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

afep

Mouvement des Entreprises de France MEDEF

IASB

30 Cannon Street

London EC4M 6XH

UK

Paris, 19 September, 2013

Exposure Draft ED/2013/6 Leases

Dear Chairman Hoogervorst,

We welcome the opportunity to comment on the IASB's second exposure draft dealing with "*Leases*" (the ED2).

Although we acknowledge that the Boards have tried to respond to the criticism of the earlier exposure draft on leases, we still have significant concerns with the proposals of the project as it currently stands, since in our view it fails to achieve an acceptable cost/ benefit balance, mainly because of its complexity, lack of robust principles and the poor incremental value it offers for external users.

Indeed, we believe that:

- Convincing evidence that the proposals will lead to improved financial information has not been provided, while the costs of providing such information are, in our view, likely to exceed the benefits that may be obtained from the proposals. Applying this proposed standard will dramatically change the way entities will have to account for all operating leases without the certainty of providing any information of added value to the reader. At the same time we see no corresponding relief from the volume of disclosure. The inference we draw is that the proposed accounting model is still unsatisfactory in its informational content.

- The objectives of the lease accounting project are not clearly defined and the project does not address all the shortcomings that the IASB identified in the current standard and which were used to justify the comprehensive revision of the standard. Indeed, it seems that its complexity, the large recourse to estimation and to judgement, and the lack of robust principles may strengthen the current perceived shortcomings instead of remediating them.

- The proposals do not yet adequately reflect the differences in economic substance of different contracts.

The reasoning behind the conclusions above is given in Appendix 1.

Consequently, we share many of EFRAG's preliminary conclusions on this project, especially, that "without a proper debate on the underlying concepts and the related transactions, the right-of-use model will not be understandable for constituents and will add to the feeling that this proposed IFRS is unduly complex" and thus we are in favour of the plan of actions proposed by EFRAG, namely:

- To work first to improve disclosure on lease arrangements to ensure that users have access to the information they need.

- To take advantage of the discussion on the conceptual framework to refine all the fundamental principles which are a pre-requisite for the development of an appropriate approach to leases contracts: the definition of the right-of-use asset, the distinction between this right and the other rights which are bundled in the asset, the investigation of whether the consumption of economic benefits of the underlying asset has a role to play, the refinement of the guidance to identify what activities convey the ability to direct the use of an asset and how this links with the business models of lessors (providing finance or managing assets), the definition of the performance and which cash-flows should be represented in net income, the role of prudence, a comparative analysis between the concept of transfer of risk and rewards compared to the transfer of control and so on.

- Finally, in the light of this work, question again the most appropriate accounting model for lease contracts, and if still proved necessary, work on a revision of the standard with the benefit of clarified objectives and a carefully identified lease population and the results of the current consultation.

This approach to conducting the project may also avoid creating the following concerns:

- That further time would be spent without the certainty of reaching a standard that would provide an appropriately balanced cost / benefit ratio;

- That some countries currently considering the adoption of IFRS might retract, due to their disagreement with the project (see the letter addressed by Keidanren to the IASB in 2013 which expresses, in every major respect, the same concerns that we have consistently expressed); and

- That companies would be forced to adopt a complex standard which does not allow them to reflect their business model, thus leading to an expansion of the use of non-GAAP indicators.

Finally, we are aware that the FASB's main investor advisory panel will formally object to the lease proposals and that the FASB itself is divided on the merits of the project. If this project which was intended to be a joint project, has to be abandoned by the United States, then in our view it would be fully justified for the IASB to do the same.

Appendix 1 provides our assessment of whether the project achieves its initial objectives. Appendix 2 provides our responses to the questions posed in the ED2.

Please do not hesitate to contact us if you have any further questions upon this response.

