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Mouvement des Entreprises de France MEDEF

A F E P

Association Française des Entreprises Privées

IASB
30 Cannon Street
London EC4M 6XH
UK

Paris, July 7, 2009

Re: *DP« Leases »*

We welcome the opportunity to comment on the IASB discussion paper dealing with "*Leases*", while regretting not having any positive comment to provide.

We have indeed the following concerns:

1- The Board has not analysed thoroughly what information would truly benefit users. As a result, the Board jumps to preliminary views without defining what improvements it intends to achieve. Users seem to miss some information: what information is it? Information about assets? Information about liabilities? Does it mean additional assets and liabilities being recognised? Or additional disclosures?

2- The Board fails to analyse the economic substance of leases. There again a mere assertion is provided that all leases are 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.

3- The Board believes that its preliminary views make the existing distinction between finance and operating leases unnecessary, and that it would be difficult to improve that distinction. We believe that the Board fails to see the need for an even more difficult distinction, one between lease and other binding contracts for goods and services. No analysis of that distinction has been carried out. We believe such an analysis is necessary. The Board needs to explain why assets and liabilities that arise from binding contracts other than leases do not need to be recognised while assets and liabilities that arise from operating lease arrangements do.

4- The Board has separated its project into two phases, lessee accounting on one hand, lessor accounting on the other, for the very same transaction. The economic effects of the transaction do not change, depending on the perspective, lessor or lessee, from which it is analysed. We therefore believe that no fundamental change should be required, before a comprehensive and sound analysis is carried out, as both parts of the project are inter-related and informative of each other.

With the approach the Board has adopted, the risk is quite high that the Board triggers heavy changes in the accounting practice, changes that would be deemed not relevant once the project is finalised. Financial markets cannot bear changes in financial reporting that are not thoroughly thought out and companies should not be forced into bearing the related cost.

5- Very limited material is being provided in the DP on lessor accounting. Such material has been included at quite a late stage before publication, without any proper deliberation by the Board. We believe that the DP stage is required and at present not met.

6- Proposals are neither internally consistent, nor consistent with quite recent tentative decisions made by the Board, supplementary evidence we believe that the project lacks technical robustness:

   a. The right of use approach relies on the identification of items that meet the definition of assets and liabilities. Whether recognition of those items would provide useful information is not developed in any way. Nonetheless the Board has recently reaffirmed that providing useful information to users was THE objective of financial reporting;

   b. While the approach relies solely on the definitions of assets and liabilities, the so-called “single asset and liability” approach retained by the Board fails to be compliant with those definitions. The Board’s preliminary views would call for reporting as liabilities amounts that entities have all means to avoid, as they have the choice to exercise, or not exercise, the options they have purchased. The approach is therefore conceptually flawed;

   c. The approach retained by the Board relies on the analysis that lessors transfer rights of use of assets at inception of leases. Nonetheless the Board has recently concluded that such transfers are operated by lessors progressively throughout the contract;

   d. While the Board qualifies (unduly in our view) all leases as financing arrangements, the Board decides against adopting for the resulting liabilities similar accounting as for other financing/ liabilities, without explaining why and how different accounting treatments are required.

7- Proposals by the Board would trigger recognition of loads of supplementary assets and liabilities, each of them requiring both initial and subsequent measurements. Although the Board indicates (IN23) that it intends to implement changes that are respectful of a reasonable cost/ benefit trade off, no preliminary view presented by the Board reflects any cost concern. Furthermore, no announcement has been made about any prior impact assessment of the Board proposals and we believe that those impacts are huge. We therefore believe that such an impact analysis should be planned as a necessary step in the process.

Our overall conclusion is that the planning of the whole project should be revised and changed, so that no fundamental change is brought to financial reporting without being based on comprehensive due process and analysis.

