



Association pour la participation des  
entreprises françaises à l'harmonisation  
comptable internationale



**A F E P**

**Association Française des Entreprises Privées**

IASB  
30 Cannon Street  
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Paris, 15 December 2010

Re: Exposure Draft *Leases*

We welcome the opportunity to comment on the IASB's exposure draft dealing with "*Leases*" (the ED).

While we understand that there is a need to improve on the existing requirements in order to prevent what the Board sees as structuring opportunities, we believe that the primary objective in developing a new standard should be to improve the usefulness of financial information, not to establish anti-abuse rules.

In our opinion, the Board's proposals fail to achieve this primary objective. We think that this may be because the Board has not drawn appropriate conclusions from its analysis of what information would truly be of benefit to users, and where this information would best be placed in the financial statements (questions such as, for example, is, should additional assets and liabilities be recognised or is more disclosure the best approach? What kind of liabilities and assets should be recognised?). We also think that there has not been adequate weight given in this analysis to the economic substance and purpose of each kind of lease contract and that as a result the ED does not respond appropriately to the different economic circumstances of different arrangements. The lease is a legal form that encompasses a lot of different economic transactions and is not always a financing transaction.

Although we think that many of the comments we made on the discussion paper are still valid (and included in Annexe 3), we do understand that the Board's objective is to amend IAS 17 in such a way as to ensure that many more assets and liabilities related to lease contracts will be recognised in the future than today, and thus we recognise that it will be fruitless to maintain our position and reiterate our support for no fundamental change to be made to IAS 17.

We believe, however, that there are a number of areas in which the current proposals do not deal appropriately with the accounting representation of the economic circumstances. For this reason, in an effort to contribute constructively to the process, we propose to the Board an alternative model, based on the economic substance of the contract and compliant with the IFRS Framework, which we think represents a good compromise between IAS 17 and the latest proposals.

The key features of this alternative model are:

- No change in respect of the current so-called finance lease contracts, either in their definition, or in their accounting, for both lessors and lessees
- A symmetrical right-of-use model for both lessors and lessees when the contract transfers the right of use of a specific asset (a term which needs to be correctly defined). Assets and liabilities recognised under this approach are limited to the committed fixed term and committed payments (no renewal options nor contingent rent)
- All other contracts where a non-specific asset is used as a vehicle to provide a service, should be accounted for as executory contracts.

We think that this alternative model might offer a more feasible route to achieving the Board's objective of producing an acceptable standard in time to meet its 2011 deadline. **This model is presented in Appendix 2.**

The application of this future standard depends largely upon the definition of a "lease", which in turn depends upon a clear and unambiguous definition of the "specified asset". There is no formal definition of this term in Appendix A *Defined terms*, but paragraphs B2 and B3 of Appendix B attempt to explain what a specified asset is. We find explanation of the term in these paragraphs confusing and therefore recommend that the Board develop a formal definition and redraft the explanatory guidance in order to facilitate the interpretation and application of the future standard. We have used the term "specific asset" throughout our response as this is the headline term used in IFRIC 4 and we think its meaning is better understood at present, but we do recognise that even IFRIC 4 uses "specific" and "specified" somewhat indiscriminately.

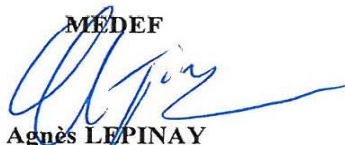
In respect of investment properties, we strongly suggest that the Board also specifically exclude investment properties that are measured after initial recognition using the cost model, unless it becomes clear in the future standard that these items are never or very rarely specific assets. Please see our discussion of this in our response to Question 5 and see our proposals concerning the notion of a specific asset in Appendix 2).

Finally, we are firmly of the opinion that the future standard must deal fully with the accounting for the lessee and for the lessor in a consistent way. The future standard must be robust and of high quality before it is published, and not rushed through because of the deadline that the Board has set itself.

Should you wish any supplementary comments or explanations, please do not hesitate to contact us.

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## Appendix 1 to our letter on IASB ED “Leases”: Answers to the specific questions raised in the invitation for comments

Remark: We have used the term “specific asset” throughout our response with the same meaning as that of the headline to paragraph 7 of IFRIC 4. Given the importance of this term to the future standard we think that it should be included as a “defined term” and the explanations in paragraphs B2 to B4 of the Application guidance need to be reconsidered and redrafted.

### THE ACCOUNTING MODEL

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#### Question 1: Lessees

- (a) Do you agree that a lessee should recognise a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?*
- (b) Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?*

We deal with questions 1 and 2 together. Please see our response under Question 2.