Yours faithfully,

ACTEO	AFEP	MEDEF
Patrice MARTEAU Chairman	François SOULMAGNON Director General	Agnès LEPINAY Director of economic and financial affairs

Appendix 1: Did we achieve the objectives initially set? (Based on the objectives as set in the Discussion paper issued in 2009)

"Many users think that operating leases give rise to assets and liabilities that should be recognised in the financial statements of lessees. Consequently, users routinely adjust the recognised amounts in an attempt to recognise those assets and liabilities and reflect the effect of lease contracts in profit or loss. However, the information available to users in the notes to the financial statements is insufficient for them to make reliable adjustments to the recognised amounts"

From our exchanges with French "users", we understand that:

- The needs of analysts differ depending on whether they are credit or equity analysts:

  - Credit analysts are interested in an entity's firm commitments for future payments. In this context, we can understand that they may be interested in the level of debt corresponding to the discounted firm future cash flows. However, these analysts are also interested in the related financing cost and will probably, in our view, restate financial statements in order to reintegrate the financial charges relating to Type-B contracts.

  - Equity analysts on the other hand will focus more on the value of the asset on which projections of future performance are based, in order to ensure consistency between income generation and capital employed. In this context, we think that the carrying value of the right of use as proposed by the IASB is insufficient for certain analysts, as they would find information about the fair value of the underlying asset more useful.

- For both categories of users, additional information concerning the options to extend or cancel the lease term or to purchase the asset are necessary to help them understand the flexibility provided to the entity by the lease arrangement, whether it be the flexibility to reduce the financial commitment or the flexibility in the renewal of the lease or the purchase of the asset. Such information allows the user to model different scenarios of future capital employed. We think that it is preferable to provide full and objective information about these options in the notes rather than to integrate these into balances in the financial statements, as the latter would be less transparent and require the exercise of a great deal of judgment.

  Users will always restate financial statements according to their own specific requirements. This means that they will also have to incur costs to modify their existing formulas, and to understand all the new impacts of the new standard on the financial statements. It is also for this reason that we believe that the provision of comprehensive and relevant information in the notes will be more transparent, more useful and less costly, than the establishment of balances in the financial statements.

“The existence of two very different accounting models for leases (the finance lease model and the operating lease model) means that similar transactions can be accounted for very differently. This reduces comparability for users”

We have always contested this idea that all leases are economically similar. We do not agree with the Board’s statement that the proposals will improve financial information as we do not see it as an improvement to force uniformity of treatment for different economic substances. The Board itself has recognised the validity of the distinction between different lease types since it has recently reintroduced two models for the recognition of contracts for lessors, partially based on the current distinguishing criteria as stated in IAS 17. However, it has not followed through the same reasoning to arrive at a model for lessees which mirrors the lessor model.

We also believe that the proposals will not improve comparability because they will lead to the existence of even more varied accounting models than before: services, short-term lease contracts and two different accounting models for other lease contracts.

“The existing standards provide opportunities to structure transactions so as to achieve a particular lease classification”

In our view, it is not an acceptable objective for a project on leases to redraft significantly a well-known and understood standard just in order to prevent some perceived “balance-sheet management”:

• The vast majority of entities manage their lease contracts not for accounting purposes but in order to optimise their resources;

• If the Board believes that some contracts were not appropriately accounted for under the previous standard, it would have been easier to deal specifically with those contracts, without imposing some very onerous and expensive work on all preparers. Indeed, in order to “discipline” a few companies, the Board will penalise the whole community of preparers, who will not be able to reflect in their financial statements the specific circumstances and use of their lease contracts.

Finally, whereas clear principles were developed under IAS 17 (transfer of substantially all the risks and rewards) which could be applied consistently to all contracts and to all parties (lessee / lessor), the new project as currently drafted appears to be more an aggregate of rules that may well be easier to skirt around (if it were an entity’s intention to do so).

Furthermore, in our view, the objective of accounting standards is to provide useful financial information and not anti-abuse provisions. We think it is the role of the market to sanction appropriately any perceived abuse of leases, not that of the standard-setter.

