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United States of America

Paris, 17 July 2009

Dear Madam, Dear Sir,

**Response to the Discussion Paper: "Leases: Preliminary Views"**

We welcome the opportunity to comment on the joint IASB-FASB Discussion Paper "Leases: Preliminary Views" (DP). In the context of this answer, France Telecom Orange participated in several French and European forums about the DP and together with others had the opportunity to meet with the Staff. While we believe many views raised in this letter are shared, this letter represents solely the views of France Telecom Orange.

About France Telecom Orange

At the end of 2008, France Telecom Orange had consolidated sales of 53.5 billion euros and at 31 March 2009, the Group had a customer base of almost 184 million customers in 30 countries. Orange the key brand of France Telecom, covers Internet, television and mobile services and, under the brand Orange Business Services, covers telecommunication services to multinational companies.

Like other telecommunications companies, France Telecom Orange is both a lessor and lessee:

- As lessor, France Telecom Orange rents to customers set-top boxes and modems/routers as adjuvants to its services.
- As lessee, France Telecom Orange leases some of its real-estate (technical premises, office buildings, shops, antennas sites etc.), some telecommunication equipments, and non core equipment like cars, PCs and copiers.
- France Telecom Orange also enters into agreements for satellite broadcasting or cable transmission capacities that may qualify as lease or service contracts.
- With the development of intangibles in the present world, arrangements relating to trade mark licenses, broadcasting rights, VOD rights, audience sales etc. represent a growing area where little accounting guidance exists under IFRS.

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Our letter articulates five recommendations:

A - The Boards should assess whether their proposals remedy the criticisms to the current lease models

B- The Boards should analyze whether their proposals are not putting at risk the confidence in financial reporting

C- Similarly, the Boards should evaluate the possible business impact of their proposed accounting

D- The asset and liability that would be recognized should not be based on the look-through approach

E- The asset and liability that would be recognized are linked and the accounting should reflect this link

before presenting a summary of key revisions to the project to better serve the needs of users.

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* *

The first three recommendations encourage the Boards to thoroughly analyze areas that have fundamental consequences on how to develop a proposal for lease accounting:

### A - The Boards should assess whether their proposals remedies the criticisms to the current lease models

In the first chapter of the discussion paper, the Boards present the main criticisms of the current lease accounting model:

- users think that operating lease give rise to *assets and liabilities* that should be recognized on the financial statements of lessees,
- *comparability*: the existence of two very different accounting models means that similar transactions can be accounted for differently,
- the existing standard provides *opportunities to structure* transactions so as to achieve a particular lease classification,
- existing standard is *difficult to apply*: difficulties to define the dividing line between finance lease and operating leases.

*Users needs of assets and liabilities*

Although we understand that answering to users' needs is one of the main purposes of the discussion paper, we observe that users' needs are not appropriately and deeply analysed in the DP:

- do users really want to recognize assets and liabilities or are they dissatisfied about the current disclosures for operating leases? For all lease contracts or only for certain contracts or certain activities? What are they desires in terms of income and cash flow statements?
- the model proposed in the DP increases volatility in the statement of financial position and in the income statement. It disconnects the income statement from the cash flow statement. Is this really what users want?

Furthermore if the main concern of users is to recognize assets and liabilities arising in all lease contracts on the financial statement of position, it does not necessarily imply to remove the distinction between operating lease and financial lease. This point is very important because this removal determines all the DP approach.

*Comparability and value of the information*

Based on their assessment of the probability weighted payments and most likely terms, two companies with identical contracts with the same term and renewal options will record them differently not only in

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their statement of financial position but also in their statements of income and cash flows although they have the same contractual rights and obligations and even potentially the same incremental borrowing rate. Moreover, two different lease contracts could be accounted for in the same way. Consider two contracts where the first one is a five-year lease and the second one is a three-year lease with an option to extend for additional two years that would be considered likely to be exercised. Under both cases, the lessee would recognize an obligation to pay five years of rentals even if the economy of both contracts is not the same.

Hence, contrary to the stated objective of the DP, the new model will not improve the financial statements comparability.

*Structuring opportunities*

If in the past, lease accounting has been an area of regulatory actions in the U.S., the initial difficulties appear to have been overcome. Furthermore, lease accounting has not been at the forefront of issues raised in reports on internal control over financial reporting nor in the current economic and financial environment.

Please refer to comment B hereunder for quick wins under the existing standard.

*Difficulties to apply*

We are unconvinced by the assertion that the dividing line between finance and operating leases under the current literature is a major difficulty. Making a determination always requires a judgment, and the Boards recognize that accounting includes a certain amount of judgment and estimate. Usually, determining whether a lessee has entered into an in substance purchase can be inferred from the decision making, the nature of the leased asset and the business models of the parties involved.

Furthermore under the new model, differentiating leases from services will be much more important than in the past: lessees will have to perform an IFRIC 4 type analysis more often than before. Indeed, at the present time, most lease contracts are classified as operating leases. When a service contract contains a lease, IFRIC 4 analysis has currently an effect on the financial statements only if the lease component is classified as a finance lease. IFRIC 4 has poorly designed criteria[1], and when a service contract makes use of equipments, it is often artificial to split payments between equipments and services, esp. for managed services, which purpose is to discharge the customer from any responsibility for equipments.

In fact, this subject is related to the decision of the Board to stick to the current scope of IAS17: what economically characterizes a lease is not defined; the increasing role of intangibles in the economy and the growth in managed services are not analyzed; the distinction with executory contracts is poorly addressed. Putting aside the expediency of moving quickly towards convergence, the Boards have therefore not clearly articulated their views of the difference between a commitment under a lease and for a service, or on the notion of delivery of the right of use or of the underlying asset which is used to differentiate from executory contracts[2].

