E.ON AG • P.O. Box 30 10 51 • 40410 Düsseldorf

International Accounting Standards Board
30 Cannon Street

London EC4M 6XH
UNITED KINGDOM

E.ON AG
E.ON-Platz 1
40479 Düsseldorf
Germany
www.eon.com

T +49-2 11-45 79-0
F +49-2 11-45 79-5 01

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Exposure Draft ED/2010/9 – Leases

Ladies and Gentlemen:

Thank you for the invitation to comment on the exposure draft named in the subject heading. Please accept the following as our response to this invitation. Before presenting our opinion on selected aspects of the exposure draft, we would like to open with a few general remarks.

General remarks

New concept for lessor accounting

We expressly welcome that in this exposure draft, the IASB and the FASB have now, for the first time, added accounting guidance for lessor accounting. Only a complete analysis of the overall lease accounting can reveal potential conceptual and methodological inconsistencies in the proposals for lease accounting. Users like E.ON that are both lessors and lessees are now able to construct an overall picture of lease accounting in the future and analyze its pros and cons. We will explain our concerns regarding the proposals for lessor accounting in our comments on selected aspects.

Revised lessee accounting

Lessee accounting has been partially revised by the boards. Nevertheless, there remain the concerns we already presented in our comments on the discussion paper regarding a general presentation of all lessee relationships on the balance sheet without distinguishing between operating and finance leases.

Although the fundamental concerns we expressed regarding a change to lessee accounting as proposed in the discussion paper have largely been ignored, the boards did make some changes to the proposed concept, and these we strongly welcome. This is particularly true as regards the application of an unchanged interest rate throughout the lease term unless explicit reference rates are used. This change is appropriate, because it reflects during the entire contract term the initial financial situation and the interest rate that existed in the past, when the obligation under the lease arose. In contrast, the constant adjustment of interest rates in response to changes in the lessee's

incremental borrowing rate would lead to the ongoing creation of new leases at changed conditions.

Comments on selected aspects of the exposure draft

Question 2: Lessors
(a) Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term, and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?
(b) Do you agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

We see conceptual problems in applying the performance obligation approach and the derecognition approach, problems so serious that we must express our strong preference for keeping the current lessor accounting concept and making no changes to current classification into finance leases and operating leases.

The application of the derecognition approach would result in the lessor no longer recognizing all or part of an asset on its balance sheet. The lessee, in turn, would not recognize the derecognized asset, however, but a right. This inconsistency in the accounting treatment of disposals of assets on the one hand and the recognition of rights on the other hand alone represents a repositioning of assets and rights across balance sheets that cannot be justified objectively. The result would be that property, plant and equipment that very much exists physically, and is owned by the lessor, who might even be using it as its principal manufacturing base, would never again be reported on any balance sheet.

We also see conceptual problems in applying the performance obligation approach. In this approach, the performance obligation of the lessor would be merely an adjustment item for the balance sheet. Because the measurement of this balance sheet adjustment item is governed exclusively by the Leases standard and not by IAS 37 or IAS 39, it would form a separate measurement category. The result of that would be a conceptual inconsistency with the two existing categories of obligations.

These arguments can also be made with respect to the hybrid model for lessor accounting, making that model similarly unsustainable from a conceptual standpoint. In addition, the possibility of difficulties arising in practice in deciding when to apply the derecognition or the performance obligation approach cannot be ruled out. There are two main reasons for this:

1. The existing risk-and-reward approach is supposed to be replaced by a right-of-use model, yet the wording of the exposure draft indicates that either the derecognition or the performance obligation approach should be chosen on the basis of a risk-and-reward approach. That is inconsistent.

2. If risk-and-reward principles should nevertheless be used in deciding which of the approaches to apply, the exposure draft lacks adequate guidance as regards the basis for these risks and rewards, and when it should be assumed that they have passed to a third party.

We therefore believe that existing lessor accounting, with its distinction between finance leases and operating leases, should be preserved. This distinction in lessor accounting has in current practice led to a representation of assets and liabilities that already reflects in large part the conceptual considerations of this Leases exposure draft. Accordingly, existing lessor accounting has never been criticized as strongly and fundamentally as has the existing accounting treatment of operating leases at the lessee and the relegation of their disclosure to the notes.

Question 4
(b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?

We believe that purchase or sales contracts should not be included in the scope of the new Leases standard. Systematically, such transactions would have to be addressed in Exposure Draft 2010/6 – Revenue Recognition.

We also consider the revision of the Leases standard to be in close proximity and, in the case of the derecognition approach in particular, directly related to Exposure Draft 9 – Joint Arrangements, now postponed. The content of these two standards should be reconciled, and they should take effect simultaneously.

Yours sincerely,

Michael C. Wilhelm
Senior Vice President
Accounting

Andreas Roeper
Vice President
Accounting Policies