"Preparers and auditors have criticised the existing model for its complexity. In particular, it has proved difficult to define the dividing line between finance leases and operating leases in a principled way. Consequently, the standards use a mixture of subjective judgements and 'bright-line' tests that can be difficult to apply."

In our opinion, the current project does not remove these perceived shortcomings and we consider that it will even accentuate them:

• Even more numerous "Accounting bright lines" are introduced:

- Lease contracts (or component) versus service contracts (or component)
- Short-term lease contracts versus other lease contracts
- Model A versus model B for lessees (with two different patterns for P&L recognition)
- Model A versus model B for lessors (with the latter akin to the current model for "operating leases").

• Complexity of implementation and the need for the use of judgment are maintained or even increased:

- Qualification of a lease with many calls for the use of judgment at each stage of the assessment :
  - The notion of the substantive right of the lessor to substitute an asset with its related assessment of the potential barriers which may prevent the lessor from exercising its right;
  - The ability of the lessee to direct the use of the asset, and especially the assessment of any protective rights (as described in paragraph 16) that should be carried out by analysing all relevant facts and circumstances, not only the contractual elements; and
  - The ability of the lessee to derive the benefits from use along with the notion of assets incidental to the services and the potential existence of assets / services provided by other suppliers, which can be used with the asset leased.

- The identification of separate components of contracts with the notion of assets dependent on, or highly interrelated with, other underlying assets in a contract.

- The determination of the lease term by assessing whether the lessee has a significant economic incentive to exercise renewal or termination options.

- The classification of leases: even though the criteria are based on those used in IAS 17, the thresholds are different and the need to reassess all contracts using a new notion of "insignificant part" or "insignificant relative to" may lead to difficulties and divergences in implementation.

- Applying the model for Type-A contracts to lessors is likely to be highly complex with many calls for judgement, especially in determining the value of the "residual assets", based on very long-term projections of business and market environments. Accounting for variable lease receipts as part of the carrying value of residual assets may also be complex to implement.

- Applying the two lessee models will also be complex, as it will require the entity to recognise liabilities accounted for under the effective interest method for all qualifying contracts. It will also require the development of a new accounting model for "amortising" the right of use for Type-B contracts which has no clear conceptual or economic basis.

- Another source of complexity will arise from the requirement for the reassessment of the lease liability of lessees/ lease receivable of lessors at the end of each reporting period when the lease payments include variable lease payments that depend on an index or a rate.

Moreover, on the assumption that these issues can be relatively well managed at the level of a single contract, it is important to note that the main difficulty for the entity will be to find a methodology and develop IT systems to allow it to perform all of these analyses and calls for judgment in the most efficient way in order to process a large amount of contracts. Even if some information has already been collected for disclosure under current IAS 17, it will be another matter to integrate all of this in accounting systems which work in a standard way with little room for judgement from operational staff.

Finally, we expect that, as far as banks are concerned, this new accounting model for the lessee side will lead to additional and counter-productive regulatory capital costs.

Appendix 2: Answers to the specific invitation to comment

Please note that the following reply and comments are provided to assist the Boards in their deliberations and do not represent endorsement of the project as a whole, as discussed above.

Scope

Question 1: identifying a lease

Do you agree with the definition of a lease and the proposed requirements in paragraphs 6–19 for how an entity would determine whether a contract contains a lease? Why or why not?

If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease, is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

While we appreciate the Board's efforts in refining the definition of contracts that will be within the scope of the new accounting models, we still have many concerns:

As stated above, application of the proposed criteria will require significant judgment to conclude whether the contact's underlying nature is that of a lease or a service. This application will be even more challenging as contracts which qualify as leases will henceforth have a systematic impact on entities' balance sheets.

1. The main difficulties we expect will be the assessment of whether the lessor has a substantive right to substitute the underlying assets (contractual terms not being sufficient) and the determination of whether the lessee has the ability to use this asset and the ability to derive benefits from its use.