We understand that one of the primary concerns of the Board is that the existing literature is failing to prevent structuring opportunities. We wish to observe that IAS17 contains no bright line, and that, now that IFRS basic principles have been appropriated by practitioners, applying IAS 17 principles is achievable by those who wish to report faithfully. We believe that the only reasonable objective that the Board can have within the 2011 deadline that it has set for itself is to bridge the potential existing gap. We would support such an objective.

In addition to these main comments, answers to the detailed questions of the invitation for comment are provided in the appendix.

Should you wish any supplementary comment or explanation, please do not hesitate to contact us.

ACTEO	AFEP	MEDEF
Patrice MARTEAU	**Alexandre TESSIER**	**Agnès LEPINAY**
Chairman	Director General	Director of economic and financial affairs

Appendix to our letter on IASB DP "Leases". Answers to the specific questions raised in the invitation for comments

Some preliminary comments

The IASB explains in chapter 1 of the DP the reasons for undertaking the project. We believe that the analysis provided in that section is at least partly flawed.

1. 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.

All in all, work needs to be done in order to better determine how to identify in-substance purchases. A principle based approach to those arrangements needs to be defined. The assumption that all arm's length transactions between knowledgeable, willing participants are exchanges of equal fair values should serve as the core principle supporting the identification of in-substance purchases[1]. We observe that in present practice the comparison of the present value of the minimum lease payments to the fair value of the asset is one of the most efficient existing indicators, along with the comparison of the economic life of the asset to the lease term.

2. 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.

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[1] We are using the notion of « in-substance purchases » in this document with a broader meaning than US GAAP. We wish to encompass all transactions that are, regarding their economic substance, the economic equivalents of a financing arrangement for the purchase of an asset, i.e. substantially all the economic benefits in the asset are transferred. "Operating leases" designate all leases that do not qualify as "in-susbtance purchases". "Financing leases" is used when referring to the existing requirements.

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[2]), 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.

3. Operating leases are akin to contracts for the purchase of goods and services

All contracts for the purchase of goods and services are dealt with as executory contracts in IFRS literature[3]. Operating leases are, in our view, very similar in nature to other contracts for the purchase of goods and services.

In most operating agreements, either there is no market for the right of use and/or lessees are prevented from disposing of their rights freely. Therefore lessees cannot access the underlying economic benefits, but period after period, day after day, exactly as the entity that has committed to purchase certain quantities of goods or services to be delivered at regular intervals for a period of three years will benefit from those goods as they are delivered. We note that the Board is sharing our analysis when it tentatively decided, as has been done after publication of the DP, that lessors perform their obligation to lessees progressively throughout the life of the contract. We therefore believe that the best depiction for operating leases lies in the executory contract approach.

Transfer of a right to use in an operating lease by a lessor is not different from transfers of rights in other binding contracts. The consequence for the lessor of a right of use transfer is that the underlying asset is no longer available for any other use during the agreed lease term. The same analysis applies to a definite term employee contract. As of inception of the contract, the employee has transferred to his employer the right to ask for the best use of his skills, for example, between 8 am and 5 pm every working day for18 months. The employee can no longer make any other use of his time during that period, but work for the benefit of the employer. Any binding contract for the purchase of goods or services that extends for a period of time transfers a right to the customer and puts constraints and duties on the supplier. As of today such contracts do not trigger recognition of the assets and liabilities they generate. We observe that in *every contract, rights are transferred at inception* of the contract. The mere fact that the underlying asset involved in a lease is clearly identified, and is usually placed under custody of the lessee at inception, does not introduce a substantive difference in those operations, from the perspective of the lessee.

[2] Please refer to our letter of comments on the ED “Derecognition” and our analysis of repos.

[3] See Conceptual Framework – 91, IAS 39 AG35 b) and also IFRIC 12 BC66-68

We therefore believe that the whole project should be driven by the identification of why and how recognition of assets and liabilities arising from binding contracts would bring useful information to users, and what that information should be. We have not encountered any valid rationale or analysis either in the DP or during Board's deliberations.