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[1] As a minimum, the Boards should reconsider the notion of specific asset as the first criteria to determine if an arrangement contains a lease. We wonder if this criterion is pertinent. For instance, 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. This example is an eloquent example of the limit of the "specific asset" criteria (or any exclusivity criteria).
Similarly in many service contracts, the suppliers need to use fixed assets to perform the service whether in its own premises or in the customers premises. Here again determining that an arrangement conveys a right to use an asset based on control of physical access is highly questionable. Obtaining more than an insignificant amount of the output of an asset is also not a straightforward criterion to make such a determination. More importantly, it questions the basis for a different recognition of assets and liabilities.
[2] The Framework does not provide with a clear guidance on how to account for executory contracts :

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We respectfully suggest the Boards to reconsider their analysis of the scope and related issues as it challenges the basis of the proposed asset /liability approach.

B- The Boards should analyze whether their proposals are not putting at risk the confidence in financial reporting

As we have already mentioned in our comment on the DP "Revenue Recognition in Contracts with a Customer" Financial Reporting is a regulated dialog between management and users that is built on confidence. As evidenced recently by the market turmoil, without confidence in the information provided, financial markets do not operate properly.

The Boards have chosen a road -whereby all leases are "unified" under the umbrella of right of use purchases, and a "one size fits all" measurement approach is applied: an assessment of probability weighted future payments and of the most likely term- that is supposed (I) to overcome any incentive towards legal structuring of terms and payments, (ii) to better reflect the expected outcome of the lease contract.

We do not think that such an approach will deliver the desired objectives, because key attributes will be missing: verifiability and understandability. This is not necessarily because of voluntary errors, but more simply because the Boards have failed to recognize that:

- in-substance purchases are transactions that differ from other leases, and therefore warrant a specific accounting treatment,

- for non in-substance purchase leases, a lessee is arbitraging its level of cost with the required flexibility - conversely, the required security- to adapt to new circumstances (hence its level of commitment whether through the minimum term or minimum payment). The contract reflects that being flexible to adapt to new circumstances is a business necessity in today's world. Determining the most likely term before the time the decision to quit or renew is contractually needed negates the business purpose and the contractual equilibrium of such leases. Similarly, the Boards have missed the opportunity to reassess the role of past event in the determination of the accounting for payments contingent upon future actions from the lessee: usage or sales proportionate payments reflect an agreement between the parties to share risks and acceptance by the lessor to depend upon future actions from the lessee.

Introducing measurement principles that do not reflect the business purpose or force the lessee to abandon its flexibility to address an uncertain future is akin to building into the standard risks of errors that no internal control measures can alleviate.

Furthermore proposing measurement principles that build in constant modifications of reported figures will more likely than not jeopardize the confidence in reported figures.

On the other hand, some quick wins could have been achieved with the current model:

- Amend the use of the incremental borrowing rate as the alternate basis for the test of minimum payment vs. fair value of the leased item : there is no reason why a BB rated company should more likely pass the

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Paragraph 91 of the framework states that "obligations under contracts that are equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements. However, such obligations may meet the definition of liabilities and, provided the recognition criteria are met in the particular circumstances, may qualify for recognition. In such circumstances, recognition of liabilities entails recognition of related assets or expenses." In addition, paragraph 61 states that: "An obligation normally arises only when the asset is delivered or the entity enters into an irrevocable agreement to acquire the asset. In the latter case, the irrevocable nature of the agreement means that the economic consequences of failing to honour the obligation, for example, because of the existence of a substantial penalty, leave the entity with little, if any, discretion to avoid the outflow of resources to another party".

test compared to a AA rated one, or if fails should report a lower asset and liability. The borrowing rate should be clarified to be for a loan with the same degree of security of access to the guarantee by the lender (i.e. lessening the impact of the credit risk of the lessee). Alternatively, consideration could be given to eliminating this test in favour of an assessment of the rights to the residual value.

- Amend IAS7.43 and 44a by recognising that in substance purchases through a finance lease are not non cash transactions but a contractual compensation of an investing outflow by a financing inflow, that should be reported as such (i.e. gross) in the statement of cash flows.

Such quick wins would participate in higher confidence in reported figures by bringing consistency in the assessment between companies and in presentation among financial statements, while recognizing that the essence of leasing (other than in substance purchases) is not so much about the credit risk of the lessee than about the risk of recovery of the leased asset and its residual value if the lessee ceases payments.

### C- Similarly, the Boards should evaluate the possible business impact of their proposed accounting

If benefits to users are uncertain, what is certain is that the implementation of the DP model to all lease contracts will be a very burdensome exercise for preparers: they will have to implement new procedures and controls and to modify their IT systems in order to secure and monitor the process related to the initial measurement (assessment of the most likely term, probability weighted average of contingent rentals and residual value guarantee) and to the periodic reassessment.

The Boards should have done an analysis of the success of leases in the economy and should have described the various importance of the assets that are rented, the varying types of lessors and lessees, the highly structured deals and plain vanilla ones. In doing so, the Boards would have identified that large ticket deals represent a very significant portion of the value of leases portfolio, while the bulk of contracts are for individual asset with low unit value. It would also have helped focus the design of the proposals on what needs repair, if this was the conclusion reached.

The intrinsic value to lessees of the bulk of leasing arrangements resides in their simplicity and flexibility. That an accounting standard would deprive companies, esp. SMEs or emerging markets, of these qualities is neither a desirable nor an acceptable outcome.

Therefore, it would not be acceptable that the Boards do not address this concern in their final standard through a clear scope exception for non core assets or short term leases. If no theoretical reason exists to exclude them from the scope of the future standard, both types of exclusion can be supported under a cost/benefit assessment with their respective Pros and Cons.

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With respect to the proposed lease accounting method, our recommendations focus on two areas:

### D- The asset and liability that would be recognized should not be based on the look-through approach (single asset/liability approach)

In our view, in the case of a simple lease contract, the recognition of assets and liabilities could only be supported by the irrevocable commitment given by the lessee to pay, not by its control of the right of use:

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- Indeed, almost (but not all) all lease contracts include an irrevocable commitment corresponding to the non cancellable period. Any extension does not represent a present irrevocable commitment from the lessee, only an option. It is not a liability.
- Access by the lessee to an extended rental period through an option (which pricing is embedded in the initial or extended term payment conditions) does not support the idea that the value of this option equals the future payments of the extended period : the lessee will deprive the lessor of an economic value only if ultimately the excess of the market rent over the contractual rent is higher than the cost of getting a new customer or of an idle asset (conversely, the incentive given by the lessor to the lessee by granting an option to renew will have a value to the lessee only if ultimately the benefits it can achieve by staying in the premises exceeds those that it can achieve by moving out).
- Control of the right of use by the lessee seems therefore artificial and presented only to justify the proposed acquisition accounting of the right of use. The lessor guarantees the continued access of the lessee to the underlying asset and puts limitations to the free use of the underlying asset. We are unconvinced by the Boards analysis that the delivery of the leased item is the past event. In addition, the Boards tentatively decided that a lease contract creates a new right and obligation for the lessor. Under this approach, the lessor has a performance obligation to deliver and then to permit the lessee to use the leased item. The performance obligation would be settled over the term of the lease. This view is not consistent with the Boards proposal on lessee accounting.