   Concerning the notion of substantive rights, we understand that the Board wished to align the assessment criteria with the new IFRS 10 provisions about controlled entities. However, these concepts, which are already not easy to implement in the context of strategic decisions which occur relatively infrequently and are often monitored by experts, are even more difficult to apply when used to address a multitude of contracts managed by many entities throughout a group. It will indeed be very difficult for lessees to assess whether or not there are any barriers that would prevent the substitution of an asset from the perspective of lessors. To make such a judgement requires the lessee to know the operational and financial constraints of the supplier and its trade-offs in connection with the lessor's own business model. We expect endless discussions both internally and with the auditors to determine what levels of substitution costs may be deemed critical by the lessor.

   Moreover, the standard should also specify that a requirement for the lessee's consent may also be viewed as only a protective right (protecting access for security reasons) and should not prevent the conclusion that the lessor has a substantive substitution right. The discussion in paragraph BC105(b) could be helpful here.

We also have concern about the “ability to derive benefits from use” criteria that could also be difficult to implement and will require many instances of difficult application of judgement.
Example 3 in “Illustrative Examples” on leases is somewhat simplistic and may be difficult to apply in practice in a real-life example: Medical equipment may work properly or can be covered by a guarantee only if Supply consumables (that is, consumables supplied exclusively by the supplier under the terms of the contract) are used. There could be issues related to responsibility for the monitoring of the patient if consumables are bought from other suppliers. Some “consumables”, such as oxygen or other medical gases are considered to be a medicine in some jurisdictions, thus the equipment could be deemed to be a “container” of a medicine, even if the substances are available from other suppliers. Although the customer can in theory derive the benefits of the equipment without the Supply consumable, it would neither be in the customer’s interest to do so (for the legal reasons suggested above, for example) and nor would such an interpretation represent the nature of the commercial activity carried out by the supplier, whose only purpose is to supply the consumables but needs the equipment to do this. It seems to us that to consider scenarios not contemplated, or even expressly excluded, by the contractual clauses in some cases will not reflect the economic substance of the contract, and will make the analysis even more complex.

2. Still on the definition of a lease, we note that the Board has introduced the term « consideration » instead of “payments” used in IAS 17 and we wonder if it might it extend the scope of the forthcoming standard. For example, consider a contract in which the lessor gives to the lessee the right to control an asset in exchange for the right to control another non-financial asset owned by the lessee. We wonder if such transaction is a lease contract and if so, we believe that the Board should perform further analysis to ensure whether the model proposed by the exposure draft is appropriate for such a contract.

3. Concerning “take-or-pay” contracts, it is not clear whether they are in the scope or not, depending on the interpretation of paragraphs 14 and 15, and whether primary outputs are considered or not. We therefore believe that the Board should perform further analysis to assess whether appropriate accounting treatment is obtained in common cases. Although some criteria were not always easy to implement, the dual analysis between "IFRIC 4" and "IAS 17" allowed one to arrive at an appropriate accounting treatment in most cases: assets provided for supporting a service were not recognised in the lessee’s financial statements (because they were qualified as an operating lease), while assets for which the entity assumed the risks and rewards were for their part recognised. Indeed, because the companies commonly apply a "risk / benefit" approach when negotiating their contracts, the combined criteria of previous texts, also based on the same principles, led to consistent approaches. Migrating to a principle of transfer of control from one of risks and rewards, may distance the accounting from the business models of companies. This is one of the fundamental aspects of the proposals which should be worked through in the light of the conceptual framework before being transposed into individual standards. At the very least, we question whether there is a real benefit for users where standards lead to the recognition of some assets leased for reasons of "flexibility" whereas other, strategic assets will disappear from the balance sheet (such as some take-or-pay contracts under the lease proposals, or joint ventures under IFRS 11).