4. 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.

5. The borderline between what are today operating leases and servicing contracts is much thinner and difficult to apply in practice than the existing dividing line between financing and operating leases

The Board rejects the existing dividing line between financing and operating leases on the grounds that it is difficult to define and that it results today in structuring opportunities remaining open. This triggers the following comments:

- the objective of standard setting is to appropriately depict differences in economic substance; whether it is difficult or easy to achieve does not diminish the need for achievement;
- the Board refers to "inappropriate bright lines"; there is no bright line in the existing IFRS; some have tried for both good and bad reasons to import in IFRS practice US GAAP application guidance; practice may be in need for improvement, without any change in the standard;
- existing practice has benefited in the last years of appropriation by practitioners of IFRS basic principles; difficulties with the existing IAS 17 dividing line have been overcome by those who clearly intend to apply IAS 17 faithfully;
- whatever the IASB decides, a dividing line will be needed; if the IASB were to define a dividing line between operating leases and other servicing contracts, it would tackle a difficulty that we believe is far greater – and in much less known grounds – than the existing dividing line between financing and operating leases. This is due to operating leases being more akin to servicing contracts than to financing leases.

6. **Should liabilities arising from operating leases be recognised?**

We fail to see how recognising assets and liabilities arising from operating leases would bring in the primary financial statements information about assets that users need to assess the entity's financial position. The only economic benefits to be derived from an asset leased in an operating lease contract consist in the contribution of the leased asset to the operations of the entity throughout periods while the asset is being leased. In our view showing the right of use in the statement of financial position does not enhance information usefulness because:

- the assets shown would very much depend on the lease contract duration,
- the cost of using the asset is best and easily portrayed if rents are reported in the income statement directly,
- in most operating lease contracts, conditions in which the asset is used and maintained are strictly defined in the contract, or subject to the lessor's approval, so that the use of the asset interacts with the entity only in its operations (costs and periodic cash outflows) without participating in the understanding of the entity's financial position.

We could sympathise with the acknowledgement that a lease, whatever its economic substance, generates for the lessee a commitment to pay minimum lease payments that meets the definition of a liability and that also meets (at least in some simple operating lease contracts) the framework's recognition criteria for assets and liabilities. This however verifies for lots of commercial contracts that industrial and commercial entities enter into in the most recurring fashion to comply with their operational needs (see paragraph 3 above). As a result, nothing justifies that operating lease liabilities are recognised while other contract liabilities are not.

We therefore recommend the Board to:

- work on improving the existing distinction between financing and operating leases;
- keep operating leases reported as executory contracts;
- ensure that proper disclosures provide users with all information they need to assess the entity's financial position.

Furthermore we are strongly opposed to having in-substance purchases and operating leases accounted for similarly, without any differentiating accounting features in the primary financial statements. We believe that such a decision would seriously undermine the relevance and usefulness of financial reporting.

Chapter 2: Scope of lease accounting standard

Question 1

The boards tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards. Do you agree with this proposed approach? If you disagree with the proposed approach, please describe how you would define the scope of the proposed new standard.

No, we do not agree that possible changes to be made to the scope remain unexplored.

IAS 17 scope includes intangibles and IFRIC 4 associated with IAS 17 scope on one hand and the accounting proposed for operating leases on the other hand would most probably open the door to accounting for assets (as counterparties to the liabilities) that would soon no longer be needed to be identifiable (in the mood of IFRIC 8, it could be easily concluded that the entity would not have committed to future outflows in exchange for no asset and required that in case the asset cannot be identified or does not meet the conditions to be recognised the entity should record an expense at inception of the contract). The existing requirement that the asset be specifically identified does not rely in our view on an economic substantive feature. If a manufacturer entrusts a shipping company with the transport of goods and the shipping company has one vessel only, the agreement could qualify as embedding a lease, as the asset necessary to service the manufacturer would be specified. If however the shipping company had a fleet of several vessels, the manufacturer would be deemed to purchase transport services only, because the vessel to be used would remain unspecified. Nonetheless there is arguably no difference of economic substance between the two situations.