#### Question 2: Lessors

- (a) Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term, and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?*
- (b) Do you agree with the boards’ proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?*

We deal with these two questions together since we think that there is a strong link between the two. We think that the treatment on the lessee’s side and on the lessor’s side should be as symmetrical or mutually consistent as possible. Moreover, the treatment should in both cases reflect the different types of transaction which can be regarded as leases.

## Part 1 – Main concerns about the proposed accounting model

We have a number of concerns about the accounting model proposed in the ED:

***The proposals are neither internally consistent, nor consistent with quite recent tentative decisions made by the Board.***

We believe that this is supplementary evidence that the project lacks technical robustness:

- We think that it is inconsistent for the Board to reach the conclusion that it requires two different accounting models to best depict two different business models for lessors, while at the same time the Board in its revenue recognition project it is trying to merge the two existing standards into one single model for all industries.
- We are also quite surprised that the Board is contemplating two different accounting models for lessors, but not for lessees. We believe that there are also essentially two different business models for lessees' use of lease contracts: one is financing and the other one is the obtaining of services while maintaining flexibility. We do not think that the Board has adequately analyzed the economic substance of leases and therefore treats all leases as if they were financing arrangements. We do not believe that that is the case. The existing distinction between finance and operating leases is in our view useful and should be maintained as the starting point for lease accounting, albeit with a change of the frontier between the two to ensure that strategic assets used by the entity assets are recognised as such in the financial statements.
- Another area where we think the IASB is being inconsistent is in the way both the notion of control and that of risk and rewards are used in the ED (although inadequate guidance is given in the ED as to how to apply the notion of risks and benefits), whereas the Board in its other current projects is systematically migrating from a risk and rewards model to a transfer of control model (Revenue, Derecognition ...). We believe that this inconsistency between projects demonstrates that the concept of control is not yet robust enough to be inserted in all standards. This tells us that there is a need for prior reflexion and debate at the conceptual framework level on the usefulness and relevance of such criteria for translating all transactions into financial reporting.

Control is too binary a notion to allow it to depict the full range of the substance of all contracts, and does not allow the accounting to reflect adequately the part of risk and rewards retained by each party to the contract. The fundamental distinction between the different types of contract and whether the assets should be presented on the balance sheet cannot depend upon the simplistic notion of whether the entity controls the resource or not, since this cannot reflect the range of the greater or lesser extent to which the entity has accepted or relinquished the risks and rewards linked to the asset (and which forms the basis of the value creation model in the capitalist economic system). The relinquishing of risks and rewards is not “all or nothing” but more or less and depends upon the business model of each entity or sector.

As has already been the case in respect of other projects for the development of accounting standards, we greatly regret the abandonment of the principle of risk and reward in favour of one of control. We request that a fundamental evolution like this, which is of the nature of a major change in the Framework and consequently a change in the objective of financial statements, be debated and approved before the individual accounting standards are changed.

- We also believe the “performance obligation” model for lessors is not consistent with the model proposed for lessees : on the one hand, the IASB explains that the lessee has an unconditional obligation to pay for the full contract once the lessor has provided him with access to the underlying asset; but on the other hand, paragraph BC18 of the basis for conclusion states that the lessor also still has an obligation over the full lease term, and that providing the access to the underlying asset is not an economic event that gives rise to revenue.
- Furthermore, although the Basis for Conclusion of the ED states (in BC99) that the performance obligation approach is based on that of the ED Revenue from Contracts with Customers (revenue recognition ED), the two appear to us to be very different. Under the performance obligation approach of the revenue recognition ED, the performance obligation is not recognised (or is recognised on a net basis of zero) as long as both parties have not performed or have performed equally. Under the leases ED, the lessor’s obligation is shown gross with a corresponding asset at the commencement of the lease.
- Focus is made on the distinction between leases and services and yet these notions are still not adequately described in this exposure draft. Existing application difficulties and interpretations linked to IFRIC 4 are not yet resolved and will now affect all lease contracts.
- Finally, the Board has reproduced the pitfalls that commentators might object to in the current standard: the proposed model for the lessor industry is complex and based on different levels of bright lines (lease versus in-substance sales / obligation performance versus derecognition model).

***The proposals do not result in an improvement over existing requirements***

- Lessor industry: none of the two proposed models seems to depict faithfully the different economic transactions:
  - The derecognition model leads to the recognition of a day-one gain that does not reflect the financing arrangement, while the obligation performance model requires maintaining two assets on the statement of financial position.
  - The most obvious case of financing arrangements, the lease which is in substance a sale or a purchase, is scoped out of the ED without adequate guidance for the initial and subsequent accounting.
  - Existing requirements for lessors seem better adapted whether for financial or manufacturer / dealer lessors. We note that there is no real problem with the current accounting approach to leases in the books of lessors and that it is not necessary or desirable to change this to an approach which is more complex.

