in Accounting Policies and Errors*.

HoTARAC considers that a lessor should be permitted to correct such an error by applying the requirements of IAS 8 or AASB 108.

Accounting entries

The ED sets out the recognition and measurement requirements for lessors under the performance obligation approach [paragraphs 33 and following] and the derecognition approach [paragraphs 46 and following].

HoTARAC suggests that the proposal could usefully benefit from examples illustrating the basic accounting entries, given that many lessors will be unfamiliar with accounting for assets and liabilities arising from leases.

★ *Q3. Short-term leases*

Question 3. The exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is twelve months or less:

(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?

HoTARAC agrees that simplified requirements should apply to short-term leases but notes that the proposed relief is relatively minor and in some cases may be effectively unavailable due to other requirements. In particular, there appears to be little benefit for subsidiary entities within a consolidated group where the subsidiaries have leases with each other. Where such subsidiaries are reporting entities, as is common within the public sector, they need to apply consistent accounting policies. Therefore, any election by the lessor to adopt the simplified requirements and not recognise assets and liabilities arising from short-term leases may be unavailable due to the need to mirror the lessee's accounting for consolidation/elimination purposes. This is an issue for governments whose agencies have leases with each other, and it would also be an issue for private sector subsidiaries that are reporting entities.

HoTARAC recommends that the boards reconsider short-term leases with a view to giving greater relief that can be used reciprocally by lessors and lessees. For example, short-term lessees might be permitted to recognise lease payments as they are incurred, thereby mirroring the lessor's treatment.

HoTARAC presumes that the lessee in a short-term lease would be required to amortise its right-of-use asset. HoTARAC also recommends that the eventual standard be clearer about how the right-of-use asset is to be dealt with, especially where the lease term extends beyond the end of a financial year.

Q4. Definition of a lease

> Question 4. 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).
>
> (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?

HoTARAC agrees with the proposed criteria for distinguishing a lease from a purchase or sale and the proposed guidance for distinguishing a lease from a service contract. However, HoTARAC has concerns with some aspects of the ED's definitions and distinctions:

- Lease definition
- Meaning of control of an asset
- Distinction between control and risks/benefits
- Distinction between a derecognition-approach lease and a sale
- Quantum of risks and benefits transferred in a purchase or sale contract
- Inconsistent description of underlying asset
- Inconsistent risk/benefit thresholds.

Each of these is discussed separately below. The issues are interrelated and, unless addressed, will make the definitions and distinctions difficult to apply in practice. HoTARAC therefore recommends the boards clarify these matters.

★ *Lease definition*

The ED proposes to define a lease as a contract in which the right to use a ***specified asset*** (the underlying asset) is conveyed for a ***period of time***, in exchange for consideration [Appendix A (emphasis added) and paragraph B1].

HoTARAC has concerns with the words ***specified asset*** and ***period of time***.

First, it is unclear why the contract needs to specify a particular, non-substitutable asset in order to qualify as a lease [paragraph B3]. HoTARAC considers that it makes no difference whether a contract relates to an underlying asset generically or specifically. For example, a motor vehicle lessee may be indifferent to the vehicle's make and model or, alternatively, may require a particular vehicle, identified by its registration number. If only the latter case qualified as a lease, a contract could easily be written to avoid being within the scope of the proposal. The requirement for a lease contract to specify the underlying asset also raises questions about the degree of specificity required to be stated in the contract. HoTARAC recommends that the word *specified* be removed from the lease definition. HoTARAC also questions why there cannot be substitution of an underlying asset, provided the right to use the asset is the most important feature of the arrangement.

Second, HoTARAC considers that the phrase ***period of time*** is so broad that it could include the underlying asset's entire economic life, especially if the contract does not specify the period of time. Therefore a contract for the purchase or sale of an asset could fall within the definition of a lease. This has been a problem with the interpretation of the scope of IFRIC 4 and AASB Interpretation 4 *Determining whether an Arrangement contains a Lease*. HoTARAC therefore suggests that the definition refer instead to ***limited period of time as specified in the contract*** (if the contract specifies the period) or ***period of time shorter than the asset's economic life*** (if the contract does not specify the period).