Any proposal would need to be extensively field-tested in order to ensure that no unintended consequence would arise. In our view the risk is high that the Board otherwise opens Pandora's box.

Question 2

Should the proposed new standard exclude non-core asset leases or short-term leases? Please explain why. Please explain how you would define those leases to be excluded from the scope of the proposed new standard.

As indicated in our preliminary comments (see paragraph 4 above), the question raised by the Board is very difficult to answer as the information content that the Board is seeking to provide is not adequately defined. We have set out rationale why we believe that recognising assets arising from operating leases would fail to provide meaningful information. As a result, we can provide the following comments:

- We do not believe that defining robust criteria to distinguish non-core assets from core assets or setting a relevant period beyond which a leased asset would be short-term are feasible, or easier than strengthening the distinction between finance and operating leases;
- The distinction between core and non-core assets is quite subjective, any definition of a short-term lease is arbitrary;
- Were the Board to pursue, any exclusion of the scope would be welcome (on either of the two proposed bases) as such exclusions would at least partially help cope with the increased administrative burden that the proposed requirements would undoubtedly generate.

Chapter 3: Approach to lessee accounting

Question 3

Do you agree with the boards' analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract? If you disagree, please explain why.

We strongly disagree that in-substance purchases and operating leases be analysed in the same away as they encapsulate transactions that are very different in economic substance (please refer to our preliminary comments). In-substance purchases should remain analysed as financing transactions and give rise to the recognition of assets in the same conditions of accounting and presentation as assets that have been purchased.

We agree that the commitment to pay minimum future rents be analysed as meeting the definition of a liability.

Theoretically the “right of use” notion meets the definition of an asset, as indeed the lessor is committed in not having any claim on its asset before the end of the contract. As explained in our preliminary comments we do not believe there is much valuable information content to be expected from accounting for those rights of use. Would they represent anything but expenses accounted for in advance?

That being said we truly believe that identifying that items meet the definition of assets and liabilities is not in itself sufficient to justify those items being reported. Items that meet the definition of assets and liabilities need to be recognised only if such recognition brings valuable information to users. While we have reiterated support for the purpose of the existing IAS 17, we do not believe that recognition of assets and liabilities arising from operating leases would bring meaningful information (please refer to our preliminary comments – paragraphs 3 and 6).

Question 4

The boards tentatively decided to adopt an approach to lessee accounting that would require the lessee to recognise: (a) an asset representing its right to use the leased item for the lease term (the right-of-use asset) (b) a liability for its obligation to pay rentals. Appendix C describes some possible accounting approaches that were rejected by the boards. Do you support the proposed approach? If you support an alternative approach, please describe the approach and explain why you support it.

As explained in our preliminary comments, we believe that:
- in-substance purchases should remain accounted for as financing leases today;
- operating leases should remain accounted for as executory contracts; however disclosures should be improved so that users are provided with the information they need.

Question 5

The boards tentatively decided not to adopt a components approach to lease contracts. Instead, the boards tentatively decided to adopt an approach whereby the lessee recognises: (a) a single right-of-use asset that includes rights acquired under options (b) a single obligation to pay rentals that includes obligations arising under contingent rental arrangements and residual value guarantees. Do you support this proposed approach? If not, why?

We are strongly opposed to the decision made by the Board not to adopt a component approach. We indeed believe that the decision made by the Board would lead two companies that have entered into identical contracts, but one having acquired an option to extend or cancel, while the other has not[4], to report very different financial positions although they incur the exact same liabilities.

4 We acknowledge that such an assumption is not realistic as having an option generally means a higher rent.

In our view, having acquired an option to extend or cancel brings the entity a supplementary flexibility or the potential access to an extension of a lease in favourable terms. Such options are assets, so that the entity having acquired an option should, anything else being equal, report an incremental net asset compared to the entity without the option. This is not what would result from the proposed accounting treatment.