- Although in the course of its deliberations the Board identified the difficulty of articulating a usable approach to the impairment testing of the lease receivable, underlying asset and lease liability in the performance obligation model, the ED provides no guidance for this. Instead the problem is ignored and only the lease receivable considered for impairment testing, thereby leaving the question open as to whether an impairment test should ever be performed on the underlying asset.
- o Lessees: Furthermore because of the failure to distinguish between different types of leasing, the proposals lead to the recording of some assets and liabilities that do not meet the definition of the conceptual framework (please refer to our comments on renewal options and contingent rents for example).

## **Part 2 – Our proposals for an improved accounting model**

Our proposals are based on the main following assertions:

- o One of the objectives of financial reporting is to facilitate comparability. In our view, this does not just mean representing like transactions in the same way but also means showing different economic substances differently, that is, not to disguise differences by making transactions which are different in substance appear to be the same. It is important to show users that entities do have different business models if they are different.
- o We believe that the current distinction between financial and operating lease is helpful in depicting the different substances of these contracts. We also believe that the current criteria for classification based on risk and rewards is still valid and should be maintained as it permits the financial statements to reflect the fact that contracts can be set up differently depending on the degree of risk (and rewards) that each party agrees to retain or transfer.
- o Current requirements in the lessor’s books for financial leases are satisfactory and there is no real need for change.
- o As said above, we understand the need to improve the existing requirements for “operating lease” that currently are seen to fail to prevent structuring opportunities. Thus, we can agree with the “right of use” model for lessees but only in the following conditions:
  - The right of use model should be restricted only to “lease contracts” as defined in a new standard (see below for discussion of definition)
  - Other contracts should not be scoped out but should be dealt with appropriately in the leasing standard.
  - The accounting model for lessees and lessors should be symmetric / mutually consistent.
  - The measurement of assets and liabilities should be restricted to the minimum lease term and lease payments

**Please find in Appendix 2 the summary of our proposals**

### Question 3: Short-term leases

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

- (a) At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognise lease payments in profit or loss over the lease term (paragraph 64).*
- (b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognise assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit or loss over the lease term (paragraph 65).*

*(See also paragraphs BC41–BC46.)*

*Do you agree that a lessee or a lessor should account for short-term leases in this way?*

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

We do not see any justification for different “simplified” treatments of these leases between the lessee and the lessor. The lessee approach is based on the concept that the lessee has an existing obligation as a result of a past event which has to be recognised in its entirety at the date of commencement, whereas for the lessor the right to payment is deemed to arise only with the passage of time. If the aim of these proposals is to avoid the imposition of onerous requirements to provide information of limited utility, and that is what the justification would appear to be as far as the lessor is concerned, then we think that this is unsuccessful for the lessee. The only relief afforded to the lessee is not to have to perform the discounting of the contractual cash flows. This is hardly a concession, as in most cases the effect of discounting would be immaterial over 12 months and it is the projection of the cash flows which is the more onerous exercise.

The simplest approach, in our view, is to allow the proposed option for the lessors’ accounting to lessees as well, and thus to use accrual accounting for the income statement without recognising an asset on the balance sheet of the lessee. In the interest of comparability, it would be best to make these simplified approaches mandatory rather than optional for both lessors and lessees.

We do not think that the suspicion of manipulation that appears to be driving these requirements is well-founded. In our view, this is of course that of the entity, contracts are constructed to respond to a real economic objective and not to achieve an accounting outcome. It would be inadvisable for either a lessee or a lessor to take the risk of entering only into short-term lease contracts for material strategic assets without an option for renewal in order to avoid having to apply an accounting standard. The entity would expose itself to the operational risk that the asset might become unavailable and the financial risk that rental payments would be much higher than otherwise in order to enable the lessor to cover its residual value risk.

### Question 4

*(a) Do you agree that a lease is defined appropriately? Why or why not?*

*If not, what alternative definition would you propose and why?*

*(b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?*

*(c) Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?*

Please refer to our answer to question 1 and to our proposed model in appendix 2 where we try to define what should be dealt with as lease contact.

We note that the whole issue of the scope of the ED depends upon the definition of a lease and in particular on that of the “specified asset” (“specific” asset in IFRIC 4). Unfortunately, the definition of the specified asset which is provided in paragraphs B1 to B4 is very confusing and must be completely redrafted if the ED is to be operational and implemented on a consistent basis. In addition, the integration of IFRIC 4 is incomplete and not successful. The incorporation of IFRIC 4 should be rethought and in particular it should be considered whether guidance about units of account and reassessment should be brought in (paragraphs 3, 10 and 11 of IFRIC 4).