4. We also note that the IASB has finally decided not to scope out intangible assets for lessees completely and we welcome this decision. We wonder, however, whether all such contracts can really be designated as leases. We also wonder how the Board will achieve consistency between the accounting for such assets by the lessee and the treatment by the lessor based on the forthcoming standard for “Revenue recognition”. Indeed, some of the criteria of ED2 seem difficult to apply to leases of intangible assets (i.e. assets without physical substance), especially the prohibiting of designating a non-physically distinct portion of an asset as an identified asset. As far as consistency with the “Revenue” standard is concerned, we think that:

   - Although the lessor may conclude that its revenue may be recognised over time (because the contract represents a promise to provide access to its intellectual property, rather than a promise to transfer a right), the lessee may not succeed in qualifying this agreement as a lease contract because it relies only on a non-physical portion of the whole lessor’s intellectual property, and because there is no initial transfer of a right that may justify recognising an asset and a corresponding liability at contract inception.

   - If the lessor concludes that there is a transfer of a right which allows it to recognise revenue at the commencement, it will mean that the lessee could consider that it has obtained a right to use an asset and that the contract may then qualify as a lease. The difficulty will then reside in the classification of the contract between the A and B types of lease.

   We would therefore recommend that the Board re-work this issue in order to ensure that it is clear that lessees will be able to account for intangible asset leases in the future.

5. We also have concerns about the proposals for separating components of a contract. Actually, although the principle of allocating the whole price between components is well understood, we expect many implementation difficulties, especially for current “operating leases” for which such analysis is not required. Moreover, in the absence of observable prices, we do not believe that the best solution, which provides the most useful information, is to recognise the whole contract as a single lease component, but is rather to account for the contract on the basis of the model applicable to the predominant item. Furthermore, if no observable prices are available for any of the components, it may suggest that all components are highly interrelated and the contract is therefore unlikely to contain a lease component (because non-lease or service components are not distinct, as suggested by BC 116(c)). We believe that lease and non-lease components should always be accounted for separately, and if necessary management judgment should be used to separate these components.

To conclude, this new articulation of the elements defining the lease may require a great deal of judgment and endless discussions with auditors and regulators. Moreover, the strong emphasis that is now based on this definition may create new "accounting bright lines", thus negating one of the primary objectives sought by the IASB. The distinction between operating leases and finance leases will be replaced by a distinction between leases model A, leases model B and services.

Finally, we think that that the forthcoming standard should not apply to freight contracts held by commodity and freight broker-traders who manage such contracts along with derivatives. These contracts should, in our view, benefit from similar exemption to that which exists in IAS 2 for commodities inventories, thereby accounting for them at fair value (through net income), as are the hedging derivatives subscribed on these contracts. If the Board agrees, it would be helpful for this be made explicit in the scope paragraphs.

The accounting model

Question 2: lessee accounting

Do you agree that the recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

While we agree that different accounting treatments and presentations should be available to depict appropriately the differences in economic nature between different lease contracts, we nonetheless have many concerns with the proposals of ED2.

1. Distinguishing criteria

If the board were to maintain the approach of recognising an asset and a liability for all lease contracts, we would be in favour of maintaining the criteria currently used under IAS 17 to distinguish operating leases from finance leases. Indeed, because the distinction between the two types of lease will have no significant impact on the balance sheet, it would be easier to retain the criteria that companies have been used to applying for a long time and whose rationale is well understood by both preparers and external users. This would avoid entities having to reconsider all their contracts in the light of potentially confusing new criteria, since these are partly based on the existing notions of IAS 17 but applied with different thresholds and purpose.

Moreover, we believe that a distinction based on a notion of the transfer of risk and rewards is much more relevant and conceptually robust than the proposed distinction, which appears to be based mainly on the nature of the underlying assets.

Consideration of the nature of the underlying assets may be more useful in determining whether the contract is a lease or service arrangement, rather than in determining the accounting model. Indeed, when property is provided under a contract, there could be an explicit (rebuttable) presumption that the contract is a lease contract as the supplier can typically not substitute other assets without the consent of the customer.