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 conditions for measuring options in lease contracts reliably may not be met. We however do not believe that the alternative to no reliable measurement can be the recognition of items that do not meet the definition of liabilities. Indeed the entity having acquired an option does not incur any liability beyond the minimum lease payments involved in the first period of the lease[5]. No supplementary liability should be recognised, in our view. If no reliable measurement of options is achievable, appropriate disclosures should be provided[6].

The Board seems also to believe that the proposed requirement would play the role of anti-abuse provision, i.e. prevent entities for contracting short term leases with options instead of longer leases. While we have constantly been against anti-abuse provisions that most of the time are not compatible with principle based and robust principles, we believe that the Board's approach is flawed. Indeed entities do not decide whether to negotiate an option for accounting purposes. Options have a cost, and are decided if the flexibility that they provide is needed. Furthermore, not all lessors accept to grant options within reasonable cost limits. Whether an option is purchased or not is, and shall remain, an economic decision, and the resulting position is economically quite different for the entity.

[5] It is worth noting that the cost of options is generally reflected in higher rents. Therefore even without any specific recognition requirements, options are mechanically reflected in the minimum lease payments reported.

[6] We observe that the Board has asked the Revenue Recognition team to investigate what alternatives to the « look-through » approach in the accounting for options would be available.

We have analysed why we reach on this issue apparently quite different conclusions that we have in Insurance contracts phase II, when defining what cash flows arising from positive policyholder behaviour should be reflected in the measurement of insurance contract liabilities. Indeed we had concluded at the time that exercise of renewal options by policyholders should be estimated and taken into account when measuring insurance contract liabilities. There are in our view quite substantive distinctive features: renewal options in insurance contracts are in the hands of the policy holder, not of the entity; renewal options in insurance contracts therefore generate for the insurer stand-ready obligations whose measurement would not be relevant if not based on net cash in and out-flows arising from the contract. Insurance liabilities are managed on the basis of portfolios, policyholders' behaviours can be observed, and measurement of the impact of options is indeed reliable. Although estimates are carried in practice on contracts taken as a whole the approach to those options stem in reality from a component approach.

Chapter 4: Initial measurement

Question 6

Do you agree with the boards' tentative decision to measure the lessee's obligation to pay rentals at the present value of the lease payments discounted using the lessee's incremental borrowing rate? If you disagree, please explain why and describe how you would initially measure the lessee's obligation to pay rentals.

No, we do not agree. In-substance purchase contracts being financing arrangements, the implicit interest rate in the lease is likely to be available. Consistently with other debts, we believe the financing liability owed to be discounted using the interest rate agreed between lessee and lessor. The incremental borrowing rate would serve only in those cases where the rate implicit in the lease would not be easily identified.

We have observed already that operating leases were not financing transactions, but servicing transactions. Therefore we agree that the rate implicit in the lease would rarely, if ever, be available.

We would have expected the Board to determine the discount rate on other arguments than the transaction being a financing transaction. In the absence of appropriate arguments we remain unconvinced that the incremental borrowing rate is the appropriate rate to apply (while not necessarily rejecting it).

Note to the IASB: In answering to the following questions, we do not necessarily repeat our opposition to the Board's proposal to eliminate the distinction between in-substance purchases and operating leases. Our answers are provided in the context of the tentative decision of the Board, in a constructive manner.

Question 7

Do you agree with the boards' tentative decision to initially measure the lessee's right-of-use asset at cost? If you disagree, please explain why and describe how you would initially measure the lessee's right-of-use asset.

We agree with the Board's proposals in this area.

Chapter 5: Subsequent measurement

Question 8

The boards tentatively decided to adopt an amortised cost-based approach to subsequent measurement of both the obligation to pay rentals and the right-of-use asset. Do you agree with this proposed approach? If you disagree with the boards' proposed approach, please describe the approach to subsequent measurement you would favour and why.