## SCOPE

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### Question 5: Scope exclusions

*The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33–BC46).*

*Do you agree with the proposed scope of the proposed IFRS? Why or why not?*

*If not, what alternative scope would you propose and why?*

If short-term leases can be dealt with in an appropriately simplified way within the scope of the proposed leasing standard we would be content for them not to be excluded from its scope.

In respect of investment properties, we strongly suggest that the Board also exclude investment properties that are measured after initial recognition using the cost model, unless it becomes clear in the future standard that these items are never or very rarely specific assets. We believe that this would be the case when a lessor can reasonably expect to rent easily the investment property to any lessees other than the current one. (see our proposals concerning the notion of a specific asset in Appendix 2).



We think that the cost model is the most appropriate accounting to reflect the business model of lessors whose primary objective is to manage and hold investment properties in order to generate cash inflows from rentals rather than from capital appreciation. Some sales may be realised and still be consistent with the business model. This can occur, for example, when investment properties no longer meet the entity's investment policy, when there is a need to readjust the property portfolio to reflect changes in the expected duration of the portfolio or when capital expenditures need to be funded. This can be the case in the insurance industry where the only way to adjust the size and content of the investment portfolio to match the insurance liabilities is to effect some sales. As a corollary to this, accounting for lease rental income on an accruals basis (as for the lessor under the ED's proposals for short-term leases) provides the best reflection of the economic reality of these arrangements. In our view, the proposed performance obligation model would lead to an inappropriate increase in yields during the early years of a lease and to a decrease during the later periods. In the assumptions about duration. We therefore believe that in this area the benefits for users, if any, will never exceed the cost for preparers.

A lessor may manage his portfolio at an aggregate level and not lease by lease. The current proposal that would require the assessment of the occupancy duration on a probability basis for each lease is incompatible with that mode of management and would be onerous to apply. For this reason, in the worst case, if the Board maintains its preliminary decision, we urge it to allow an approach with the use of statistic data based on a portfolio level even if one may face some practical difficulties to implement and manage it.

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

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

*(a) the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.*

*(b) the IASB proposes that:*

- A lessee should apply the lease accounting requirements to the combined contract.*
- A lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.*
- 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?***

We cannot see a justification for having different approaches for the lessee and the lessor. As a principle, the service component should be always estimated and tracked separately for both lessors and lessees.

Nonetheless, we agree that it is often difficult for the lessee to estimate the service component. In such cases, we believe that the lessee should determine whether the contract is predominantly a contract for services or a lease of an asset, and account for the whole arrangement on the basis of the predominant element. To do this, the entity should develop criteria for distinguishing service contracts from leases based upon its own business model and apply them consistently.

We agree that the lessor will usually have information available to it to enable it to separate the service component from the lease component and should account for these separately.

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

***The exposure draft proposes that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraphs 8, BC63 and BC64).***

***Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?***

We believe that the guidance existing in IAS 17 is relevant and should be maintained:

- A bargain purchase option should remain as a strong indicator that the contract is in reality a purchase rather than a lease and thus may lead to the recognition of the underlying asset before the option is exercised.
- All other purchase options should be ignored as long as the reporting entity is not reasonably certain of exercising them.

## **MEASUREMENT**

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

***Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?***

As we stated in our response to the discussion paper, we disagree with this approach.

We share the arguments developed by Mr Cooper in AV3, that is, that options provide a lessee with flexibility and reduce its risk. The entity having acquired an option does not incur any liability beyond the minimum lease payments involved in the first period of the lease. No supplementary liability should be recognised, in our view. If no reliable measurement of options is achievable, appropriate disclosures should be provided.

Besides leading to the recognition of liabilities that we think do not meet the framework criteria, the proposals will lead to the same accounting outcome for two companies that have entered two different contracts and have different obligations in economic terms.

The Board explains that they have made that decision because valuing components might prove difficult and involve complex and not necessarily reliable modelling. We agree with the conclusions of the Board that the measurement of options in lease contracts may not meet the requirement for reliability. We do not believe, however, that the only alternative to no reliable measurement is the recognition of items that do not meet the definition of liabilities. Furthermore, we believe that it is much more useful to give information in note concerning renewal options rather to provide an unreliable value in the statement of financial position.