In addition, HoTARAC would prefer the eventual standard to define ***contract*** and to include associated guidance such as that given in paragraphs 9 and 10 of the boards' recent ED on *Revenue from Contracts with Customers.*

★ *Meaning of control of an asset*

The ED distinguishes between a sale and a lease largely on the basis of whether the contract results in the transfer of control of the underlying asset [paragraphs 8 and BC59-BC61]. A sale transfers control but a lease does not. However, the ED has little to say on how to determine control, despite its importance in distinguishing leases from sales or purchases and therefore in determining whether a contract comes within the scope of the proposed standard. Moreover, the ED contains no definition of *control of an asset.*

The proposal notes that control normally transfers if the contract transfers title to the underlying asset or includes a bargain purchase option [paragraph B10]. The boards also propose that an entity should determine whether a contract transfers the underlying asset to another entity using the principles developed in their projects on revenue recognition and consolidation [paragraph BC60]. However, those paragraphs (ie B10 and BC60) are insufficient in defining control.

HoTARAC notes that:

- IAS 38 and AASB 138 *Intangible Assets* states that an entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of other to those benefits [paragraph 13]
- The boards' recent ED on *Revenue from Contracts with Customers* defines control [of a good or service] as an entity's ability to direct the use of, and receive the benefit from, a good or service [Appendix A].

HoTARAC recommends that the proposal should, as a minimum, include a definition of control based on the guidance in IAS 38 or the ED on *Revenue from Contracts with Customers.*

HoTARAC further recommends that the boards should give more guidance on indicators to determine control of an asset. The proposed guidance referring to title to the underlying asset is considered too simplistic as ownership does not necessarily equate to control.

★ *Distinction between control and risks/benefits*

The ED describes a contract for the purchase or sale of an underlying asset as one that results in an entity transferring control of the underlying asset and all but a trivial amount of the risks and benefits associated with the underlying asset [paragraph 8]. The distinction between control on the one hand and risks and benefits on the other is not explained.

HoTARAC notes that, as mentioned above, guidance on control is given in IAS 38 and AASB 138 and the boards' recent ED on *Revenue from Contracts with Customers.* That guidance incorporates the notion of benefits (and, by extension, risks) in the concept of control.

HoTARAC considers that an entity's exposure to the risks and benefits associated with an asset is an indication of the entity's control of the asset. Control and risks/benefits are complementary rather than competing concepts. HoTARAC is uncertain whether an entity could transfer control separately from transferring risks and benefits associated with an underlying asset.

HoTARAC therefore recommends that the boards either clarify that risks and benefits are indicators of control or, alternatively, explain the difference between control and risks/benefits so that the proposed guidance on purchase or sale of an underlying asset can be applied unambiguously.

★ *Distinction between a derecognition-approach lease and a sale*

A lessor that did not retain exposure to significant risks or benefits associated with an underlying asset would apply the derecognition approach [paragraph 29]. This would require the carrying amount of the underlying asset to be split based on the rights transferred and the rights retained by the lessor. The transferred amount would be derecognised and the retained amount would be reclassified as a residual asset [paragraphs 46 and 50].

The ED also scopes out contracts for the sale (or purchase) of an underlying asset, ie contracts transferring control of the underlying asset and all but a trivial amount of the risks and benefits associated with the underlying asset to another entity [paragraph 8].

A derecognition-approach lease and a sale both transfer risks and/or benefits to the counterparty and require the derecognition of at least part of the underlying asset. The retention of control at the end of the contract appears to be the critical distinction between a sale and a lease [paragraph B10]. The ED suggests that title to the underlying asset is an indicator of control [paragraph B10(a)].

HoTARAC considers the proposed distinction between a sale and a derecognition-approach lease to be unclear and, in some cases, conceptually doubtful. While the distinction may be valid where the lessor retains some significant risks or benefits that would give rise to the residual asset, HoTARAC cannot see the value of the distinction in cases where the lessor does not retain any significant risks or benefits. The proposed distinction could result in economically insignificant factors leading to substantively similar transactions being accounted for differently. Some might argue that retention of title alone is a trivial benefit if all economic benefits have been consumed and so may classify such a transaction as a sale.

Consider a contract that transfers all significant risks and benefits associated with an underlying asset for five years, being the remaining economic life of the asset. Suppose that at the end of the contract, the transferor retains title to the asset although it is then of insignificant value.

Because control (ie title) is retained by the lessor at the end of the contract, the ED would appear to require the transaction to be treated as a lease rather than a sale. The lessor would then apply the derecognition approach and derecognise the entire underlying asset because the lessor retains no significant rights therein. Had the entity treated the contract as a sale, it would similarly have derecognised the underlying asset. In both cases the overall financial effect is the same but due to the retention of control (evidenced by title to the asset) the transaction is treated as a lease rather than a sale.