We agree with this approach.

Question 9

Should a new lease accounting standard permit a lessee to elect to measure its obligation to pay rentals at fair value? Please explain your reasons.

No, we do not think that such an option is advisable:

- we support amortised cost for debt instruments as we believe that such a method best features future cash outflows;
- we cannot think of any circumstance where revaluation of the related asset would bring valuable information and fair valuing the liability would avoid accounting mismatch.

Question 10

Should the lessee be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate? Please explain your reasons.

If the boards decide to require the obligation to pay rentals to be revised for changes in the incremental borrowing rate, should revision be made at each reporting date or only when there is a change in the estimated cash flows? Please explain your reasons.

In our answer to question 6, we have clearly indicated that the rate implicit in the lease should be used wherever available. Clearly this rate does not change in the course of the contract. We see the incremental borrowing rate of the entity as a proxy for the rate implicit in the lease when that rate is not available. As a result we are against any change in the lessee's incremental borrowing rate to be reflected. We can add the following arguments:

- Within a cost approach to subsequent measurement, we believe that using the discount rate at inception is more consistent.
- Locking the discount rate at inception is also more consistent with the current IAS 39 amortised cost approach.
- Furthermore, we do not believe that gains and losses that would arise from revising the lessee's incremental borrowing rate would have any useful information content, not to mention the ongoing controversy about whether changes in value of liabilities should reflect changes in the entity's own credit risk.

Question 11

In developing their preliminary views the boards decided to specify the required accounting for the obligation to pay rentals. An alternative approach would have been for the boards to require lessees to account for the obligation to pay rentals in accordance with existing guidance for financial liabilities. Do you agree with the proposed approach taken by the boards? If you disagree, please explain why.

In-susbtance purchases being akin to a financing transaction, we believe that the obligation to pay rentals should be accounted for as a financing liability.

Liabilities that arise from operating leases are similar to accounts payable, except that entities quite rarely, if ever, have to record amounts due to suppliers several years in advance of benefiting from the service. We believe these liabilities are more akin to operating liabilities and should be clearly separated from liabilities arising from finance leases.

Question 12

Some board members think that for some leases the decrease in value of the right-of-use asset should be described as rental expense rather than amortisation or depreciation in the income statement. Would you support this approach? If so, for which leases? Please explain your reasons.

As we have already explained, the distinction between in-substance purchases and operating leases should be maintained. Our answer to question 12 depends on the category of leases considered:

In-substance purchases: we support the existing requirements in IAS 17 for finance leases. We are therefore supportive that the decrease of the right of use asset be described and measured in the income statement in accordance with IAS 16/ 38 requirements;

Operating leases: we have expressed the view that operating leases would be better handled as executory contracts. We have also indicated that we could understand why some would want to account for the liability arising from the minimum lease payment obligation. As a result, we support those Board members in favour of the "rental expense" method. Such a method brings the liability on the balance sheet and leaves the income statement unchanged and hence more meaningful. As we have already pointed out, we cannot see any meaningful information content in the asset that would result from the proposed approach.

Chapter 6: Leases with options

Question 13

The boards tentatively decided that the lessee should recognise an obligation to pay rentals for a specified lease term, i.e. in a 10-year lease with an option to extend for five years, the lessee must decide whether its liability is an obligation to pay 10 or 15 years of rentals. The boards tentatively decided that the lease term should be the most likely lease term. Do you support the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why.

In answer to question 5, we have explained why we reject the decision made by the Board. Nonetheless, in the context of the Board's decision, we believe that the most likely lease term is a better option.

