

International Accounting Standards Board  
30 Cannon Street  
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Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
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Dear Board Members

**Exposure draft: Leases**

Thank you for the invitation to comment on the Exposure Draft for Leases. This letter represents the view of the Kesko Group, a Finnish listed company and the leading provider of trading sector services in Finland. Kesko manages retail store chains highly valued by customers, and efficiently produces services for retail store chains' purchasing, logistics, network development and data management. Kesko's operations include the food trade, the home and speciality goods trade, the building and home improvement trade and the car and machinery trade. Kesko has about 2,000 stores engaged in chain operations in the Nordic and Baltic countries, Russia and Belarus.

The store site network is a strategic competitive factor for Kesko and it provides opportunities for developing business operations. Kesko leases only properties needed in its own business operations.

Kesko Group's rent expenses on operating leases amounted to €383.1 million at 31 December 2009 and operating lease commitments disclosed as per 31 December 2009 amounted to €2,359.5 million.

The implementation of the standard as proposed would have a material impact on the lease accounting and presentation of the Kesko Group's leasing activities. In our opinion, the benefits to the users of financial statements are at the same time uncertain and questionable. In fact, we believe that the suggested right-of-use model would, for the most part, have an opposite effect as intended by the boards.

Overall, we agree with the boards' objective to improve lease accounting and that lease accounting should provide users of financial statements with a complete and understandable picture of an entity's leasing activities. Moreover we support the objective of the renewal that lessee's obligations should be presented in the balance sheet to meet the needs of the users of the financial statements.

The Kesko logo consists of the word "KESKO" in a bold, blue, sans-serif font. It is positioned on a yellow, rounded rectangular background that tapers to the right, resembling a stylized shape or a drop.

However, the exposure draft (ED) contains issues which will not necessarily improve the information presented in the financial statements. The main problem is that the ED includes a lot of issues which need management's judgment and estimates. Our concern is that because of these subjective views, the purpose of the standard to give more comparable information is not fulfilled. Moreover, the ED is quite complex and creates a significant amount of work in the transition, but also afterwards. All the changes should thus create real benefits and improve the comparability of different entities but as such the standard will not fulfill this purpose. For instance, by increasing the amount of information included in the notes instead of the capitalisations, the comparability could be improved more effectively.

If the boards, however, continue to develop the standard based on the right-of-use asset model we would like to comment on the issues that concern us mostly. Our comments only cover the lessee accounting.

Our main concerns include definition of the lease term, definition of the discount rate and front-loading cost recordings caused by the new standard:

- If the lease term is defined as the longest period 'more likely than not to occur' the liabilities will also include cancellable and avoidable lease payments.
- The definition of the discount rate is complicated and because it will lead to completely different results between entities, it will not give comparable information in the financial statements.
- Recording costs related to lease activities front-loading does not represent the true substance of operating leases.

Moreover, there are many issues, such as reassessment procedures and notes information which need a lot more application guidance for the standard to be applicable.

Our responses to the specific questions posed in ED are set out in the Appendix to this letter. We would be pleased to discuss our views further. For further information, please contact Eva Kaukinen + 358 10 53 22338.

Yours faithfully,

KESKO CORPORATION

Arja Talma  
Senior Vice President,  
Chief Financial Officer

Eva Kaukinen  
Vice President,  
Corporate Controller

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## APPENDIX

### 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?**

We acknowledge that leasing is used as an alternative to buying assets, but there are however many well-known business reasons to leasing, other than financing. We do not agree with the boards' approach that an entity's leasing activities are above all off-balance-sheet financing. In our opinion, the presentation of leases in the financial statements should reflect the substance of the transaction. Operating leases should not be treated as a purchase of the leasehold asset financed completely with borrowed funds.

Under the existing lease standard, lease agreements are classified as operating leases and finance leases based on the substance of the transaction. The lease payments under operating leases are recognised as an expense on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern of the users' benefit. In our opinion, the existing lease model provides users' of financial statements with a fairly understandable view of an entity's leasing activities and especially the performance of the lessee is measured in the income statement, reflecting the actual benefits arising from the lease agreement.

We believe that front-loading expenses of operating leases will reduce the usefulness of the income statement. This effect would be emphasised on transition.

We also believe that operating profit is an important performance indicator to the users of financial statements. Therefore, if the right-of-use model is adopted, it will raise the need for many users to adjust the interest and the amortisation expenses to, usually straight line, rental expenses. We think that this would be an unnecessary burden and it would be impossible for many preparers, to disclose enough information to enable such adjustments.

### Question 3: Short-term leases

**Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?**

(a) We believe that presenting the costs of a short-term lease as amortisations instead of rental expenses and presenting the future lease payments in non-interest-bearing liabilities would decrease the understandability of the financial statements.

