



IASB
30 Cannon Street
London EC4M 6XH

Paris, December 14th, 2010

Re. Exposure draft « leases »

The « Association des Directeurs Immobiliers » (ADI), the association of real estate Directors in France (end-users companies), is pleased to comment on the Exposure Draft ED/2010/9 *Leases* (the ED) proposed by the IASB / FASB Board Members (the Boards).

We would like to emphasise that the positions expressed herein have been presented to the Board of ADI.

The ADI is composed mainly of lessees and accordingly our comments and proposals focus mainly on the impact of the ED from the perspective of lessees.

We understand and support the initial objective of the Boards that we understand to be as follows:

- Improving the usefulness of financial information through increased comparability and transparency and reduced complexity with respect to leases;

To achieve this objective the Boards are:

- Proposing a new accounting model that would apply to leases whether short or long-term and thereby eliminating the distinction between financial and operating leases;
- Requiring lessees to recognise a right-of-use asset for all leases and a liability for the obligation to make lease payments.

While we do not have a general objection to the principle of recognising assets and liabilities in relation to certain lease contracts, our analyses have led to the conclusion that the Boards' ED fails to achieve its original objective.

Our main concern relates to the fact that the ED proposes to recognise as liabilities amounts due under "likely" renewal options and other contingent payments that are not true obligations of the lessees. By doing so, the proposals fail to increase the transparency of financial information.

We present our main arguments and conclusions, and propose alternative orientations and methods, in response to the certain selected questions of the ED in the Appendix A to this letter. We strongly believe that these alternatives are more likely to represent an effective mean of meeting the primary objective of the project.

Sincerely,

A handwritten signature in black ink, appearing to read 'M. GINOT', is written over a horizontal line.

Michel GINOT
Chairman



APPENDIX A RESPONSES TO THE CERTAIN SELECTED QUESTIONS OF THE ED

The accounting model

Question 1: Lessees

- (a) *Do you agree that a lessee should recognise a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?*
- (b) *(b) Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?*

An operating lease is an economic, operational choice made by an entity that does not reflect simply a financial decision: operating leases from part of the risk management strategy of the entity and provide the entity the flexibility to respond to evolution in the business. Contrary to the Board's assertion, financial and operating leases are not similar transactions, and therefore should not be presented in the same way in financial statements. Accordingly, as indicated in response to Question 5 we suggest that the scope of the proposed standard needs to be reconsidered.

Further, we have concerns with the right-of-use model as presented in the ED. This model appears to focus solely on the control of an asset implied by a lease and to assimilate lease contracts to the acquisition of an asset with a related liability. However, the notion of "control" applied to the asset appears vague and unable to capture appropriately all operational situations in which entities decide to lease rather than purchase assets. In particular, whereas a lessee is able to control access to the asset, until there is a legal commitment by the lessee towards the lessor, the lessee does not have any obligation to justify recognition of a liability on its balance sheet. We strongly believe that existence of a legal obligation is the only basis on which robust accounting can be made.

Therefore, as further explained in response to Questions 8 and 9, we believe the liability recognised by the lessee should be limited to the firm or a minimum commitment toward the lessor. More specifically, all contingent, expected or potential payments (related to renewals, guarantees, penalties, ...) should not be recognised until the point in time they represent an unavoidable obligation of the lessee (i.e. when the lessee can no longer avoid payment, for example, by terminating the contract). It is only at that point that the obligation to make lease payments represents a liability as defined in the Conceptual Framework.

When a lease is signed, the tenant is committed to incur costs over the contractual term of the lease, whether under the form of rental payments and other occupancy costs (including certain tax amounts). Recognition of a liability that would include all unavoidable amounts due under the lease, in accordance with the commitment entered into for the contractual and firm term of the lease, would improve transparency.

However, as a consequence of the model proposed by the Boards, rent expense (and occupancy costs in general) will no longer be included as part of the EBITDA measure reported by most entities but will instead be reported as amortisation and interest expenses. The model also has the consequence of resulting in higher overall charges being reported in the earlier years of the contract despite the fact that the payments called for under the lease may be straight-line (or be increasing). Both of these elements are likely to create confusion. As part of its outreach activities, the Board should approach investors to ensure that the changes proposed will correspond to their needs.

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Definition of a lease

Question 5

This exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33-BC46).

Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and why?

The Boards argue that non-core assets can give rise to significant amounts of assets and liabilities and are therefore relevant to investors. As proposed, the new standard would apply to items such as fleet vehicles and photocopiers. Even though assets of this type are not within the realm of concerns of real estate directors, and therefore not in the scope of the activities of ADI, we are nevertheless concerned about the appropriateness of applying the right-of-use model to assets that are easily interchangeable. Indeed, we are of opinion that adding significant amount of liability to the financial statements of lessees for non-core, interchangeable assets, and presenting the related charges outside of EBIDTA do not result in an improvement to financial reporting.