Although HoTARAC can see the logic of the derecognition approach where the lessor retains some significant risks or benefits that would give rise to a residual asset, HoTARAC cannot see why this approach should apply if the lessor does not retain any significant risks or benefits and the lease is in substance a sale.

Put simply, the ED does not clearly articulate the distinction between a sale and some types of lease.

Quantum of risks and benefits transferred in a purchase or sale contract

The ED describes a contract for the purchase or sale of an underlying asset as one that results in an entity transferring control of the underlying asset and ***all but a trivial amount*** of the risks and benefits associated with the underlying asset [paragraph 8 (emphasis added)].

The requirement that all but a trivial amount of the risks and benefits be transferred appears to preclude situations where all the risks and benefits are transferred.

HoTARAC suggests that, for clarity, the requirement should be amended to read: "all, or all but a trivial amount of, the risks and benefits" ...

Inconsistent description of underlying asset

The proposal scopes out contracts representing a purchase or sale of either the underlying asset [paragraph 8] or the ***entire underlying asset*** [paragraph B9].

HoTARAC suggests that references to an underlying asset in paragraphs 8 and B9 should be expressed consistently unless there is intended to be a difference between *underlying asset* and *entire underlying asset*, in which case the difference should be explained.

Inconsistent risk/benefit thresholds

The ED proposes two thresholds that require an entity to determine the risks and/or benefits associated with an underlying asset. Whether a transaction is a sale or purchase rather than a lease depends, in part, on the entity transferring all but a trivial amount of risks and benefits [paragraph 8]. Whether a lessor applies the derecognition approach rather than the performance obligation approach depends on the lessor retaining exposure to significant risks or benefits [paragraph 28].

The two proposed thresholds are inconsistent in several ways without apparent reason.

First, the quantum of risks and benefits is ***significant*** in the derecognition/performance obligation threshold but ***all but trivial*** in the sale/lease threshold. What is the difference between ***significant*** and ***all but trivial***? HoTARAC recommends that the boards eliminate or else explain the difference.

Second, the sale/lease threshold is based on transferring both risks ***and*** benefits whereas the derecognition/performance obligation approach threshold is based on retaining either risks ***or*** benefits, which appears to be a lower threshold. HoTARAC recommends that the boards either eliminate or explain the reason for the differential requirements.

HoTARAC recommends that the risks and benefits criteria be applied consistently throughout the proposal, for both lessors and lessees.

Scope

Q5. Scope exclusions

Question 5. The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33-BC46). Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and why?

HoTARAC considers that leases of intangible assets should not be excluded from the scope of the proposed standard. HoTARAC notes the boards' observation in relation to intangible assets [paragraph BC36].

The boards' recent ED on *Revenue from Contracts with Customers* proposes a model for accounting for licensing and rights to use intellectual property and other intangible assets. The model also distinguishes between a sale and a licensing of such assets. Despite the conceptual similarity between leases and licences, the proposed accounting models in the EDs on revenue and leases differ. HoTARAC suggests that the boards should consider a more consistent approach because of the degree of similarity between leases and licences. A consistent approach would also minimise opportunities to legally structure agreements to avoid particular accounting treatments.

If leases of intangible assets are excluded from the eventual standard, HoTARAC considers it unlikely that any guidance on accounting for such items will be issued in the near future, given the boards' existing work programs.

HoTARAC also notes that the ED does little to conceptually justify the proposed exclusion of leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources.

★ *Service concession arrangements*

The ED defines a lease as a contract in which the right to use a specified asset (the underlying asset) is conveyed, for a period of time, in exchange for consideration [Appendix A].

HoTARAC considers that this definition is likely to catch service concession arrangements, when viewed from either the operator's (lessee's) or the grantor's (lessor's) perspective. In many service concession arrangements a grantor (lessor) gives an operator (lessee) a right to use a specified asset (infrastructure) for a period of time (concession period) in exchange for consideration (constructing the infrastructure for the grantor at the operator's cost). (SIC-29 and AASB Interpretation 129 *Service Concession Arrangements: Disclosures* specifically refer to rights to use assets [paragraphs 2 and 6].)