E- The asset and liability that would be recognized are linked and the accounting should reflect this link

By considering that the lessee acquires a right of use through differed payments, the Boards propose a model where the asset and liability are delinked: the asset which equals the liability at inception is rateably amortized, and the liability represents the net present value of future payments.

For non in-substance purchases, we believe that recognizing the link between the two present multiple advantages to the Boards approach:

- Simplicity : the link between cash flows and expense is retained; the accounting processes are less imperilled : the asset and the equal liability can be recorded at each closing dates,
- Verifiability : if the look-through approach is abandoned, the figures are easily verifiable by reference to the lease,
- Clarity: the value of the remaining right of use is equal to the remaining liability: this immediately establishes that the lease is not onerous; if it was the asset would be impaired; neither does it imply any revaluation of the right of use.
- Faithful representation: the link between the rights and obligations is how a lease relationship corresponds to the business representation of the arrangement.
- Pragmatism: users will see directly on balance sheet the liabilities for the future use of the leased asset.

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In summary, we do not believe that the proposed single model that rests upon a regularly updated expected outcome of the contracts, serves the needs of financial markets and investors. We suggest the Boards, in view of the comments received, fairly reconsider the possibility of amending the current IAS17 and IAS7 as suggested in comment B above.

If such amendments were to be rejected, the key revisions we believe should be made to the Discussion Paper to serve the needs of users are the following:

- Keep the distinction between in-substance purchases and other leases arrangements as they represent economically different transactions; retain a treatment of in-substance purchases close to the one current one.
- Focus on key commitments : include scope exceptions based on a cost/benefit analysis to exclude either non core assets or short term leases ; eliminate the need and the requirement for permanent reassessment ;
- Analyze what differentiates a lease (that is not an in-substance purchase) from a service arrangement and an unrecognized executory contract; clarify the basis for any balance sheet recognition;
- If recognition of a liability is affirmed for leases other than in-substance purchases,
    - stick to the definition of a liability : do not include any payment linked to an optional period in the "liability"; do not include payments that do not represent an actual obligation to the lessee (usage or sales proportionate payments);
    - account for the right to use and the liability through a linked approach that maintains the current close relationship between the cash payment and the expense;
    - do not use the incremental borrowing rate to present NPV as it does not represent any valid measurement basis- if the contract implicit rate is unavailable, use a guarantee adjusted rate.

- Before any Exposure Draft, republish a DP integrating lessor (and subleases) accounting, sales and leaseback transactions and vendor's leasing as they are good tests of the coherence of the approach and compatibility with the revenue recognition and the derecognition projects.

If you would like to discuss our comments further, please do not hesitate to contact Nicolas de Paillerets (nicolas.depaillerets@orange-ftgroup.com) or myself (gervais.pellissier@orange-ftgroup.com).

Yours sincerely,

Gervais Pellissier
Deputy CEO
Group Finance and Information Systems

Jacques de Galzain
Chief Accounting Officer

Nicolas de Paillerets
Director of group accounting principles

cc:

Mrs Christine Lagarde, Ministre de l'Économie, de l'Industrie et de l'Emploi
M. Jean Pierre Jouyet, Président de l'Autorité des Marchés Financiers
M. Jean François Lepetit, Président du Conseil National de la Comptabilité

M. Charles McGreevy, European Commissioner for the Internal Market and Services
M. Eddy Wymeersch, Chairman of CESR
M. Pedro Solbes, Chairman of EFRAG

Members of the ETAF

In support to the main comments of this letter, answers to the detailed questions of the invitation for comment

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# Answers to the specific questions raised in the invitation for comments

*Note to the reader*
*These answers should be read in conjunction with the cover letter*

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## *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.

- It is fundamental to solve the difficulties and murky areas of the current scope of IAS 17. Those have increased since IAS17 was drafted : in today's world, intangibles form a significant portion of assets, and new production or distribution organizations have emerged, like managed services, and new forms of ecosystems. Defining a lease by characterizing it as a right of use is insufficient. The distinction with executory contracts is poorly addressed.

  Thus, the Boards ought to reconsider their preliminary views about several issues relating to the scope before moving forward. The DP lists several drawbacks not to change the scope of the existing standard. We totally agree with the drawbacks listed. In particular,
  - the Boards should clearly articulate their views on the difference between a commitment under a lease and under a service, and on the notion of the delivery of the right of use or of the underlying asset which is used to differentiate from executory contracts;
  - more specifically, the Boards should clarify the accounting treatment for contracts on intangible assets like software licences, or for right to use a component of a larger asset.

- As the boards tentatively decided to recognize an asset and a liability for all leases, the distinction between a service contract and a lease contract will become all the more essential. In particular, the boards should reconsider the notion of specific asset as the main criteria to determine if an arrangement contains a lease. Indeed, determining whether a contract conveys a right to use appears to be relatively straightforward, but whether an asset is specific or not will be much more difficult to establish, particularly for contracts that are today classified as operating leases. We wonder if this criterion makes sense from an economical point of view. For instance, 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. This example is an eloquent example of the limit of the "specific asset" criteria (or any exclusivity criteria).

  Similarly in many service contracts, the suppliers need to use fixed assets to perform the service whether in its own premises or in the customers premises. Here again determining that an arrangement conveys a

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right to use an asset based on control of physical access is highly questionable. Obtaining more than an insignificant amount of the output of an asset is also not a straightforward criterion to make such a determination. More importantly, it questions the basis for a different recognition of assets and liabilities.