The Board also seems to believe that the proposed requirement would play the role of an anti-abuse provision, i.e. it would prevent entities from contracting for short-term leases with options instead of longer leases. We have constantly been opposed to anti-abuse provisions on the grounds that most of the time these are not compatible with principle-based and robust standards, and in addition we believe that the Board's approach in this instance is flawed. In reality, entities do not decide whether to negotiate an option for accounting purposes. Options have a cost, and are taken if the flexibility that they provide is necessary. Furthermore, not all lessors will grant options within reasonable cost limits. Whether an option is purchased or not is, and probably will remain, an economic decision, and the resulting position is economically quite different for the entity from that it would have been in if it had taken up a firm longer term.

We also agree with Mr S. Cooper's view expressed in AV4 concerning the impact of this approach applied to lessors, because it will underestimate the business risks retained by lessors which grant such options.

Finally, we have also concerns about the way proposed to determine the expected term as the longest possible term that is more likely than not. This approach represents a lowering of the threshold for recognising longer lease terms than the current « reasonably certain » criterion. It also requires the estimation of probabilities for future scenarios which it is highly unlikely that the entity can estimate at the inception of the lease.

Indeed, in most cases the entity can assess the likelihood of changing from one scenario to another only at the point that it decides to change its plan. We therefore disagree with the proposals and believe that these will introduce an unacceptable degree of unreliability into the accounting and generate a burden for the preparer which does not result in the provision of useful or reliable information for the user.

## **Question 9: Lease payments**

*Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?*

*Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be measured reliably? Why or why not?*

Once again, we agree with many of Mr Cooper's arguments against the inclusion of contingent rentals in the measurement of the assets and liabilities. We would make the following points:

- We urge the Board to make a distinction between rentals contingent on an index or rate and rentals contingent on asset usage or performance.
- We do not think that the second category meets the criteria for the recognition of a liability as it the lessee could avoid to pay them by ceasing or reducing its activities. In other words, these are costs which may be incurred in the future for the entity to operate at a certain level in the future. We think that this is inconsistent with the principles for recognising liabilities contained in the Framework, and current IAS 37 would not allow these to be recognised.
- Reflecting contingent rentals does not provide relevant information as it does not fairly depict the operational risk retained by the lessors. Contingent rentals compensate the lessor for the operational risks linked to the underlying asset, which the lessor bears. The lessee should reflect in its asset the limiting of the operational risk related to the asset. This is done by accounting for only the firm and unavoidable rental payments it is committed to. The lessor should reflect its increased risk related to the underlying asset by retaining a greater part of this on its balance sheet, and less in the lease receivable
- In our experience, users never ask for information about contingent rentals to enable them to restate financial statements.
- Information about the contingent items should be provided in the notes.

## **Question 10: Reassessment**

*Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not?*

***If not, what other basis would you propose for reassessment and why?***

As stated above, we do not agree that rentals contingent on usage or performance or lease-term options should be recognised in advance of being incurred. Elimination of these proposed requirements would help greatly in reducing the frequency of reassessment.

We agree that there should not be a requirement for systematic remeasurement on a periodic basis, but that there should be a requirement to consider whether any changes in facts or circumstances indicate that there may have been a significant change in the lease liability or asset. This should be similar to the requirement for a review of indicators of impairment under IAS 36 and further guidance on this should be added to the ED.

## **SALE AND LEASEBACK**

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### **Question 11**

***Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?***

We agree that sale and leaseback transactions should be analysed to identify any indicators that such transactions could be either be a financing transaction or a true sale.

We also agree that a true sale should lead to the recognition of an immediate gain from the derecognition of the asset whereas in the case of a financing transaction, clearly no gain on disposal should be reflected in the income statement.

Nonetheless, we do not agree with the mandatory application of the “performance obligation model” for the transferee as we believe that a partial derecognition approach is much more relevant, as already discussed in our response to question 1.

It would be helpful to provide a comprehensive example of how the accounting for a sale and leaseback works in Appendix B.

## **PRESENTATION**

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

- (a) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment or investment property as appropriate, but separately from assets that the lessee does not lease (paragraphs 25 and BC143–BC145)?***

***Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?***

- (b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?***

- (c) *Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?*
- (d) *Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?*

As a general principle, we think that the primary financial statements should be presented in the way which provides a good balance between relevance and clarity, while facilitating communication with users and comparability between entities. This is not easy to achieve or to lay down rules for. We note that there is a trend within IFRS and US GAAP towards increasing volumes of detail to be presented on the face of the primary financial statements. We think that this is counter-productive as it leads to a cluttering-up of the primary statements with items which are not necessary for the “first look” at the financial reports that these statements provide. We believe that the individual entity is best placed to make the judgement about how to achieve the best compromise in the balance between presentation and disclosure in the notes in the light of materiality and its knowledge of the sector it operates in.