HoTARAC notes that, while IFRIC 4 (which the ED proposes to replace) scopes out arrangements falling within the scope of IFRIC 12 *Service Concession Arrangements*, the ED does not propose to scope out such arrangements. Therefore service concession arrangements appear to be within the scope of the proposal. Further, as the ED does not propose to replace IFRIC 12 or SIC-29, service concession operators may become subject to the eventual standard and IFRIC 12 and SIC-29 and grantors may become subject to the eventual standard and SIC-29. (Service concession grantors are not subject to IFRIC 12.)

Consider an arrangement, typical in Australia, where an operator finances, constructs and operates a toll road for 30 years and then hands it over, in a contractually-specified condition, to the grantor to operate for the not-insignificant remainder of its economic life. The operator recovers its construction and operating costs through tolls. Effectively, the grantor receives the road in consideration for granting the service concession to the operator.

Control of the infrastructure may transfer to the grantor at the start or end of the concession period. This arrangement would appear to qualify as a lease regardless of whether the grantor were to obtain control (eg through ownership) of the toll road at the start or end of the concession period. In the latter case, the contract still conveys a right to use a specified asset for a period of time, even though the underlying asset is not controlled (or owned) by the grantor.

Assuming the grantor obtained control at the start of the concession period, HoTARAC considers that the operator/lessee would recognise its right to use the infrastructure and its liability to make lease payments, which might only consist of a residual value guarantee. As the grantor/lessor would retain significant risks or benefits after the concession period it would apply the performance obligation approach and recognise its right to receive lease payments (the infrastructure) and lease liability. It is unclear how the grantor/lessor would measure its asset and liability in the absence of receiving cash payments from the operator/lessee.

HoTARAC recommends that the boards clarify in the eventual standard whether service concession arrangements are within its scope and, if they are, to provide guidance on how they are to be recognised and measured from both the lessor's and lessee's perspectives.

Q6. Contracts that contain service components and lease components

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

HoTARAC considers that the lease and service components of a contract need to be distinguished and accounted for separately but acknowledges that sometimes this will not be possible.

HoTARAC considers that a lessor should usually be able to separate the lease and service components of a contract but that a lessee may have difficulty in doing so. In such circumstances, an alternative practical solution might be to permit the lessee to account for the contract based on its dominant component, considering the nature of contract taken as a whole, rather than requiring lease accounting in all circumstances.

HoTARAC prefers the IASB proposal to the FASB proposal because the IASB proposal requires a lessor, when applying the derecognition approach, to account separately for the lease and service components of a contract rather than combining them.

Q7. Purchase options

> Question 7. The exposure draft proposes that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraphs 8, BC63 and BC64).
>
> Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not. If not, how do you think that a lessee or a lessor should account for purchase options and why?

HoTARAC agrees with the proposal that a lessee or lessor should only account for purchase options when they are exercised. Such options represent uncertain future events and should therefore only be accounted for if and when they are exercised. HoTARAC therefore agrees with the boards' conclusions presented in paragraph BC64.

Measurement

★ *Q8. Lease term*

Question 8. The exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that 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). 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?

HoTARAC disagrees with the proposal to determine the lease term by taking account of options to extend or terminate the lease.

First, HoTARAC is not convinced that, under the *Framework for the Preparation and Presentation of Financial Statements*, an option to extend the lease would necessarily give rise to a liability for the lessee or an asset for the lessor at the inception of a lease. A lessee would usually be free to choose whether to exercise the option and would therefore have no present obligation to the lessor. The proposed approach may therefore undermine the *Framework*. Arguably, future rights and obligations under leases are similar to rights and obligations under executory contracts. If the proposed principle was applied to other arrangements currently treated as executory contracts, such as employee contracts, this would have significant ramifications.

Second, even if it meets the asset or liability definition, it could be difficult, at the date of commencement of the lease, to determine the likelihood that an option will be exercised. It would be especially difficult for the lessor, as the exercising of the option is not within its control. The requirement to make such estimates would lead to greater reliance on management judgement which could be subjective and open to manipulation to achieve desired accounting outcomes.

HoTARAC also notes and supports the alternative view on this matter given in the ED, which recommends only recognising options where there is an incentive to extend the lease period [paragraph AV2 and following].

Another option would be for the boards to consider permitting a lessor or lessee to use the minimum lease term, unless an extension of the term is reasonably certain. This would be consistent with the view of those board members who preferred a higher threshold than 'more likely than not', such as 'reasonably assured' [paragraph BC119].