The need of clarification of IFRIC 4 is essential in order not to trade a difficulty (distinction between operating leases and finance leases) for an other one (distinction between lease contracts and service contracts).

| 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. |

Yes, we agree that scope exemptions are needed.

- The Boards should have done an analysis of the success of leases in the economy and should have described the various importance of the assets that are rented, the varying types of lessors and lessees, the highly structured deals and plain vanilla ones. In doing so, the Boards would have identified that large ticket deals represent a very significant portion of the value of leases portfolio, while the bulk of contracts are for individual asset with low unit value. It would also have helped focus the design of the proposals on what needs repair, if this was the conclusion reached.

  The intrinsic value to lessees of the bulk of leasing arrangements resides in their simplicity and flexibility. That an accounting standard would deprive companies, esp. SMEs or emerging markets, of these qualities is neither a desirable nor an acceptable outcome.

- We believe that reference to IAS1/FMW by preparers to the concept of materiality will not be sufficient.

  Therefore, it would not be acceptable that the Boards do not address this concern in their final standard through a clear scope exception for non core assets or short term leases. If no theoretical reason exists to exclude them from the scope of the future standard, both types of exclusion can be supported under a cost/benefit assessment with their respective Pros and Cons, although exemption for short term leases is probably less judgmental.

  In order to provide information to users on contracts not presented on the financial statement of position, preparers should be required to describe in the note of financial statements:
  - the nature of the lease contracts which are not accounted for in accordance with the standard,
  - as today, the minimum lease payments related to those contracts.

## *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. |

No, we do not agree.

- **Accounting for lease should retain different accountings for in substance purchases and other leases**

First we want to specify that, in our view, it is fundamental to maintain a distinction between "in-substance purchase leases" and other lease contracts (thereafter referred to as 'operating leases') as the economic of those transactions is absolutely not the same :

- "in-substance purchase" leases correspond, in substance, to the purchase of an asset financed through debt;
- the substance of an operating lease is much more similar to a service contract than to the purchase of an asset. The lessee is looking for flexibility when it has not a clear picture of its future needs. Those uncertainties might be related to technological evolution, future needs, etc. In addition, the lessee is more interested in the service provided by the leased item than the leased item itself.

Consequently, a lessee who enters into a lease with the intention to finance the acquisition of an asset is not in the same situation than a lessee who has decided to get a temporary right to use an asset, thus responding to its need for flexibility. However, the proposed model does not allow for this distinction and, provides users with an indistinctive information about these two different situations.

- **With respect to rights and obligations in an operating lease contract**

In our view, the entity shouldn't recognize any liability in respect of the rental payments because both parties are still to perform to an equal degree the actions promised by and required of them under the contract. Control of the right of use by the lessee seems artificial and presented only to justify the proposed acquisition accounting of the right of use. The lessor guarantees the continued access of the lessee to the underlying asset and puts limitations to the free use of the underlying asset. We are unconvinced by the Boards analysis that the delivery of the leased item is the past event.

In addition, the Boards' justification for the lessee having a liability for its obligation to pay rentals is that the lessor is deemed to have substantially completed its performance obligation upon delivery of the leased item to the lessee. Nevertheless, recent Boards' decisions for lessor accounting conclude the very opposite : the lessor still has a performance obligation to permit the lessee to use the leased item and honour the contractual terms of the agreement even once it has delivered the item.
We fail to understand how these two conclusions can be reconciled and ask the Boards to reach consistency within the lessee and lessor models. This is a fundamental issue on which the entire new proposals for lessee accounting lie.

Lease contracts often include a non-cancellable period which corresponds to an irrevocable commitment:
- given by the lessee to the lessor to make payment under this period
- given by the lessor to the lessee to transfer the right of use the leased item under this period.

If after reconsideration of the matters raised in our answer to Question 1, recognition of a liability is affirmed for operating leases by the Boards, we believe that:

- the liability should be limited to the irrevocable commitment
- the asset should correspond to the right to use the leased item under the non cancellable period.

**On the other hand, some quick wins could have been achieved with the current models:**

- Amend the use of the incremental borrowing rate as the alternate basis for the test of minimum payment vs. fair value of the leased item : there is no reason why a BB rated company should more likely pass the test compared to a AA rated one, or if fails should report a lower asset and liability. The borrowing rate should be clarified to be for a loan with the same degree of security of access to the guarantee by the lender (i.e. lessening the impact of the credit risk of the lessee). Alternatively, consideration could be given to eliminate this test in favour of an assessment of the rights to the residual value.

- Amend IAS7.43 and 44a by recognising that in substance purchases through a finance lease are not non cash transactions but a contractual compensation of an investing outflow by a financing inflow, that should be reported as such (i.e. gross) in the statement of cash flows.

Such quick wins would participate in higher confidence in reported figures by bringing consistency in the assessment between companies and in presentation among financial statements, while recognizing that the essence of leasing (other than in substance purchases) is not so much about the credit risk of the lessee than about the risk of recovery of the leased asset and its residual value if the lessee ceases payments.

Question 4
The boards tentatively decided to adopt an approach to lessee accounting that would require the lessee to recognize:
(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.

No, we do not.

As mentioned in question 3 we are strongly opposed to the same accounting for "in-substance purchase" leases and other lease contracts (operating leases), and are unconvinced that operating leases should give rise to assets and liabilities.

**The Boards should assess whether their proposals remedies the criticisms to the current lease models**

In the first chapter of the discussion paper, the Boards present the main criticisms of the current lease accounting model:

- users think that operating lease give rise to *assets and liabilities* that should be recognized on the financial statements of lessees,
- *comparability*: the existence of two very different accounting models means that similar transactions can be accounted for differently,
- the existing standard provides *opportunities to structure* transactions so as to achieve a particular lease classification,

- existing standard is *difficult to apply*: difficulties to define the dividing line between finance lease and operating leases.