We disagree with the boards' view that 'simplified' requirements would reduce the costs of applying the right-of-use model. It is

more likely that different treatment of short-term leases would lead to additional accounting costs.

However, we believe that the simplified accounting for short-term leases would not be an additional burden to lessees as long as it is voluntary.

**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 disagree with the boards' proposal. In our opinion only unconditional rent obligations should be recorded as liabilities. Therefore options to extend the lease term or any other estimate should not be included in the lease term.

If the determination of the lease term would somehow be adopted in the final standard, we think that the application guidance of the definition 'the longest possible that is more likely than not to occur' is needed.

The ED includes an example (par. B17) concerning how the probabilities of usage of options to extend the lease term could be determined. In practice the lessee does not in many cases have the information needed for this estimation process. If we consider a situation similar to the example but in a new rental retail store, the lessee would not have enough information to evaluate the possible extension of the lease term reliably at the inception of the lease. After doing business for a couple of years in that store site the knowledge will have increased but it will still be unlikely that the lessee can estimate whether the options to extend are used or not. If the lessee could, however, make such estimations it would be obvious that the actual choices would be not to use options at all or to use both of the options to extend the lease term. We don't see in this situation, nor in any other, how an entity could, without definite plans to terminate, evaluate the possibilities to use only one or some of the options to extend the lease term. Moreover, if the lessee would know at the inception of the lease that it will use any of the options, the fixed lease term would be longer. This is due to receiving better terms the longer the lease term.

Also, the determination of the lease term for fixed term leases without options to extend the lease term or leases that are in force until further notice needs to be clarified.

We would also like to point out that in case the lessee takes into account an option to extend the lease term, and records it as an asset and a liability, but then later decides not to exercise the option, the accounting method will lead to a positive income effect, because of front-loading expenses in the right-of-use model. We do not find that this presentation helps the users of financial statements to understand the leasing activities of the entity.

### **Question 17: Benefits and costs**

**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?**

In our opinion, the apparent substantial costs of implementing and applying the right-of-use model would definitely exceed the benefits. For instance, the costs from new IT systems and personnel resources to constantly review the contracts would be significant. As stated above, we do not believe that the application of the ED would have material benefits to the users of financial statements. On the contrary, it would significantly reduce not only the information on an entity's leasing activities, but also the usefulness and understandability of the financial statements as a whole.

### **Other comments**

#### **Discount rate (paragraphs 12, 33a, 49a, B11, B12, B13, BC95)**

The discount rate is an essential factor when determining the present value of lease payments. Using an appropriate discount rate, the present value of lease payments equals the fair value of the leasehold asset at the inception of the lease. The definition of the discount rate in the ED will lead to two problems in the lessee accounting, which are: the comparability between lessees and the fair values of the liabilities and the underlying assets.

According to the Exposure Draft, if the rate the lessor charges the lessee cannot be 'readily determined', the lessee should use the incremental borrowing rate as a discount rate while calculating the present value of the liability of the lease obligation. The boards define the lessee's incremental borrowing rate as 'the rate of interest that, at the date of inception of the lease, the lessee would have to pay to borrow over a similar term, and with similar security, the funds necessary to purchase a similar underlying asset'(Appendix A).

Using the lessee's incremental borrowing rate as a discount rate is problematic, because lessees have individual incremental borrowing rates. If these rates are used as discount rates it would lead to over- or undervaluation of the underlying asset and liability at the inception of the lease. This result would not be consistent with the definition of the cost of the right-of-use asset and would contradict various paragraphs of the proposal (e.g. BC71). It would also lead to serious comparability issues between lessees.

Moreover in practice, as the lease term increases, the rate implicit in the lease usually declines along with the residual value risk to the lessor. The market based interest rate for borrowing funds tends to grow, however, as the loan term increases. Using lessee's incremental borrowing rate as a discount rate would, in a longer lease term, thus usually mean higher discount rate and lower

liability presentation. Considering e.g. two lease agreements with lease terms of five and ten years, with otherwise similar contract terms, the longer lease term would usually be subject to lower liability on the balance sheet (looking at the first five years). This outcome would be adverse to the risks associated with the lease agreements. We would also like to note that the Expose Draft proposes that the discount rate used to determine the lessee's liability to make lease payments should be the lessee's incremental borrowing rate or, if it can be *readily determined*, the rate the lessor charges the lessee (par 12). However, the wording in the application guidance is different. It is said (par B11) that the rate the lessor charges the lessee can be used, if it can be *reliably determined*. We suggest introducing clear guidance regarding the discount rate of the lessee.

We propose that if the rate implicit in the lease can be reliably determined the lessee could use it for calculating the present value of the liability. The rate implicit in the lease is rarely readily available for the lessee but can be determined reliably. We believe that the lessee's incremental borrowing rate as a single option, if the rate implicit in the lease is not readily available, does not give comparable and useful information for the users of the financial statements.