



## COMMENTS ON EXPOSURE DRAFT - REPORTING OF LEASE CONTRACTS

Brussels, 15 December 2010

### For the attention of the IASB and FASB

Dear Sir or Madam,

The *European Retail Round Table* is very pleased to provide comments to the International Accounting Standards Board on its request for views on the Exposure Draft Leases (ED). We are strongly concerned about the approach which has been proposed in the ED and we share the general view that the present exposure draft does not reflect commercial reality, particularly in the retail sector. While the proposals seek to enhance transparency and comparability, we believe that the opposite will be achieved.

We strongly believe that the proposed model will not improve the quality of financial information and will not provide users with more useful or clearer information. Conversely, serious risks of introducing elements of confusion that would lead to a lack of reliability exist. We disagree with the proposed model for the reasons outlined below:

1. The vast majority of users will not understand the new Financial Statements arising from the Exposure Draft. Operating leases do exist and they **are key parts of the retail business**. They are used in the retail industry as an alternative to acquisition to gain flexibility based on contingent rents, options to renew or breaking options. A lease contract is a live contract usually opened to renegotiations, renewals or amendments very related to the business performance and which make it difficult to understand the concept of asset relying under the new proposal.
2. Lack of reliability and comparability in information for users. A typical retailer can spread business over thousands of real estate lease contracts, in several countries with a wide range of lease clauses applying to contingent rents mainly linked to store sales and PCIs, lease renewals, breaks, etc. and featured usually by the long term of the agreements. We underline the risk of obtaining misleading information from the subjective assessment of the huge and diverse information arising from thousands of lease contracts, particularly some categories of primary users of financial statements, such as the investment community, that would expect to have clearer information, less subject to judgmental estimates and less volatile information about the assets and liabilities recognized in the balance sheet.

Risks of confusion and volatility arise essentially as a result of the **significance of estimates** recognized and measured based on a very judgmental criteria and the **lack of reliability of long term estimates for** lease terms, sales, price indexes, currencies, etc. Therefore, the new reporting scenario

will be strongly influenced by management estimates and projections. Given their significance, it should be expected that assets and liabilities recognized with respect to leases will significantly differ between entities thus seriously jeopardizing comparability.

3. Significance of economic impacts in the Financial Statements. For the retail industry, lease expense represents a high percentage of its total expenses. The new proposals will cause a relevant impact overcharging expenses significantly during the initial periods of the lease term and undercharging expenses during the final periods with an accrual impact unaligned with the business operation, since correlation between sales income and expense will be missed. Moreover, the proposed change would take a significant operating cost from EBITDA, a widely used measure in the industry - to finance and depreciation costs - and would change cash flow statement presentation. Therefore, the **resulting Financial Statements will be misleading** for retail industry analysts who will request additional disclosures on real rental expense to be able to follow the business.
4. Volatility in the Financial Statements. Additionally, the need for reassessments during the lease term, will lead to **high volatility in the financial statements** arising in amendments in assets and liabilities and impacts in the profit and loss account, which are not related to the reality of the business.
5. The proposed changes to accounting for leases per the exposure draft would require companies to recognise lease assets and liabilities which do not meet the definition of assets or liabilities under the conceptual framework, while the proposed treatment introduces a significant number of inconsistencies between the accounting applied by lessees and lessors and inconsistencies with existing standards, resulting in reduced comparability, creating accounts which would fail to meet the needs of the end user.
6. High compliance cost against a short potential benefit. We believe that the *principle of balance between benefit and cost* contained in the Framework for the Preparation and Presentation of Financial Statements is not met in the proposed DP: while the benefits of the proposed approach are strongly arguable, the **costs would increase significantly**.

However, we positively accept a review of the current lease accounting rules through enhanced recognition rules and additional disclosures in order to simplify lease accounting and provide final users with clearer and more useful information. Particularly, information on commitments would be highly improved including qualitative disclosures in the notes about contingent rents, options and similar uncertain items (by means of sensitivity analyses, ranges of interest rate applicable to group of contracts with similar characteristics, qualitative information about the most significant contracts and their future developments).

Yours sincerely,



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Director, European Retail Round Table

**ERRT** is a network of business leaders established to express the views of large retailers on a range of issues of common interest. ERRT members are: **Ahold, Asda / Wal-Mart, C & A, Carrefour, Delhaize Group, El Corte Inglés, H&M, IKEA, Inditex, Kingfisher, Marks & Spencer, Mercadona, Metro Group and Tesco**. Their businesses operate worldwide and represent a cross-section of the retail sector. The combined turnover of ERRT members is over €400 billion. The retail sector in the European Union is vibrant and successful. It makes a vital contribution to the economic and social well being of the EU.

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