*Users needs of assets and liabilities*

Although we understand that answering to users' needs is one of the main purposes of the discussion paper, we observe that users' needs are not appropriately and deeply analysed in the DP:

- do users really want to recognize assets and liabilities or are they dissatisfied about the current disclosures for operating leases? For all lease contracts or only for certain contracts or certain activities? What are they desires in terms of income and cash flow statements?
- the model proposed in the DP increases volatility in the statement of financial position and in the income statement. It disconnects the income statement from the cash flow statement. Is this really what users want?

Furthermore if the main concern of users is to recognize assets and liabilities arising in all lease contracts on the financial statement of position, it does not necessarily imply to remove the distinction between operating lease and financial lease. This point is very important because this removal determines all the DP approach.

*Comparability and value of the information*

Based on their assessment of the probability weighted payments and most likely terms, two companies with identical contracts with the same term and renewal options will record them differently not only in their statement of financial position but also in their statements of income and cash flows although they have the same contractual rights and obligations and even potentially the same incremental borrowing rate. Moreover, two different lease contracts could be accounted for in the same way. Consider two contracts where the first one is a five-year lease and the second one is a three-year lease with an option to extend for additional two years that would be considered likely to be exercised. Under both cases, the lessee would recognize an obligation to pay five years of rentals even if the economy of both contracts is not the same.

Hence, contrary to the stated objective of the DP, the new model will not improve the financial statements comparability.

*Structuring opportunities*

If in the past, lease accounting has been an area of regulatory actions in the U.S., the initial difficulties appear to have been overcome. Furthermore, lease accounting has not been at the forefront of issues raised in reports on internal control over financial reporting nor in the current economic and financial environment.

Please refer to question 3 for quick wins under the existing standard.

*Difficulties to apply*

We are unconvinced by the assertion that the dividing line between finance and operating leases under the current literature is a major difficulty. Making a determination always requires a judgment, and the Boards recognize that accounting includes a certain amount of judgment and estimate. Usually, determining whether a lessee has entered into an in substance purchase can be inferred from the decision making, the nature of the leased asset and the business models of the parties involved.

Furthermore under the new model, differentiating leases from services will be much more important than in the past: lessees will have to perform an IFRIC 4 type analysis more often than before. Indeed, at the present time, most lease contracts are classified as operating leases. When a service contract contains a lease, IFRIC 4 analysis has currently an effect on the financial statements only if the lease component is classified as a finance lease. IFRIC 4 has poorly designed criteria (please refer to question 3) and when a service contract makes use of equipments, it is often artificial to split payments between equipments and services, esp. for managed services, which purpose is to discharge the customer from any responsibility for equipments.

In fact, this subject is related to the decision of the Board to stick to the current scope of IAS17: what economically characterizes a lease is not defined; the increasing role of intangibles in the economy and the growth in managed services are not analyzed; the distinction with executory contracts is poorly addressed. Putting aside the expediency of moving quickly towards convergence, the Boards have therefore not clearly articulated their views of the difference between a commitment under a lease and for a service, or on the notion of delivery of the right of use or of the underlying asset which is used to differentiate from executory contracts[1].

- Other approaches

We agree with the rejection of the *Whole asset approach* :
It does not faithfully depict the rights and obligations arisen in lease contracts. Except for in-substance purchased leases, an entity that enters into a lease contract is in a very different position from an entity that purchases an asset principally because it has more flexibility than those that purchase an asset. In addition, the whole asset approach is conceptually flawed because it consists to recognize assets and liabilities that do not meet the framework definition and, as a consequence, overstates the assets and the liabilities of the lessee.

With respect to the *Executory contract approach*, please refer to our answer to Question 3.

* * *
* *

*Our responses to questions 5 to 23 do not consider leases that are in-substance purchases of the leased item, in our view these contracts should be accounted for under provisions similar to the existing IAS17 finance lease mo*dels, taking into account the quick wins discussed in Question 3.

| |
|---|
| Question 5<br>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 recognizes:<br>(a) a single right-of-use asset that includes rights acquired under options<br>(b) a single obligation to pay rentals that includes obligations arising under contingent rental arrangements and residual value guarantees.<br>Do you support this proposed approach? If not, why? |

[1] The Framework does not provide with a clear guidance on how to account for executory contracts :
Paragraph 91 of the framework states that "obligations under contracts that are equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements. However, such obligations may meet the definition of liabilities and, provided the recognition criteria are met in the particular circumstances, may qualify for recognition. In such circumstances, recognition of liabilities entails recognition of related assets or expenses." In addition, paragraph 61 states that: "An obligation normally arises only when the asset is delivered or the entity enters into an irrevocable agreement to acquire the asset. In the latter case, the irrevocable nature of the agreement means that the economic consequences of failing to honour the obligation, for example, because of the existence of a substantial penalty, leave the entity with little, if any, discretion to avoid the outflow of resources to another party".

We are strongly opposed to the "single asset and liability" approach. We are in favour of a component approach.

- **The single asset and liability model is conceptually flawed**

While we agree that the valuation of options included in a lease contract may not always be straightforward, we consider that requiring lessees to address uncertainty surrounding the lease term through recognition as suggested in the discussion paper is conceptually flawed and fails to represent lessee's actual rights and obligations.

An option gives the lessee a right, but not an obligation, to purchase more time or usage. The lessee has no liability in respect of the exercise of the option because no present obligation to make further payments relating to optional renewal periods arises until the lessee takes action to create one by exercising the option. This approach is consistent with normal accounting for the purchase of options in most other circumstances. Until an option is exercised, the recognised assets and liabilities will reflect the consideration given for the option, not the consideration that becomes payable when the option is exercised.

In addition, we are of the opinion that if the value of the option is immaterial to the lessee's financial statements, or it cannot be measured reliably, the option should not be accounted for separately. As a result, the whole of the minimum lease payments would be deemed to relate to the usage of the asset. Indeed, we do not believe that the alternative to no reliable measurement can be the recognition of items that do not meet the definition of liabilities.

- **Informational content**

An important drawback of the "single asset and liability" is that it fails to recognise features such as options and contingent rentals which are an important part of the financial flexibility negotiated between the lessee and lessor. The purpose an operating lease contracts is to provide entities with flexibility and adaptability when there are uncertainties on their future needs: a lessee that has the flexibility of an option will be treated in exactly the same way as a lessee without any flexibility. In our view this will deprive users from important information.