We also believe that is not relevant, in the case of properties, to determine the accounting model based on the remaining economic life. Such criteria will lead to classifying differently two identical contracts depending on whether they are contracted for at the beginning or the end of the property's life, even though they transfer identical rights and obligations to the lessee. We therefore propose that the lease term should be compared to the whole economic life of the underlying assets, for all assets, whatever their nature.

Finally, we do not think that the threshold for leases of other than property to pass from the Type-A to Type-B model is set at an appropriate level: the threshold of an "insignificant" part of the economic life or relative to the fair value of the underlying asset effectively excludes all realistic possibility of the criteria being met. The common interpretation of the word "insignificant" is that it means "trivial" or "without importance". In other words, it depicts a very low degree of importance and is certainly at a level much lower than "not significant". Furthermore, the whole body of stakeholders will certainly spend a lot of time trying to reach a common interpretation of the notion of "insignificant" and this will doubtlessly lead to the creation of new quantified bright lines.

2. "Single lease expense" model

We really appreciate the Board's attempt to propose dual accounting models for lease contracts. Indeed, we are fully convinced that contracts qualifying as lease contracts do not all share the same characteristics, objectives and economic substance and should not therefore be accounted for in the same way. Accounting for all contracts in the same fashion would not increase consistency in financial reporting; it would instead bring uniformity where differences in substance exist and should be highlighted for users.

However, we do not believe that the single lease expense model has a strong conceptual basis or will improve financial information:

- The recognition of a financial liability without its corresponding financial expense will not help users obtain a good understanding of the financial statements as a whole. Instead, it is highly likely that they will continue to restate financial reporting in order to maintain consistency between balance sheet and income statement data.

- The carrying amount of the right-of-use asset will be very difficult to explain, either internally within the entity or to external users, and entities will need to develop new accounting schemes in their reporting systems in order to achieve the accounting entries.

- The amortisation of the right of use, corresponding to the net change in the value of the debt, is not conceptually consistent with the concept of amortisation of non-financial assets in IFRS. Indeed, if the right of use, as a non-financial asset with a finite useful life (the lease term as a minimum) should be amortised, we do not think that the proposed model reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity (see IAS 38.97). Moreover, we wonder if this "balancing" amortisation method, which does not reflect the economics of the lease contract, could create some issues regarding the impairment of the carrying amount of the right-of-use asset according to IAS 36.

- While we support the Board's proposal regarding the lessor accounting model for Type-B contracts, the lack of symmetry between lessee and lessor accounting models will also add to complexity and will surely impair the quality of financial information. This asymmetry also raises the question of the merits of applying a "right-of-use" method for Type-B contracts in the lessee's financial statements. Since the Board has considered that such a model is not relevant for Type-B contracts in the lessor's books, we wonder why it should be more relevant and appropriate for lessees. This decision suggests that the Board's main or only objective is to prevent what it considers being abusive accounting by lessees, whereas IFRS should be principle-based and not driven by anti-abuse rules.

We also wonder how one will justify having an asset accounted for twice in different financial statements (as an asset owned in the lessors' books for Type-B leases and as a right of use in the lessee's books. As said above, IFRS has resulted in the deletion of billions dollars-worth of assets through IFRS 11 in forbidding the recognition of assets / liabilities in joint-venture which are therefore recognized nowhere as such (and recognised only in a net position through the net share in equity affiliates) and now individual assets will be accounted for twice. We are not convinced that this provides a better depiction of the economic substance of all these transactions.

For all the reasons above, we would be in favour of having an accounting model for lessee's Type-B contracts modelled on the one retained for lessors.

Finally, we would like more details on the treatment of the right of use, particularly for model A. Today there is a cross-reference between IAS 17 and IAS 16, which leads to the treatment of assets recognised through finance leases in accordance with the provisions of IAS 16 as if they were in substance own purchases financed by debt. Thus it is in this case possible (required) to adopt a component-based approach (e.g. for replacements). As the new standard would exclude "in-substance purchases" and focus only on the right of use, we wonder whether a component approach is still permitted.