Separately from the above concerns, HoTARAC finds the illustration of how to determine the more-likely-than-not lease term, counter-intuitive and difficult to follow [paragraph B17]. If the boards proceed with the proposed approach to estimating the lease term, perhaps it could be explained more clearly. Alternatively, it may be simpler to merely require the entity to assess the most probable lease term.

Overall, HoTARAC thinks that moving from a contractual to an expected period approach would make assessing the lease term more subjective and variable. It would also be costly to implement.

★ *Q9. Lease payments*

Question 9. The exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that 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. 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?

HoTARAC disagrees with the proposal to include all contingent rentals and expected payments under term option penalties when measuring lease assets and liabilities. The reasons are similar to those given in relation to the lease term.

First, HoTARAC is not convinced that, under the *Framework for the Preparation and Presentation of Financial Statements*, such payments would necessarily give rise to a liability for the lessee or an asset for the lessor at the inception of a lease. For example, the obligations may not be unconditional at that time. A lessee may be able to control the degree to which it is exposed to, or incurs, contingent rentals and term option penalties. It may therefore have no present obligation to the lessor for such rentals and penalties. The proposed approach may therefore undermine the *Framework*. Arguably, future rights and obligations under leases are similar to rights and obligations under executory contracts. If the proposed principle was applied to other arrangements currently treated as executory contracts, such as employee contracts, this would have significant ramifications.

Second, it could be difficult, at the inception of the lease, to estimate the likelihood that such a payment will occur. For example, the lease term may be long or the lease payments may not be based on publicly-available rates or indices or they may be subject to future events. The requirement to make such estimates would lead to greater reliance on management judgement which could be subjective and open to manipulation to achieve desired accounting outcomes. In lease portfolios, contingent rentals could be lease specific, making estimation even more onerous and impracticable.

HoTARAC also notes and supports the alternative view on this matter given in the ED [paragraph AV5 and following].

If the proposal to include contingent rentals and expected payments under term option penalties and residual value guarantees goes ahead, HoTARAC strongly supports the proposed requirement for reliability of measurement. This is consistent with the *Framework* which requires reliable measurement as a prerequisite to recognising assets and liabilities. It should therefore be required of lessees as well.

Q10. Reassessment

Question 10. The exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that 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).

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?

HoTARAC agrees with the proposal.

HoTARAC notes that its preferences in response to questions 8 and 9 are likely to increase reassessments.

HoTARAC supports the boards' decision that the discount rate used to determine the present value of lease payments should not be revised where there are subsequent reassessments of the expected lease term or contingent rentals [paragraphs 19, 40, 57 and BC135].

Q11. Sale and leaseback

Question 11. 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).

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?

HoTARAC agrees with the proposed criteria for classification as a sale and leaseback transaction.

Presentation

Q12. Statement of financial position

Question 12. 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).

(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)? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

HoTARAC agrees with presenting assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows. This will enhance users' understanding of the financial impact of leases.

However, HoTARAC strongly believes that lessors should only present the required information in the notes rather than cluttering and introducing complexity into the face of the statement of financial position. HoTARAC does not agree with presenting net in addition to gross figures on the face of the financial statements where those figures arise from leases.

Q13. Statement of comprehensive income

Question 13. Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

HoTARAC agrees with the proposal to present lease income and lease expenses separately but considers that it would also be acceptable to disclose that information in the notes.

Q14. Statement of cash flows

Question 14. Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

HoTARAC agrees with the proposal to present lease cash flows separately but considers that it would also be acceptable to disclose that information in the notes.

Q15. 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?

HoTARAC agrees with the disclosure objectives.

However, HoTARAC notes that the proposed disclosures are far more extensive that those of the existing standard and considers that this would be excessive for some entities.

Therefore, HoTARAC urges the boards to review the need for so many disclosures. Perhaps some could be made non-mandatory. Alternatively, where there are many leases, a general policy outline may be more appropriate.

HoTARAC suggests removing the reconciliation and maturity analysis disclosures proposed in paragraphs 77, 80, 85 and 86.

Q16. 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 that 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?

HoTARAC agrees with the proposed simplified retrospective approach.

HoTARAC has no objection in principle to permitting full retrospective application. However, given the long-term nature of some leases, differences between the full and simplified approaches could produce undesirable long-term comparability issues between or within entities. Further, fully retrospective application would probably add to the complexity of initial implementation with little real benefit for users of financial statements.