As we have already mentioned in our comment on the DP "Revenue Recognition in Contracts with a Customer" Financial Reporting is a regulated dialog between management and users that is built on confidence. As evidenced recently by the market turmoil, without confidence in the information provided, financial markets do not operate properly.

The Boards have chosen a road -whereby all leases are "unified" under the umbrella of right of use purchases, and a "one size fits all" measurement approach is applied: an assessment of probability weighted future payments and of the most likely term- that is supposed (I) to overcome any incentive towards legal structuring of terms and payments, (ii) to better reflect the expected outcome of the lease contract.

We do not think that such an approach will deliver the desired objectives, because key attributes will be missing: verifiability and understandability. This is not necessarily because of voluntary errors, but more simply because the Boards have failed to recognize that:

- in-substance purchases are transactions that differ from other leases, and therefore warrant a specific accounting treatment,

- for non in-substance purchase leases, a lessee is arbitraging its level of cost with the required flexibility -conversely, the required security- to adapt to new circumstances (hence its level of commitment whether through the minimum term or minimum payment). The contract reflects that being flexible to adapt to new circumstances is a business necessity in today's world. Determining the most likely term before the time the decision to quit or renew is contractually needed negates the business purpose and the contractual equilibrium of such leases. Similarly, the Boards have missed the opportunity to reassess the role of past event in the determination of the accounting for payments contingent upon future actions from the lessee: usage or sales proportionate payments reflect an agreement between the parties to share risks and acceptance by the lessor to depend upon future actions from the lessee.

Introducing measurement principles that do not reflect the business purpose or force the lessee to abandon its flexibility to address an uncertain future is akin to building into the standard risks of errors that no internal control measures can alleviate.

Furthermore proposing measurement principles that build in constant modifications of reported figures will more likely than not jeopardize the confidence in reported figures.

## *Chapter 4: Initial measurement*

**Question 6**
Do you agree with the boards' decision attempt 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 disagree.

Subject to our previous comments on the recognition of an asset and liability, we do not support the Boards proposal to discount the obligation to pay rentals using the lessee's incremental borrowing rate: there is no reason why a BB rated company would report a lower asset and liability compared to a AA rated one. The essence of leasing (other than in substance purchases) is not so much about the credit risk of the lessee than about the risk of recovery of the leased asset and its residual value if the lessee ceases payments. Reference to the incremental borrowing rate even if is defined as taking into consideration the nature and quality of the security provided by the leased item gives too much emphasis on the credit standing of the lessee.

(For in substance purchases, either the IAS17 approach or the incremental borrowing rate should be retained)

**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.

Subject to our previous comments, we agree with the boards that the right of use, if shown as an asset, should equal the liability.

## *Chapter 5: Subsequent measurement*

| |
|---|
| Question 8<br>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.<br>Do you agree with this proposed approach?<br>If you disagree with the boards' proposed approach, please describe the approach to subsequent measurement you would favour and why. |

No, we disagree.

- **As operating leases are specific instruments, their accounting treatment should not necessarily be based on the existing IFRS Standards**

In the case of an operating lease, we strongly disagree with this approach. Indeed, this approach results in an up-front increase in costs and may deviate from the timing of recognition of the economic benefits.

As there are fundamental differences between an operating lease and a purchased asset or an in substance purchased lease, the accounting treatment related to the subsequent measurement should not be the same: in an operating lease contract,

- the right to use the asset and the obligation payment are intrinsically linked given that they arise from the same contract and do not exist independently of each other;
- the lessor has not sold an asset to the lessee. Conversely, the lessor provides the lessee with a service through the leased item;
- the lessee pays for its right to use the leased item at the same time it receives the right and consumes its benefits.

For those reasons, we think that the linked approach is the most appropriate one to reflect economic substance of an operating lease. As there is no financing provided by the lessor, no interest charges should be recognized. § AG 55 of IAS 39 states that "Generally, interest does not start to accrue on the asset and corresponding liability until the settlement date when title passes". Following our previous comments, we do not believe that any interest should be recognised in the case of an operating lease as the title passes over the lease period.

The linked approach we favour is not the one described in the DP. In many cases, the DP (mortgage based amortisation) fails to correctly reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

We suggest a model used by some energy companies which have commitments related to nuclear end-of life cycle operations, when a part of the cost of those operations is born by a third party. In this case, provisions for end-of-life-cycle operations is valued at the start-up date of the nuclear facilities and is an integral component of the cost basis of those facilities; it is recognized in property, plant and equipment. The share of provisions for end-of-life-cycle operations corresponding to funding expected from third parties is recognized in a non-current asset account, End-of-life-cycle asset - third party share, which is discounted in exactly the same way as the related provisions.

Even if the right of use asset in an operating lease contract does not meet the definition of a financial asset, we believe it should follow the same accounting treatment than described above.

At each reporting period, both the asset and the liability should be undiscounted. As a consequence, the effect on the income statement of undiscounting asset and liability would be nil. The right of use asset would be amortized over the non cancellable period of the contract according to the straight-line method. The liability would be reduced at each rental payment. As a consequence, right-of-use asset would remain equal to the liability over the lease term.
This model is illustrated in the example below:

| | |
|---|---|
| Annual rental | 35000 |
| Rate | 8% |
| Lease term | 5 |

| | Year 0 | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | |
|---|---|---|---|---|---|---|---|
| ***Balance sheet*** | | | | | | | |
| Asset | 139 745 | 115 924 | 90 198 | 62 414 | 32 407 | 0 | |
| Liability | -139 745 | -115 924 | -90 198 | -62 414 | -32 407 | 0 | |
| Cash | | -35 000 | -35 000 | -35 000 | -35 000 | -35 000 | |
| ***Income Statement*** | | | | | | | |
| Rental expense | | -35 000 | -35 000 | -35 000 | -35 000 | -35 000 | |
| *discounting cost* | | *11 180* | *9 274* | *7 216* | *4 993* | *2 593* | |
| *discounting profit* | | *-11 180* | *-9 274* | *-7 216* | *-4 993* | *-2 593* | => net to zero in the income statement |
| Financial result | | 0 | 0 | 0 | 0 | 0 | |
| Net Result | | -35 000 | -35 000 | -35 000 | -35 000 | -35 000 | |