Question 3: lessor accounting

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

For distinguishing criteria see our answer to the previous question.

As far as the accounting models proposed are concerned, we would firstly state that we are pleased that the Board has maintained a dual approach, permitting preparers to distinguish between instances of different economic substance. We also support the accounting model for Type B, as it helps to provide an appropriate accounting treatment which depicts well the nature of the transactions, and also remains pragmatic and easy to implement.

Concerning the approach proposed for Type-A leases, overall, we believe that the proposals do not pass the cost / benefit test:

- Current accounting models for lessors have never been criticised, and have never, far as we know, given rise to adjustments of financial statements.

- One valid reason to change these well understood models would have been to create symmetry between lessor and lessee accounting. However, the proposals are not symmetric in various areas, in particular in respect of the two models model for Type-B contracts but also in the treatment of variable payments.

- The proposals for “Type-A “contracts are very difficult to implement, requiring a lot of judgement, and the use of long-term assumptions, especially for long-lived assets leased many times during their economic life. The model proposed does not result in a depiction as useful as that of IAS 17 of the difference in substance between a financing lessor and a manufacturer / lessor, since the recognition of day one profit is relevant only for this latter category. Moreover, for the financing (non-manufacturing) lessor who enters into successive lease contracts for the same underlying asset, we believe that it is not relevant or prudent to recognise a day-one profit which depends on assumptions regarding cash flows expected after the end of the lease term (the rate implicit in the lease is used to calculate the present value of the lease payments and therefore the day-one profit depends on the amount the lessor expects to derive from the underlying asset following the end of the lease term).

- We would also like to highlight an issue concerning the estimation of the value of the residual asset. Beyond the difficulties in implementation that we expect as a result of the need for judgement on conditions over what could sometimes be a very long period, such a “proxy fair value” may raise an issue when the lessor reclassifies the asset at the end of the lease period into an asset category where other assets will be measured at amortised cost. This value also raises the issue of whether there is consistency between the long-term assumptions the entity will have to use to determine it and the prudence principle which is implicit in IAS 36 for projecting cash flows. Lastly, we wonder if the estimation of the residual value may entail some impairment issues as the assumptions used to measure the residual value differ from the ones to be used according to IAS 36 (for example, the discount rates used or the period covered by cash flows projections).

Question 4: classification of leases

Do you agree that the principle on the lessee’s expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 28–34, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

See our response to question 2.

Measurement

Question 5: lease term

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

We are not convinced that a renewal option is a debt. In our view, it represents an element of flexibility which often influences the economic choice between leasing and purchasing an asset. Furthermore, a 10-year firm commitment is economically different than a 5-year firm commitment associated with a renewal option for 5 years; these two contracts should not be accounted for identically.

We therefore do not agree that an option should lead to recognise a liability for the lessee, especially since it does not seem consistent with the principles of IAS 37 which prohibits the recognition of a liability when the entity has an alternative to settle its “obligation”.

Furthermore, the integration of renewal options in the value of the right of use does not help users arrive at an accurate picture of the underlying asset’s value:

- Take the example of a lease of a building for a non-cancellable period of 5 years, renewable for up to a maximum period of 10 years: even if the right of use is evaluated on a 10-year basis, it would in most cases not reflect the value of the underlying asset.
- In the case of an implicit and indeterminate renewal option, what will be the lease term that the entity should use? Should the right-of-use value be capped at the fair value of the underlying asset (as it is specified in § 20 of IAS 17)?

If the Board should nevertheless confirm its decision to recognise a liability for certain options, we would suggest keeping the current approach of IAS 17 in respect of the lease term, which are, on the one hand, already well understood and secondly, would enable entities to avoid the reassessment of all contracts in the light of new criteria.