- a) In respect of lease liabilities: we think that it is helpful to make a distinction between liabilities which are of the nature of the financing of an asset (as described in our response to Question 1), and those that are related to the purchase of a service. To reflect this, the former should be presented within finance debt and the latter within trade and other payables.
- a) In respect of right-of-use assets: while we think that a number of different presentations could be justified, on balance we think that the most useful is to present these as if they were of the same nature as the underlying asset and the similar assets owned by the lessee. As discussed above, the presentation of the right-of-use asset in a separate line in the balance sheet should be left to the judgement of the entity.
- b) As stated above, we do not support the performance obligation approach to the accounting for leases by lessors. This proposed presentation illustrates one of the disadvantages of the performance obligation approach, that is, the unhelpful “grossing-up” of assets and liabilities which it leads to.
- c) and d) As stated above, we think that these the decision to separate leased assets from owned assets on the face of the balance sheet should be left to the judgement of the entity.

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

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

In line with our response to Question 12, we think that this is a matter for management's judgement to resolve. We therefore agree with paragraph 26 (which allows for judgement) and disagree with paragraphs 44 and 62 (which require separate presentation).

The requirement of paragraph 61 to align the presentation with the business model appears reasonable to us.

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

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

As stated above in our response to Question 12, we believe that a distinction should be made between liabilities which are of the nature of the financing of an asset (as described in our response to Question 1), and those that are related to the purchase of a service. This distinction should be the consistent between the statement of cash-flows and the statement of financial position.

Concerning the level of information provided either in the notes or in the primary financial statements, please also refer to our preliminary comments in response to Question 12;

Finally, we think that IAS 7 is the most relevant standard to deal with the requirements for cash flow information. Spreading out such requirements over different standards, as is being done here, creates an increased risk of inconsistency and makes the principles harder to understand and compliance more difficult to achieve.

## **DISCLOSURE**

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### **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?*

While we agree with the objectives and principles laid out in paragraphs 70 to 72, we have however serious concerns that the volume of disclosures suggested in paragraphs 73 to 86 may not be always appropriate. Judgment should be required to be applied in determining the level of information to be provided.

The requirements would need to be adjusted if the Board were to adopt our (and Mr. Cooper's) suggestions about lease terms and contingent payments.

## **TRANSITION**

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### **Question 16**

*(a) The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186– BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?*

*(b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?*

*(c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?*

We are in favour of the simplified retrospective approach that the ED proposes. We think that further consideration or guidance is required for

- The treatment of sales and leaseback transactions occurring prior to the date of initial application and during the transition.
- The measurement at the date of application of leases treated as finance leases under IAS 17 with bargain purchase options.

## **BENEFITS AND COSTS**

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### **Question 17**

*Paragraphs BC200–BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?*

We do not share the conclusion reached in paragraphs BC203 and BC204, as we believe that practical difficulties have been minimized, while benefits for users still remain uncertain.

In one hand, current proposals will certainly need strong accounting system and reporting process developments in order to collect and restate all the information required to comply with the forthcoming standard. They will also have strong impact on ratios and debts covenants which may affect in certain circumstances, capital requirements and cost.



Moreover, we do not agree with the Board when it states that a new lease model would not change the way a business will operate (paragraph BC203 c)).

In the other hand, we are not convinced that all the proposals will improve financial reporting, as we do not think the Board has analysed appropriately what information would truly be of benefit to users, and where this information is best placed in the financial statements, we are not sure that users would no longer need to make adjustments. Additionally, we do not agree when the Board states that the proposals will increase comparability as we do not see as an improvement to force comparability for different economic substances (see our comments on renewal options for example). Accounting for in-substance purchases in the same fashion as operating leases would not increase consistency in financial reporting. It would bring uniformity where differences in substance exist and should be highlighted to users. The flexibility bought by entities in operating leases has a cost, and both the flexibility and the cost should be easy to understand. Proposals by the Board would deprive users of a lot of information they enjoy today.

For all reasons above, we believe that the IASB should expand its outreach activities and do further work to validate its assertion that the benefits of the proposals outweigh the costs.