- **The delinked approach contemplated by the Boards may lead to very strange results**

Under the de-linked approach developed in the discussion paper for subsequent measurement, the net book value of the asset will be lower than the liability during the contract life.
If the contract is broken before its term for any reason, the lessee will recognize a gain corresponding to the difference between the asset's net book value and the liability. We fail to see any economical justification of this gain. This simple example demonstrates that the delinked approach has no economic justification.

| | |
|---|---|
| Annual rental | 35000 |
| Rate | 8% |
| Lease term | 5 |

| | Year 0 | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
|---|---|---|---|---|---|---|
| ***Balance sheet*** | | | | | | |
| Asset | 139 745 | 111 796 | 83 847 | 55 898 | 27 949 | 0 |
| Liability | -139 745 | -115 924 | -90 198 | -62 414 | -32 407 | 0 |
| Net contract position | 0 | -4 129 | -6 351 | -6 516 | -4 458 | 0 |

**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.

In an operating lease contract, the lessee is not interested in the fair value of the lease item and we do not think that such an option will provide users with better information.

**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.

No, we disagree with the principle of such remeasurement.

Where the lessee's incremental borrowing rate is used, we share the view of the FASB not to require subsequent reassessment of the incremental borrowing rate as it would be inconsistent with existing literature on the subsequent measurement of non-derivative financial liabilities. Under the amortised cost based approach, the carrying amount of financial liabilities is not revised for changes in market rates.

Furthermore, revising the lessee's rate would have any useful information content to users while increasing the burden for preparers.

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.

As describe above, we are of the opinion that, as operating leases are specific contracts, their accounting treatment should not necessarily be based on existing IFRS Standards (see question 8).

(Such reference might be adequate nevertheless for in substance purchases obligations).

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.

Yes, we agree with such an approach.

In situations where the lessee's objective is not to finance the purchase of an asset but only to benefit from services provided by the asset (operating leases), a rental expense will better depict the nature of the service than an amortisation expense in the income statement.
For example, when taking out a car lease, a firm may not be concerned about the vehicle itself, but instead wants the possibility that the contract offers in terms of providing a transport service to visit clients or deliver goods.

## *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.

No, we do not agree with the "single asset and liability approach".

The lessee should recognize neither liability nor asset for rentals related to optional periods or purchase options. Conversely, we believe that the only satisfactory treatment from an economic and conceptual point of view is the component approach.
For further comment on the accounting treatment for option, please refer to question 5.

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.

No, we disagree.

As mentioned in Question 3, for operating leases, determining the most likely term before the time the decision to quit or renew is contractually needed negates the business purpose and the contractual equilibrium of such leases. De facto, requiring a permanent reassessment of the lease term is not pertinent and would also be burdensome and not verifiable.

If the boards were to confirm the single asset and liability model (which we believe they should not), we agree with recognising the changes in obligation to pay rentals as an adjustment to the carrying amount of the right-of-use asset.

The boards' approach would not provide users of financial statements with a better information., The user's view is likely to be clouded by continuously changing lease assets and liabilities and the comparability of successive balance sheets will be impaired. Moreover, users will not be able to identify fixed and unavoidable commitments from other estimated future and uncertain commitments. Useful information on a business's value and risks lies only within the fixed commitment made by the company.

Finally, this approach will also clearly be extremely costly for preparers to apply. In our opinion, these costs would significantly outweigh benefits for users (if any).

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?<br>If you disagree with the proposed approach, please describe what alternative approach you would support and why. |

No, we do not agree.

For an operating lease contract, purchase options should be accounted for separately, in the same manner as renewal or cancellation options. We do not expect that for operating leases, such options will have any significant value.

(For in-substance purchase leases, we believe that the current accounting presentation is appropriate as it faithfully reflect the substance of the transaction).

## *Chapter 7: Contingent rentals and residual value guarantees*

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| Question 16<br>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?<br>If you disagree with the proposed approach, what alternative approach would you recommend and why? |

No, we do not agree.

- **All contingent rentals are not similar**

Leases that contain renewal and purchase options give rise to similar issues than leases that contain contingent rentals based on usage and performance. The similarity is that both kinds of leases give the lessee the option to benefit from more additional capacities or value extraction of the asset. The difference is simply whether the lessee wants more time or more usage. Logically, the same principles should be applied to both circumstances.

However, contingent rentals based on price change or index may be viewed as giving the lessee an obligation to pay an uncertain amount for the asset rather than an option to change its benefits. In the latter case, we agree that it corresponds to an unconditional liability which should be accounted for in the statement of financial position.

- **Contingent rentals based on usage or performance**

As for the options to renew or to cancel the lease, options to benefit from additional usage should be accounted for separately. The value of the rights obtained by the lessee cannot be more than the present value of the minimum payments required by the lease. Until an option is exercised, the recognised assets and liabilities will reflect the consideration given for the option, and should not reflect the consideration that becomes payable when the option is exercised. In addition, the lessee has no liability in respect of the exercise of the option because no present obligation to make further payments relating to the purchase of additional capacities or usage arises until the lessee takes action to create one by exercising the option. This approach is consistent with normal accounting for the purchase of options in most other circumstances.

Consider, for example, a lease of equipment where rentals are wholly contingent on the equipment's future use. If the leased equipment becomes obsolete or the lessee limits its usage, the lessee does not have to pay. The lessor, not the lessee, bears risks relating to adverse technical or economic conditions (and, conversely, benefits from improved technical or economic conditions). We strongly believe that the lessee should recognise no asset nor liability in respect of the future use of the equipment if there is no obligation to pay.

Consider, for example, lease contracts including contingent rentals based on performance, the contingent payments are more akin to royalties payable on sales. In addition, since the lessor's right to receive the contingent rentals is subject to demand risk relating to the lessee's business, that element present some characteristics of a joint venture between lessor and lessee, rather than a transaction giving rise to a financial liability for the lessee. The lessor, in addition to retaining a residual interest in the leased property, has in effect also received an interest in the lessee's operation of the leased property.