Finally, we believe that the notion of ”Lease term" when used for qualifying short-term contracts should be the same as that used for the evaluation of the right-of-use asset / debt (i.e. options should not be taken into account automatically). In fact, such differential treatment could lead to the recognition of assets that will actually be used ultimately for less than one year, only because a renewal clause is stipulated in the contract, whereas in practice it will not be exercised.

Question 6: variable lease payments

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

We welcome the decision to exclude from the initial liability and asset those variable payments based on the lessee’s use of the underlying asset or its performance.

In respect of variable payments based on a rate or index, we believe that the proposals are quite complex, for both lessees and lessors, but especially for the latter because of the impact of variable payments on the residual asset.

We think the following approaches may be less complex:

- To base the accounting model for lessors on that of lessees for such variable payments; and
- to measure the liability and right-of-use asset initially using forward rates or indices, in order to limit the impact of further adjustments through adjustment of the right-of-use asset (according to whether the adjustment is attributable or not to the current period).

Although we welcome the proposal that a change in the lease payments will be accounted for as an adjustment of the right of use when it is not attributable to the current period, we believe that this may be quite complex to implement when applied to a large portfolio of contracts. Indeed, the more adjustments can be reduced (through the use of projected rates at the outset, for example), the more likely it is that an entity may opt for recognition through net income (applying the principle of materiality) in order to simplify accounting treatments and ease the administrative burden.

Finally, to go further, as a general principle which goes beyond the lease proposals, we believe that changes in liabilities should not have an impact in net income systematically, and that it can be relevant in some cases to adjust the value of the asset being financed.

Transition

Question 7: transition

Paragraphs C2–C22 state that a lessee and a lessor would recognise and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why? Are there any additional transition issues the boards should consider? If yes, what are they and why?

We welcome the practical reliefs provided in this new exposure draft.

We suggest that it would be helpful to ease the burden of transition by providing another exemption for contracts ended during the year of first application, as these items would not affect future periods.

Furthermore, because new liabilities will be recognised under the proposals, some of which may be denominated in foreign currency, we ask the Board to consider the hedge accounting aspect of the transition. Recognising new liabilities in foreign currencies will automatically lead to the recognition of the effect of changes in exchange rates in net income that was not previously accounted for. Some groups currently hedge their rental expenses “economically” on a cash-flow basis, that is, cash payments for operating leases are hedged by cash receipts from sales in the same currency during the same period ; no specific derivatives are used, and there is no need for an hedge accounting documentation. To reach almost the same outcome and avoid volatility in net income, the group would need to designate the foreign liability as a hedging instrument for future cash-inflows in the same currency. Such documentation will be done during the transition to IFRS 17, and thus not at the initial recognition of the debt. It would be helpful if the Board were to specify in the transitional provisions that such an “a posteriori” designation is permitted.

Disclosure

Question 8: disclosure

Paragraphs 58–67 and 98–109 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments; reconciliations of amounts recognised in the statement of financial position; and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

We welcome the focus on materiality introduced by paragraphs 59 and 99 of the exposure draft.

We note that for lessees the proposals to recognise all leases (other than those covered by specific exemptions) have not resulted in a reduction in the quantity of information required to be disclosed, but have rather had the opposite effect, since the significant number of areas where judgement is required has given rise to the need to explain how judgement has been applied.

Moreover, although we understand that the lessee/ lessor should provide a maturity analysis of the lease liability/ lease receivable, we see no reason for requiring the cash flows to be paid/ received separately for each of the first five years (paragraph 67 and 106 of the exposure draft) whereas such granularity is not required by IFRS 7 for financial instruments in general.

Such a requirement, to provide exactly the same disclosure as for operating leases under IAS 17 and therefore enable users to recalculate the debt themselves, leads us to question the accounting principles proposed by the exposure draft. Indeed, as underlined by EFRAG in its discussion paper on disclosures, we do think that the notes should provide some measurement inputs “without providing all the information necessary to recalculate the measurement using different inputs”[1].

[1] « Towards a disclosure framework for the notes », EFRAG/ ANC/ ASB, July 2012, page 28.