## OTHER COMMENTS

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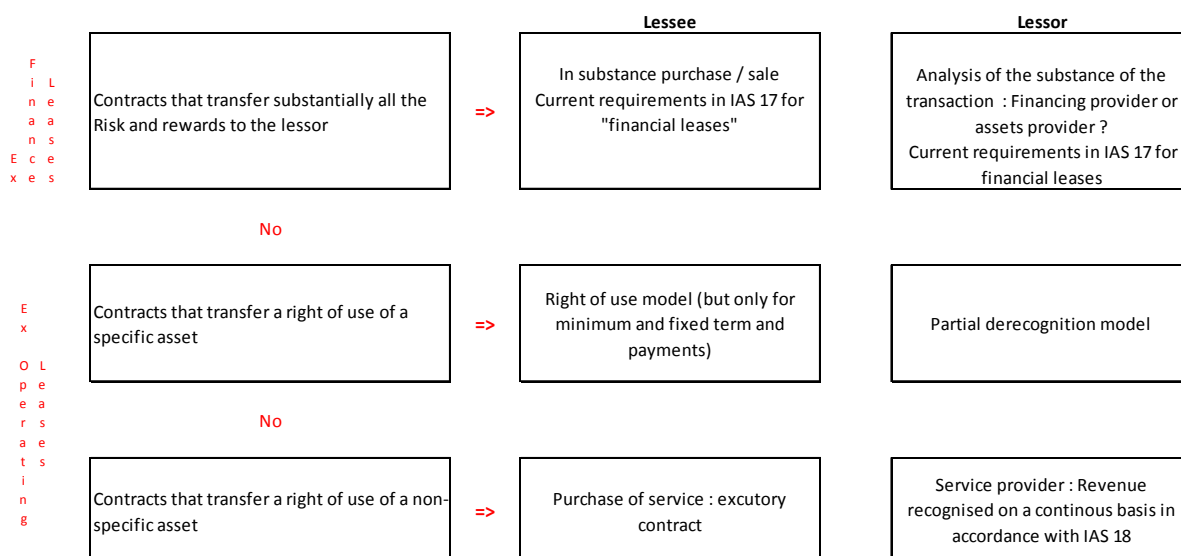
### Question 18

#### *Do you have any other comments on the proposals?*

We have no further comments on the proposals in the ED, but we attach below a summary of our proposals for a different model for lease accounting and an extract from our comments on the earlier Discussion Paper on Leases.

## Appendix 2 to our letter on IASB ED “Leases”: summary of our proposals for a new model

The chart below summarises the models that we propose for the three different families of lease contracts that we recognise- “finance leases” (in-substance purchase), leases of a specific asset (right-of-use asset) and leases of non-specific assets (service contract).



### *In-substance purchase / sale*

While we fully agree with the Board that “in-substance purchases and sales” should be distinguished from lease contracts, we do not share its view about the criteria to be used to make such a distinction. Actually, we believe that the current criteria based on risk and rewards are still relevant and helpful to provide useful information to users. Furthermore, we note that it is not the current criteria themselves which are at the origin of the criticisms that some have levelled at IAS 17, but rather the accounting for “operating leases”. If some of the current “operating leases” give rise to the recognition of an asset and a liability, such criticisms will no longer be sustainable.

Finally, we do not agree to simply scope out these in-substance purchase and sales contracts because entities will not find in other standards (such as IAS 16 or IAS 18) all the guidance necessary needed to account correctly for such specific transactions. For this reason we propose the retention of the current requirements for “finance leases” that in our view have never been the target of criticisms either from the point of view of lessors’ or lessees’ accounting.

For example, we find the current distinction between manufacturers and dealer lessors from other lessors, very useful as it depicts very faithfully the economic difference between different transactions: one is providing only financing, whatever the underlying asset, while the other is selling a good.

### Contracts that are not in-substance purchases / sales (ex operating leases)

This category encompasses all contracts where substantially all the risks and rewards incidental to ownership are not transferred to the lessee. Nonetheless, within this category, an additional sub-division is needed in order to reflect faithfully all the different economic transactions:

- Contracts that transfer the right of use of a specific asset and thus some competitive advantage.

If the contract is in substance a lease (that is, it conveys the right to use a specific asset) then we think it is logical for the treatment of the transactions to be symmetrical in the books of the lessee and the lessor. In our view, the transactions should be depicted as follows:

- The lessee should recognise a right-of-use asset ; the lessor should derecognise this right of use transferred and maintain only a residual asset corresponding to the risk and benefit retained.
- The lessee/lessor should recognise a liability/receivable relating only to the firm and unconditional part of the contract.

The lessor should recognise the receivable for rental payments on the same basis as that on which the lessee recognises the liability for payment, that is, the net present value of the unconditional lease payments. This valuation should not take into account expected renewals of lease terms or conditional rental payments. In this way the accounting will reflect fully the uncertainty and operational risks to which the lessor is exposed under the terms of the contract.

The corresponding credit in the lessor's books is allocated between the underlying asset and unearned rental income to the extent that this exceeds the future interest income to be recognised from the passage of time. The initially unearned rental income is recognised in income on a rational basis over the life of the lease contract.

- Contracts that provide the right of use of a non- specific asset and thus only flexibility and not financing.