We however do not fully support the Board's preliminary view. We believe indeed that management's expectations should be taken into account, while they should be fully documented taking into account all factors, contractual, non-contractual and business factors as identified in par 6.39. We believe indeed that decisions not to renew a lease may arise from a change in an entity's strategy, for example, while none of the factors previously considered has changed. In such circumstances we believe that taking into account the change in strategy and disclosing it is more relevant and useful to users than prohibiting management's expectations to play any role.

Question 14

The boards tentatively decided to require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances. Changes in the obligation to pay rentals arising from a reassessment of the lease term should be recognised as an adjustment to the carrying amount of the right-of-use asset. Do you support the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why. Would requiring reassessment of the lease term provide users of financial statements with more relevant information? Please explain why.

This approach sounds consistent with the decision made by the Board. Indeed whether an option to renew is expected to be exercised changes the asset that is being purchased and held. However we need to reaffirm that we do not think that the proposed requirements will bring meaningful information to users. We believe it will blur lessees' financial positions and call for endless disclosures, as the primary financial statements would cease to be understandable.

Question 15

The boards tentatively concluded that purchase options should be accounted for in the same way as options to extend or terminate the lease. Do you agree with the proposed approach? If you disagree with the proposed approach, please describe what alternative approach you would support and why.

We have explained in answer to question 5 why we reject the Board's single right and obligation approach.

Nonetheless here again we believe that the decision is consistent with the other decisions made by the Board in this area.

Chapter 7: Contingent rentals and residual value guarantees

Contingent rentals

Question 16

The boards propose that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements. Do you support the proposed approach? If you disagree with the proposed approach, what alternative approach would you recommend and why?

We do not think that those proposals are consistent with IFRS measurement requirements. Aside fair value measurements, subsequent measurements in IFRS are made on the basis of current conditions at the measurement date.

This in our view would call for using indexes and other variables as they stand at the closing date, without trying to guess in quite subjective and burdensome fashion future trends in the relevant parameters.

Furthermore we believe there are fundamental differences in what the Board is describing as contingent rentals:

- leases may generate unconditional liabilities of which amount will vary depending on some form of index; in principle, those liabilities should be measured on the basis of a current estimate;
- leases may generate conditional liabilities, the condition thereof being *dependent on the entity or the entity's performance in future periods*; for example a lease on a retail store would generate a liability only if the retail store is active in future periods; in principle, those liabilities should not be recognised before they become unconditional.

Question 17

The IASB tentatively decided that the measurement of the lessee's obligation to pay rentals should include a probability-weighted estimate of contingent rentals payable. The FASB tentatively decided that a lessee should measure contingent rentals on the basis of the most likely rental payment. A lessee would determine the most likely amount by considering the range of possible outcomes. However, this measure would not necessarily equal the probability-weighted sum of the possible outcomes. Which of these approaches to measuring the lessee's obligation to pay rentals do you support? Please explain your reasons.

Consistently with the view that we have expressed in commenting on IAS 37 proposed amendments, we support the FASB's view that the most likely rental payment is a better approach, when estimating a single risk or liability.

Question 18

The FASB tentatively decided that if lease rentals are contingent on changes in an index or rate, such as the consumer price index or the prime interest rate, the lessee should measure the obligation to pay rentals using the index or rate existing at the inception of the lease. Do you support the proposed approach? Please explain your reasons.

We believe that the FASB's position should be supported on pragmatic grounds. The Board's proposal would trigger recognition of huge numbers of assets and liabilities that remain unrecognised today. Reassessments, either on current bases or on whatever other estimates, would trigger extremely high administrative costs (for, in our view, no benefit).

Question 19

The boards tentatively decided to require remeasurement of the lessee's obligation to pay rentals for changes in estimated contingent rental payments. Do you support the proposed approach? If not, please explain why.

We disagree for the reason we support the FASB's position in question 18 above.

Question 20

The boards discussed two possible approaches to recognising all changes in the lessee's obligation to pay rentals arising from changes in estimated contingent rental payments:

(a) Recognise any change in the liability in profit or loss

(b) Recognise any change in the liability as an adjustment to the carrying amount of the right-of-use asset.