Hence, the Boards have missed the opportunity to reassess the role of past event in the determination of the accounting for payments contingent upon future actions from the lessee: usage or sales proportionate payments reflect an agreement between the parties to share risks and acceptance by the lessor to depend upon future actions from the lessee.

- Contingent rentals based on price changes or index

As explained above, we agree that contingent rentals based on index or price changes meet the definition of a liability as it corresponds to an unconditional obligation to pay rentals.
Indeed, in those cases, the amounts payable by the lessee are independent of the lessee's future actions, that is, they do not relate to the lessee's use of the leased property or to the lessee's success in using the leased property. Therefore, such contingent rentals create for the lessee at the beginning of the lease term a liability of unknown amount.

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.

*As we do not agree to recognize liabilities for contingent rentals based on usage or performance before the contingent factor is met, we do not answer to this question. Please refer to Question 5.*

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.

Subject to our previous comments, we agree with FASB's approach.

Index applied to rentals payable under lease contracts are often very volatile. As a consequence, the future changes of the index may not be reliably assessed.
Since the reliability criterion may not be met in many cases, we are in favour of measuring the obligation to pay rentals using the available index or rate. We understand that changes in amounts payable arising from changes in indices would be reflected in the liability through PL: subsequent changes in the index represent an additional cost for the entity that do not indicate any corresponding increase in the value of the originally assessed cost of the right-of-use asset.

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.

*As we do not agree to recognize liabilities for contingent rentals based on usage or performance before the contingent factor is met, we do not answer to this question. For contingent rentals based on index, please refer to our answer to Question 18*

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.

*As we do not agree to recognize liabilities for contingent rentals based on usage or performance before the contingent factor is met, we do not answer to this question. For contingent rentals based on index, please refer to our answer to Question 18*

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?

No, we do not agree.

First, because we wonder whether residual value guarantees exist for operating leases.

If they do for such leases,

- the lessee's discretion to avoid any payment that may be required under a residual value guarantee is limited, because it is affected by future events (market price changes of the used item) that are outside its control.
- residual value guarantees should be accounted for as derivatives because the evolutions of their values are linked to future events unrelated to the right of use. If the value of the guarantee is immaterial to the lessee's financial statements, or it cannot be measured reliably, the guarantee should not be accounted for but disclosed.

If the guaranteed amount is greater than the expected residual value, the guarantee has an intrinsic value at the outset, which has to be recognised as a component of the minimum. In this situation the giving of the guarantee may have resulted in a reduction in the nominal rental payments required during the term of the lease.

## *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?

Subject to our previous comments, yes, we agree.

Operating leases should be presented separately among operating liabilities. As explained above, we strongly believe that an operating lease is not akin to a financing arrangement.

(For in-substance purchase leases, we believe that the current accounting presentation is appropriate as it faithfully reflect the substance of the transaction).

> 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?

For operating leases, the assets should be presented in the statement of financial position in a separate caption (like the liabilities).

The notes to financial statements could provide a split by nature of underlying assets with any other relevant information on contingent rentals, residual value guarantees and renewal and purchase options.

(We believe that the current accounting presentation is appropriate for in-substance purchase leases as it faithfully reflect the substance of the transaction).

## *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. |

- **Costs for preparers and feasibility analysis**

We believe that the boards should have considered more deeply the practical implications in term of internal control, workload and costs associated with the new model and impacts on IT systems. We respectfully suggest to the Boards to implement a robust testing of these costs for preparers in the light of its expected benefits and to consider in particular the continuous reassessments of the liability required by the proposed model as a result of the periodic reassessment of the discount rate, the most likely term of the contract, the probability weighted approach for contingent rentals and the residual value guarantees.

- **What are the real users' needs?**

We believe that the boards has not deeply analysed users' needs. The vast majority of leases are straightforward leases for small items such as cars, photocopiers, IT or telecom equipment. These are very different from the big ticket or structured leases that are the focus of users concerns.
We recommend Boards to thoroughly discuss the following topics with users :

- Do users expect the liabilities for all lease contracts to be recognised in the statement of financial position? Or only the liabilities for certain contracts, for example, "core" assets leases? Should the liability represent rentals for the minimum lease term or include rentals for optional periods too?
- What is the level of reliability expected by users from this information? The model proposed in the DP increases volatility in the statement of financial position and in the income statement. Is this really what users want?
- Do users really want to abolish the distinction between finance leases and operating leases or do they only want to recognise liabilities and assets arising in operating leases on the statement of financial position?

Finally, we have listed several issues that are not addressed or that are not enough developed in the discussion paper. Since some of those issues have been discussed by the Boards during recent meetings, we would appreciate to be properly consulted on those issues:

- Sales and lease back transactions
- Impairment of right-of-use asset
- Transition
- Income statement presentation and Cash flow presentation

## *Chapter 10: Lessor accounting*

*As mentioned in our cover letter, the boards should publish a discussion paper integrating lessor (and subleases) accounting, sales and leaseback transactions and vendor's leasing as they are good tests of the coherence of the approach and compatibility with the revenue recognition and the derecognition projects.*

As the boards have already raised tentative decision on the rights and obligations in a simple lease contract we prefer to discuss below the issues raised by these tentative decisions rather than answering to questions 25 to 29 of the discussion paper.

In May 2009, the boards tentatively decided that:

- a lease contract creates new rights and obligations,
- lessor has an obligation to permit the use of the leased item (no derocognition of the lease item),
- revenue is recognised as the performance obligation is satisfied, that is to say, over the lease term.

We have been very pleased about this approach.
We note that it is totally inconsistent with the general principle of the discussion paper under which the lessee purchases a right-of-use asset from the lessor at the inception of the lease.
This contradiction demonstrates in our view:

- the limits of the discussion paper approach which considers that the lessee has bought a right of use at the inception of the lease,
- the necessity to distinguish at least two categories of lease: in substance purchase leases and other leases as we strongly believe that, in some circumstances, the lessor should record revenue at the start of the lease where the transaction is an in-substance sell of asset.

In the case of an in-substance purchase lease, the accounting treatment currently required by IAS 17 is consistent and should be maintained as it faithfully depict the substance of the transaction.