Therefore, HoTARAC supports the simplified retrospective approach.

★ Q17. 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?

Despite its general conceptual support for the proposals in the ED, HoTARAC is not convinced that the benefits of the proposals will demonstrably outweigh the costs [paragraphs BC200-BC205]. HoTARAC also considers that the presentation and disclosure proposals would reduce the understandability of financial statements to non-sophisticated users.

Many lessees will find it very burdensome to recognise assets and liabilities for leases that are presently classified as operating leases. It will also often be difficult to estimate contingent rentals and other uncertain future events. Where lease portfolios exist, contingent rentals might be expected to be lease-specific rather than generic, thereby making estimation even more difficult. Extensive training and system and process changes are likely to be required to accommodate the proposals in the ED and greater management judgement will be required.

HoTARAC questions the usefulness of the much greater subjectivity introduced by the proposals, even if supplemented by narrative note disclosures. HoTARAC also questions the appropriateness of proposals that would require entities to remeasure assets or liabilities in a different way for note disclosure, as proposed by paragraphs 85 and 86.

HoTARAC therefore urges the boards to consider whether any further relief can be given to ease the burden of making the proposed changes. Such relief might include allowing a substantial period for implementation prior to initial application and giving more flexibility on short-term leases. A substantial implementation period would assist lessees and lessors to fully assess the impact of the proposals.

Q18. Other comments

Question 18. Do you have any other comments on the proposals?

Yes. HoTARAC's other comments are set out below.

★ *Applicability to cancellable leases*

The ED proposes that a lessee would recognise a right of use asset and a liability to make lease payments [paragraph 10] and that a lessor would recognise a right to receive lease payments and (under the performance obligation approach) a lease liability [paragraphs 30 and 46]. It also states that those items meet the definitions of asset and liability [paragraphs BC6(d) and BC17].

HoTARAC agrees with these conclusions where a lease contract is non-cancellable but not where the lease is cancellable. Although the ED deals with options to extend or terminate the lease it does not specifically explain how a cancellable lease meets the definition of asset and liability.

HoTARAC notes that some lease contracts are cancellable at the option of either party (or both). Other lease contracts become cancellable after an agreed period of non-cancellability. Many tenancy agreements have this feature.

Where a lease presently is cancellable, HoTARAC considers that the lessee and lessor have no present obligation and a lessee has no control over the leased item. Therefore there is no asset or liability. If a lessee or lessor has an option to cancel the lease after a certain time, it has no liability beyond the non-cancellable period. If a lessor has an option to cancel after a certain time, the lessee has no right-of-use asset beyond the non-cancellable period. Such agreements appear to be in the nature of executory contracts.

HoTARAC considers that the proposal should be explicit about cancellable leases, either by specifically explaining how they qualify as an asset or liability under the *Framework*, or by scoping them out, or both.

Discontinued guidance on lease incentives and arrangements containing a lease

The ED is intended to supersede SIC-15 (equivalent to AASB Interpretation 115) *Operating Leases—Incentives* and SIC-27 (equivalent to AASB Interpretation 127) *Evaluating the Substance of Transactions Involving the Legal Form of a Lease* [paragraph 97].

However, the ED does not appear to deal with the matters covered by SIC-15 and SIC-27, despite their continuing relevance.

HoTARAC suggests that the proposal be expanded to continue the existing guidance on lease incentives and transactions involving the legal form of a lease, modified as necessary to accommodate the revised lease accounting model.

Construction of leased assets

HoTARAC notes that some lease arrangements provide for the construction of the underlying asset prior to the commencement of the lease term. The lessee often has a significant role in specifying the features of the leased item, which is typically leased for all or most of its economic life, yet remains the property of the lessor.

Questions arise as to the accounting treatment by each party during the construction period which falls between the dates of inception and commencement of the lease.

At present, IAS 17 and AASB 117 *Leases* require a lessee to recognise a finance lease asset and liability at the beginning of the lease term, ie not before. However, in some cases, the lessee may control the item prior to this time.

HoTARAC considers that it would be helpful for the eventual standard to give guidance for this situation.

Make good provisions

HoTARAC notes that a lessee is sometimes obliged to restore an underlying asset at the end of the lease term and that some lessees establish a make good provision to recognise that obligation.

It is not clear from the proposals in the ED how such make good provisions would be treated.

HoTARAC therefore recommends that the eventual standard give guidance on whether make good provisions are within scope and, if so, how they are to be treated.