Which of these two approaches do you support? Please explain your reasons. If you support neither approach, please describe any alternative approach you would prefer and why.

Here again we need to differentiate our answer, whether dealing with in-substance purchases or operating leases.

In substance purchases: we believe that the financing liability that arises from such a lease should be accounted for as a variable financial liability consistently with IAS 39 present requirements.

Operating leases: for the reasons given in answer to question 18 (and 19), we do not believe that reassessments should be carried out at all, for cost/ benefit trade-off. Furthermore, we observe that contingent rentals in operating leases are not liabilities that are contracted upon variable terms. They are generally intended to make the lessee pay for a current price in each period in which it benefits from the leased asset. Therefore changes in the liability to pay rentals should be reflected in the cost of providing the asset to the entity, and the cost of the leased item in each period should be reflected in the income statement. This requirement is also more in line with the "rental expense" method that we have favoured.

Residual value guarantees

Question 21

The boards tentatively decided that the recognition and measurement requirements for contingent rentals and residual value guarantees should be the same. In particular, the boards tentatively decided not to require residual value guarantees to be separated from the lease contract and accounted for as derivatives. Do you agree with the proposed approach? If not, what alternative approach would you recommend and why?

We have argued in favour of the component approach. We therefore cannot support the proposed approach.

Chapter 8: Presentation

Question 22

Should the lessee's obligation to pay rentals be presented separately in the statement of financial position? Please explain your reasons. What additional information would separate presentation provide?

Liabilities arising from in-substance purchases should be presented among other financing liabilities.

Liabilities arising from operating leases, if recognised, should be presented among operating liabilities.

Whether those elements are presented on a separate line should result from compliance with IAS 1 present requirements.

Question 23

This chapter describes three approaches to presentation of the right-of-use asset in the statement of financial position. How should the right-of-use asset be presented in the statement of financial position? Please explain your reasons. What additional disclosures (if any) do you think are necessary under each of the approaches?

Assets arising from in-substance purchases should be presented among other acquired assets.

Assets arising from operating leases, if recognised, should be presented separately among the category of assets to which the leased asset belongs.

We have considered whether those items should be presented on a separate line and have not come to any final conclusion. On one hand we are tempted to think that compliance with IAS 1 present requirements is enough, i.e. that entities should have to decide in their specific sets of circumstances whether assets arising from operating leases should be shown separately. On the other hand we have heard that some users are interested in whether an entity has ownership of the assets it reports on its balance sheet. As a consequence it might be useful to require separate presentation (under the materiality constraint) on the balance sheet..

Chapter 9: Other lessee issues

Question 24

Are there any lessee issues not described in this discussion paper that should be addressed in this project? Please describe those issues.

We note that the Board has ignored the difficulty to distinguish operating leases from servicing contracts, although this difficulty needs to be resolved before the Board makes any further progress in this project.

Beyond the mere mention that users reclassify minimum lease payments as the sole basis for the project, we would have expected that the Board explain what exactly it intends to portray in the financial position of lessees. We are quite concerned that the Board would assess in-substance purchases and operating leases as similar transactions, and operating leases as financing transactions.

The Board's proposals would also trigger or increase difficulties in the following areas:

- how to present cash flows arising from leases in the statement of cash flows;
- existing "financing" leases would need to be reported differently from what IAS 17 mandates. Transition requirements would need to be determined carefully.

Chapter 10: Lessor accounting

Lessor accounting, as the Boards have acknowledged repeatedly, raises fundamental issues that need to be analysed and debated appropriately. We believe that preliminary views set out in a DP are necessary and that the late and light additions that have been incorporated in the DP prior to publication cannot be assessed as meeting due process requirements. We are concerned that the Board seems to intend developing new lessor accounting requirements in the forthcoming exposure draft and object to such a process.

We have therefore decided against providing any views on questions 25 – 29.