Therefore, we strongly suggest that the Board should consider developing criteria that will distinguish more appropriately leases of assets from service contracts. While IFRIC 4 provides guidance on the distinction between service contracts and leases, we believe that IFRIC 4 is not sufficiently robust to provide a consistent and appropriate answer. We believe that the criteria for distinguishing leases from service contracts should focus on whether or not the lessee gives importance to having access to a specific asset or whether the lessee cares more about the outcome. For example, in the lease of photocopiers, many lessees will give very little importance to the specific photocopier installed in their premises as long as they get photocopies of a certain quality. We believe that this will be the case in many non-strategic assets that could be easily interchanged.

Measurement

Question 8: Lease term

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

We do not support this proposal.

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By recognising right-of-use asset and liability for the periods covered by likely renewals, the proposal creates “likely assets and liabilities”. We do not believe that the recognition of such amounts would increase the transparency of financial information since it would result in an entity recognising certain amounts that do not meet the definition of assets and liabilities in the Conceptual Framework. Transparency and usefulness of information would be reduced by the fact that the balance sheet of entities would include both real obligations and likely obligations that the lessee can avoid (by deciding not to exercise its renewal rights).

We do not understand why “likely assets and liabilities” related to leases should be recognised in the financial statements. If so, why wouldn’t this treatment also be applied to other “likely assets and liabilities” related to project plans presented and approved by an entity’s Board Members, despite the absence of an engagement towards a third party?

We also believe that the proposals imply an unrealistic degree of precision in the long term planning of an entity’s activities. While the timeline covered by the strategic and economic planning varies from one entity to another, the robustness of scenario falls beyond 4 or 5 years. Therefore, we question the reliability of the financial data that would be produced from trying to project expected renewals over longer durations? How could such assets and liabilities be certified as bona-fide? How will third-parties be informed in a trustworthy manner by such measures?

Moreover, the ED may have counter-intuitive effects on the financial position of entities:

- Economic growth expectations will lead to longer lease terms and immediate increase of the debt level, which may be perceived as a worsening of the financial position of the entity
- On the contrary, lower growth expectations will likely result shorter lease terms and automatically (artificially?) improve the entity’s debt load.

The recognition of right-of-use assets and liabilities for likely renewal periods is not without impact on the income statement of entities. If an entity reassesses the probability of renewing lease contracts and as a result increases the amount of the right-of-use asset and the related liability, this will translate in a significant negative impact on the income statement (through increase charges, particularly in the early years). However, is the entity really facing worst prospects than before? Should it be considered as less attractive than it was previously to investors? We are of opinion that these impacts go against the initial objectives of the project and would only confuse investors and preparers alike.

Question 9: Lease payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?

Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be measured reliably? Why or why not?

The concerns we raised in response to Question 8 are equally valid with respect to the proposals to include contingent rent payments. Firstly, to the extent that contingent rentals (such as those linked to usage or performance of the leased asset) are within the control of the lessee (in the sense that the lessee could avoid payment by ceasing to use the asset) we do not believe that the related obligation to make the payments



represents a real liability of the entity. Like payments related to renewal periods, these amounts represent (at best) a likely liability. Such amounts are not normally recognised on an entity's balance sheet.

We would also like to draw the attention of the Boards on a form of indexation commonly found in lease contracts that fall within the remit of members of ADI. In France, it is common for commercial real estate leases to be indexed based on the so-called "ICC" rate (construction cost index). This rate is published quarterly by the French National Institute for Statistics and Economic Studies (INSEE). No forward rates are available for this index. While the rate over the past 20 years has been approximately 2,6%, the rate can fluctuate widely from one quarter to the next. For example, whereas the index reached +8% in 2008, it was negative for part of the year in 2009. Such swings would cause significant changes in the obligation recognised from period to period. If the Board maintains its decision of including contingent rentals in the determination of the right-of-use asset and liability, we suggest that, instead of taking the index at a specific point in time when the lease is entered into, a more reasonable approach could be to estimate the rate over the term of the lease using historical data over the same period as a starting point.

Question 10

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

We believe that the concept of "significant" can mean different things to different entities and may change according to circumstances. Therefore, the Board should give clearer guidance to allow for consistent application.

Benefits and Costs

Question 17

Paragraphs BC200-BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?

We believe that most entities, faced with numerous lease contracts, will have to undertake drastic changes regarding their information systems, involving significant additional costs and dedicated teams. Indeed, entities would be required to spend a lot of time and money to keep a reliable inventory of all leases and all of their terms, and also to calculate and communicate the impact on financial statements not only upon adoption but on an on-going basis. This will likely distract real estate professionals' from their focus that should be on making decisions in line with the entity's strategy and business planning.

Further, investors would likely gain insights in an entity's performance more from information about the alignment between assets' management and the entity's strategy.

Accordingly, in our opinion, the Boards should undertake appropriate field testing to evaluate the costs necessary for entities to adopt the proposals and provide the ongoing information and to assess whether these costs clearly outweigh the benefits of gathering relevant information.