These contracts are primarily intended to obtain a service where the underlying asset is just an element of the supplier's process in providing a service. In such contracts, the lessee is mainly interested in receiving a service and is indifferent to the asset used. The criterion used to identify these could be on the basis of the predominant element in the contract. We think these contracts should be accounted for like all other service contracts, i.e. as an executory contract for both lessees and lessors.

The main difference between the two sub-categories indicated above lies in whether the fulfilment of the contract depends on providing a specific asset. In this context, we believe that the guidance proposed in paragraph B2 & B3 should be completely redrafted as it is very confusing. Thus it should be made clearer that the key features are the exchangeability or fungibility of the asset. While these two criteria are relevant for both lessors and lessees, we believe however than an additional important criteria for lessees is the nature of the competitive advantage obtained from the use of this asset

While we are quite sure that assets such as photocopiers or car fleets will usually not be considered as specific, we are less certain about how the proposed guidance will be interpreted in the case of other more complex assets. As an illustration of this point consider the following examples:

- A lease of an administrative building compared with the lease of a store on the Champs Elysées: while both of these buildings are substitutable with difficulty, only the latter provides a competitive advantage to the lessee and should be qualified as a specific asset for the purpose of the lessee's accounting.
- A plant that is built on the customer's site to provide him with a service or a supply of goods (for example, electricity, water ...) because other plants which are able to supply other customers in common are located too far away to be economical. Even if the plant could not be replaced by another, the customer is interested only in the good or service provided. Such a plant is an unavoidable necessity rather than an asset the customer wants to acquire, and, in our view, it should be considered only as a vehicle for providing a service.

## **Appendix 3 to our letter on IASB ED “Leases”: Extract from our comment letter on the IASB Discussion Paper published in 2009.**

### *What is the rationale behind IAS 17?*

IAS 17 is a direct application of the substance over form principle. Some lease arrangements being akin to financing arrangements for the purchase of an asset have to be accounted for in accordance with the substance of the purchase of an asset on one hand, the borrowing on the other. Lessors in those circumstances are providers of capital.

We agree with the Board that all lease arrangements that are in-substance purchase arrangements should give rise to recognition of the underlying asset and of a liability. Therefore if and when structuring opportunities are identified, we agree that accounting requirements should be improved to avoid misrepresenting the substance of the arrangements. We believe that difficulties – such as the reference to bright lines – are not inherent to IAS 17 per se, rather to the application of US guidance in an IFRS context, potentially in opposition with the IAS 17 more principle-based approach.

### *Arrangements that are different in substance should be accounted for differently.*

One of the major flaws in the analysis by the Board is to assert that the existing intended distinction between finance and operating leases does not reflect any difference in economic substance. Operating leases are not financing arrangements. Lessees are not purchasing the underlying assets, they are renting them, i.e. they are buying flexibility and the service of being provided with the asset they need, for the period that best serves their needs. Lessors in those circumstances are providers of services.

In addition we believe that “in-substance purchase agreements” transfer control of *the underlying asset* to lessees (lessees have access to all economic benefits embodied in the asset, the rights lessors retain serve as guarantee for money lent to lessees – no more), whereas lessors in operating leases do not transfer control of the underlying asset. We would have expected the Board to analyse and acknowledge such a difference as a difference in economic substance.

Accounting for in-substance purchases in the same fashion as operating leases would not increase consistency in financial reporting. It would bring uniformity where differences in substance exist and should be highlighted to users. The flexibility bought by entities in operating leases has a cost, and both the flexibility and the cost should be easy to understand. Proposals by the Board would deprive users from a lot of information they enjoy today. We therefore believe that the future standard should ensure that financial reporting best conveys the economic characteristics of in-substance purchases on one hand, and operating leases on the other. We note that the IASB has identified in the conceptual framework project that financial reporting should help users assess the financial flexibility of the entity.

***The objective the Board is pursuing is not really defined***

Indeed, the analysis in chapter 1 concludes that some assets and liabilities are missing. However the Board does not define the objective it is pursuing. What are users looking for? What is the information that users believe is missing? Is it information about assets? Is it information about liabilities beyond the disclosure requirements under IAS 17? Before making any amendment to existing standards, identifying what information users are really after would certainly be most helpful.

As a result we find the discussion paper very confusing and some of the issues raised difficult to assess. For example, whether a distinction between core and non-core assets is useful very much depends on the purpose that reporting leased assets should convey. The relevant method among the right of use method, the whole asset approach and the executory contract method approach very much depends on such an analysis. Whether the interaction between, for example, a strategy to outsource manufacturing activities and the financial position of the entity should be fully reflected in the primary financial statements or eliminated would be worth exploring.

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