

RWE AG. Opernplatz 1, 45128 Essen, Germany

Sir David Tweedie Chairman of the International Accounting Standards Board (IASB) 1st Floor, 30 Cannon Street London EC4M 6XH United Kingdom

December 8th, 2010

Exposure Draft "Leases"

Dear Sir David,

We appreciate the opportunity to comment on the above mentioned exposure draft.

RWE is one of the leading utilities in Europe, focussing on the electricity and gas sector. Our activities cover all of the major elements of the energy value chain. Headquartered in Germany and with external revenues amounting to 48 bn. EUR we are providing work for more than 70.000 full-time employees (figures as of 31 December 2009).

We investigated the intended rules that are introduced by the Exposure Draft for Leases. Please find below our answers to selected questions raised in the Exposure Draft. As the issues raised generally belong to more than one question we summarize our issues under headlines that should make obvious to which questions they belong.

Comments on Lessees Accounting / Contracts that contain service components / Measurement/ Lease terms / Lease payments / Reassessment / Short-term leases

We do not agree with the suggestions regarding lessees' accounting. In our opinion the right-of-use asset as well as the liability to make lease payments do not comply with the framework definitions of assets and liabilities for the following reasons:

Liabilities are defined as a present obligation of the enterprise arising from past events resulting in an outflow of resources embodying economic benefits (F.49 (b)). As a precondition of complying with this definition there has to be a present obligation arising from past events. However, ED/2010/9 suggests to measure the liabilities to make lease payments by for example considering contingent lease term enhancements. By taking these contingencies in consideration the precondition saying that there has to be an obligation arising from past events is not met. Furthermore the consideration of contingencies is in our view inconsistent with the tre-

Group Accounting

Our ref. CFR-F

 Name
 Dr. Inge Hohrath

 Telephone
 +49 (0) 201 - 12 15 757

 Fax
 +49 (0) 201 - 12 16 979

 E-mail
 Inge.hohrath@rwe.com

RWE Aktiengesellschaft

Opernplatz 1 45128 Essen

T +49 201 12-00 F +49 201 12-15199 I www.rwe.com

Vorsitzender des Aufsichtsrates: Dr. Manfred Schneider

Vorstand: Dr. Jürgen Großmann (Vorsitzender) Dr. Leonhard Birnbaum Alwin Fitting Dr. Rolf Pohlig Dr. Rolf Martin Schmitz

Sitz der Gesellschaft: Essen Eingetragen beim Amtsgericht Essen

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- atment of contingent liabilities according to IAS 37 that does not require a mandatory recognition of contingent liabilities.
- F.49 (a) states that an asset is a resource controlled by the enterprise as a result of past events from which economic benefits are expected to flow. Recognising a right-of-use asset does not originally result from investigating an economic issue under the framework's asset definition. It rather appears because of the necessity of an accrual item with the purpose of avoiding p&l effects when the liability to make lease payments is recognised first. In our understanding building up accrual items in the balance sheet is even not reflecting the Boards' view of what items should be contained in the balance sheet (contrary to for example German GAAP).

Beyond that ED/2010/9 encourages the discussion which part of uncompleted transactions have generally to be recognised within the balance sheet. Currently, beside the notes required for operational lease contracts by IAS 17.35, there is additional disclosure required for commitments that are uncompleted transactions as well, e.g. purchase commitments to buy property, plant & equipment or immaterial items. It is imaginable to apply ED/2010/9 analoguesly to these purchase commitments as the assets to be bought represent respectively "contain" a right-of-use asset (for the purchased asset) as well as a liability to pay the purchase price in future. In our view every enhancement of mandatory recognition for open purchase commitments/ uncompleted transactions would lead to less informative financial statements as this overloads the balance sheet with liabilities which firstly do not yet exist and secondly are tainted with uncertainties because of measurement assumptions for the distant future.

Furthermore we expect a lot of **practical problems** by applying the proposed provisions for lessee accounting :

- The accounting by lessees will lead to more subjectivity, uncertainty, complexity and volatility:
 - Subjectivity and uncertainty will be introduced by judgement on whether or not the lease will be extended and terminated. Given the long term of lease contracts it is a call on something in the distant future. The fact that on an annual basis the assumptions need to be reassessed and adjusted when deemed necessary also could lead to a certain degree of subjectivity in the review and thus in the valuation of the asset and debt.
 - Next to that there is also a matter of complexity in determining both the assets and the related debt where interest effect and calculations of cashflows, penalties and other effects are concerned. Although it is foreseen that reassesment only becomes necessary if circumstances changes this does not really help in terms of constraining the operational effort. If there are for example lease contracts linked to a capital equipment index reassessment will become due regularly with respective changes in p&l. Thus the rightof-use asset value changes every period and therefore the depreciation has to be recalculated every period.
 - A further item to take into account is additional volatility in the results, also due to the annual reassessment that needs to be car-





ried out. Not all changes resulting out of the reassessment will be sustainable and therefore should not cause volatility. Furthermore this volatility is caused by the revision of assumptions. We think that volatility should at least be based on facts but not at all based on assumtions.