ATTACHMENT 2

COMMENTS ON AASB SPECIFIC MATTERS

Q1. Not-for-profit entities

Question 1. Are there any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals with regard to not-for-profit entities.

No. HoTARAC is not aware of any regulatory issues or other issues specific to the Australian environment that may affect not-for-profit entities.

Q2. Reduced disclosure requirements

Question 2. Should any of the proposed disclosures be considered for exclusion under the reduced disclosure requirements.

Yes. HoTARAC considers that the disclosures proposed by paragraphs 77, 80 and 84-86 (inclusive) should be excluded under the reduced disclosure requirements. HoTARAC notes that paragraphs 84-86 relate to disclosures in AASB 7 that are excluded under the reduced disclosure requirements.

Q3. GAAP/GFS harmonisation

Question 3. In relation to AASB 1049 *Whole of Government and General Government Sector Financial Reporting:*

(a) Are you aware of any implications for GAAP/GFS harmonisation of the proposed changes other than those noted below?

(b) How do you think the implications for GAAP/GFS harmonisation should be dealt with in the context of the principles in AASB 1049?

The Preface to AASB 1049 notes that, as a result of potential amendments to the requirements in other Australian Accounting Standards, differences between Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics (GFS) not contemplated in AASB 1049 may eventuate. Consistent with the AASB's comments in the Preface to AASB 1049 addressing this matter, the AASB will have regard to the implications for whole of government and GGS financial reporting in deciding whether to amend the proposals in this ED or the requirements of AASB 1049 to either avoid or confirm the existence of a difference. In that regard, the following aspects of the ED would be expected to have implications for GAAP/GFS harmonisation:

- the proposal for lessees to capitalise all lease assets and liabilities in the statement of financial position and therefore remove the operating and finance lease distinction; and
- the proposal to change the measurement requirements of assets and liabilities arising from a lease for both lessees and lessors.

HoTARAC acknowledges the implications noted by the AASB and agrees these will be major harmonisation issues. As GFS currently distinguishes operating leases from finance leases, the proposals in the ED have a high probability of increasing GAAP/GFS divergence. HoTARAC understands lease accounting under GFS is unlikely to change in the near future.

HoTARAC notes several other possible implications of the ED's proposal to remove the distinction between operating and finance leases given that GFS is likely to retain that distinction:

- New GAAP/GFS convergence differences would arise in relation to transactions (as defined in AASB 1049) as lessees would recognise amortisation and interest expense under GAAP while having to report lease rental expenses under GFS
- New GAAP/GFS convergence differences would arise in relation to other economic flows (as defined in AASB 1049) as lessees would recognise revaluations and reassessments under GAAP but not under GFS
- The value of existing GAAP/GFS convergence differences in cash surplus/(deficit) (as defined in AASB 1049) would increase due to the differing treatment of finance (ie capitalised) leases under GAAP and GFS
- New GAAP/GFS convergence differences would arise in relation to net debt (as defined under GFS) for the same reason
- The value of a lessee government's net debt would increase, assuming that the liability to make lease payments would be treated similarly to a finance lease liability
- Lessees would have to recognise more items (eg revaluations and reassessments) thereby increasing the risk of misclassfication as between transactions and other economic flows.

HoTARAC also observes that GFS uses the term ***amortisation*** in relation to non-produced assets (eg land, subsoil assets and certain intangible assets) whereas the ED uses it in relation to right-of-use assets [paragraph 11(b)]. It is unclear whether a right-of-use asset would ever be recognised under GFS and, if it was, whether it would be regarded as non-produced and therefore subject to amortisation under GFS.

Q4. General comments

Question 4. Would the proposals result in financial statements that would be useful to users and be in the best interests of the Australian and New Zealand economies?

Yes. Subject to its response to Question 17 in Attachment 1, HoTARAC considers that the proposals would result in financial statements that would be useful and would be in the best interests of the Australian economy. HoTARAC cannot comment on the New Zealand economy.

Grantor accounting for service concession arrangements

HoTARAC notes that the ED does not propose to amend or withdraw IFRIC 12 (equivalent to AASB Interpretation 12) *Service Concession Arrangements*. If, in considering the response to Question 5 in Attachment 1, the boards decide to clarify that service concession arrangements are outside the scope of the eventual standard, HoTARAC presumes that the position for Australian service concession grantors will remain as determined by the AASB at its meeting of 12-13 December 2007.