- As already raised as a response on the Discussion Paper one of the biggest issues is the huge effort, i.e. costs caused by the new lease accounting as a huge number of contracts will have to be investigated. In addition to the investigation volume the probability of lease terms for these contracts is hard to determine because they may contain diverse options like enhancement and purchase options and termination possibilities. Furthermore the probability of lease payments is also hard to estimate - in particular in case of residual value guarantees for cars and indexed-linked lease payments for building rent contracts. As the treatment of lease and service components within lease contracts is planned to be different all of these contracts would furthermore have to be investigated in terms of confining leasing components from service components. Because it is almost impossible to investigate each single contract you have to face that based on materiality considerations processes and groupwide contraints will be implemented to make the recognition of all these contracts operationally possible. This leads to a level of impreciseness within the financial statements. Following the current provisions we in contrast find quite exact information about these contracts within the notes which are already used for rating purposes.
- Taking into account the issue of the huge operational effort we would explicitly recommend to extend the possibility of applying simplifying rules (e.g. some kind of simplifying rules as for Short-term leases) to any kind of standard rent contracts such as leasing contracts for technique equipment or generic real estate rent independent from lease terms.
- Within our grid business it is quite common to have contracts with indefinite contract terms for foreign rent areas ("Fremdpachtgebiete"). ED/2010/9 does not provide guidance on the topic how to deal with contracts that are signed for an undefinite term. On what basis shall the liability to make lease payments be measured in this case, based on perpetuity?

Comments on Lessors Accounting / Scope/ Purchase Options

With regard to the proposed lessor accounting we want to comment on the foll-wing issues:

• Following ED/2010/9 purchases shall not be within the scope of the new leasing standards (ED.8). Contrary to that, ED/2010/9 introduces the derecognition approach to be applied by lessors for certain lease contracts. As stated within the ED these lease contracts economically present a purchase contract for at least a part of the underlying asset and should be accounted for similar to a purchase by recognising a respective amount in p&l. We do not understand the scope exclusion of purchases if such transaction are obviously ruled by the planned provisions.





- Following the standard text of ED/2010/9, only exercised purchase options result in excluding the respective contracts out of the scope of the leasing standard. There are no clear rules within the (main) standard text how bargain purchase options have to be considered in terms of applicability of the leasing standard. Only the Basis for conclusions contain a remark saying that bargain purchase options are treated as if they had been exercised and therefore lead to scope exclusion of the respective contract. We would appreciate such important rules to be contained in the main text rather than in the Basis for conclusions. Furthermore we think that confining bargain purchase options and "normal" purchase options could be difficult and once again open up space for subjectivity.
- According to IAS 40.7 investment property that is measured at fair value in compliance with IAS 40 shall be excluded from lessor accounting (ED.7 (b)). We do not understand this exemption as it leads to a different lessor accounting for tangible asset leasing compared to intangible asset leasing. Lessors of tangible assets would in addition to the leased asset show the right to receive payments and a liability representing the external usage of that asset in the balance sheet or, by applying the derecognition approach, even derecognise a portion of the underlying asset. The lessor of an intangible asset/investment prooperty would instead continue to only recognise the whole asset measured at fair value. We do not see any economic reason that justifies unidentical treatment for tangible and intangible lease arrangements.
- ED/2010/9 does not point out clearly how presentation should look by applying the performance obligation approach. Some commentators assume that presentation has to look analoguesly as suggested for sublease contracts for which a multiple column presentation is envisaged (ED.B29). If this assumption is correct the balance sheet would in our opinion be overloaded with negative impact on the clarity. We would rather prefer presenting only the net position within the balance sheet by providing additional information within the notes.

Presentation

As we support the idea of a straightened presentation within all parts of the financial statements focussing on material numbers we do not think that separate presentation of all lease related positions is helpful for the reader and contributes to a clear and meaningful presentation. Moreover we think that such detailed information should be presented within the notes. However, especially because the Board intends to equally treat ownerships' and leased assets, an undifferentiated presentation would be in line with the Board's aim. It foils the Boards' aim to eqalize accounting treatment for in the Board's view similar economic issues by not consequently pervade this principle within presentation.

Beside mentioned Presentation issues suggestions for presentation within the Exposure Draft do not correspond to the suggestions discussed within the Financial Statement Presentation project (FSP). ED/2010/9 proposes to show interest expense of the lease liability within financial results of p&l and cash payments for leases within the financing activities whereas the discussions made for the FSP project intend the creation of a new category "operating finance" in which all as-





set based financing activities shall be shown. From our perspective it is absolutely not acceptable to force companies to adapt IT systems for implementing a new leasing standard and in a second run create the requirement of changing the systems once again for implementation of a new table of account that is suitable with all requirements given by a new standard for Financial Statement Presentation.

Transition

First of all we do not support the idea of a retrospective approach for implementation of the new provisions as there should be a conservation of the status quo for existing contracts which in our industry may have been established even decades ago.

The transitional rules require the lessee to measure the liabilities to make lease payments based on the lessee's incremental borrowing rate on the date of initial application (ED.90). Under a market environment in which the interest level is rather low the balance sheet will be burdened with high liabilities compared to the liabilities that would have been recognised if a higher interest level would prevail. Furthermore we are concerned about the impairment potential that is simultaneously implemented in the balance sheet as the rigt-of-use-asset is measured by the same amount. Furthermore we wonder about unequal treatment for lessors who are required to use the rate charged determined at the date of inception of the lease.

Taking into account all of these arguments we also think that comparability of financial statements will not be improved given the degree of uncertainty and level of subjectivity that will be introduced. Where previously there were strict criteria to adhere to leading to the decision to either present a lease on or off balance it could be stated that for the majority of financial statements the accounting was similar and comparable. With the disclosure on off balance sheet commitments the reader of the financial statements was also in a position to judge what effect there could be on future cash flows and profitability. With the proposed accounting for the future we feel that criteria are not that strict and could lead to difference in interpretation and judgements that make the impact of lease accounting less clear and comparable.

We hope that our comments will be useful to IASB in its further deliberations. We would be pleased to answer any question that you may have concerning our arguments or discuss any aspect of this letter.

Sincerely yours,

RWE_i Aktiengesellschaft

(CEO)

Fred Riedel (Head of Group Accounting)

