



Milan, December 15, 2010

Sir David Tweedie
Chairman
International Accounting
Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Ref.: **Exposure Draft ED/2010/9 “Leases”**

Dear Sir David,

we are writing in response to your invitation to comment the Exposure Draft *Leases* published by the IASB in August 2010 (hereinafter the “ED”).

This letter represents the view of Telecom Italia S.p.A., a company that, with its subsidiaries, operates mainly in Europe, the Mediterranean Basin and South America, with around 95 million of mobile lines, more than 22 million fixed-line network connections, and around 10 million of broadband accesses, as of September 30, 2010, including Telecom Argentina group. In 2009, the Group recorded revenues for approximately 27 billion euros.

The Telecom Italia Group is engaged principally in the communications sector and, particularly, the fixed and mobile national and international telecommunications sector, the television sector and the office products and Information Technology services sector.

We generally support the IASB and FASB (the “Boards”) objective of providing users of financial statements with a complete and understandable picture of an entity’s leasing activity; however, we are concerned on the implications and costs of the proposed approach on leases.

Our comments are set forth in the enclosed appendix that includes our answers to the specific questions.

Moreover, we underline the pervasive effects of the new accounting model on financial debt (gross and net) and operating margins (EBITDA, EBIT) and, as consequence, on some ratios like the Debt/EBITDA and “interest coverage”. Although these measures are regarded as “Alternative Performance Measures”, they are widely used by the financial community in order to evaluate companies (in particular, with regard to assessments based on multiples). It is highly desirable that, before the publication of the new standard, the Boards conduct an assessment together with the financial community about the impacts of the new accounting model in terms of company valuations and target prices.

Finally, we believe that the adoption of the ED, as currently defined, would imply significant efforts in terms of adaptation of information systems and operating procedures; in particular, we point out the significant increase in accounting records in relation to the high number of lease transactions that are currently regarded as operating leases.

We thank you for the opportunity to submit our contribution on the ED.

Very truly yours,

Riccardo Taranto
Chief Accounting Officer

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?
- (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?

Response:

- a) We understand the background and in principle we agree with the proposed model. Nevertheless we would propose some changes in the definition of the lease term and the lease payments as explained in our answers to question n. 8 and n. 9.
- b) We agree with the proposal (as a consequence of the above point a).

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?

Response:

- a) We partially agree with the proposal. We share the view of a different approach for lessor; however, we believe that the ED must be consistent with the other new standard projects and in particular with the Exposure Draft "Revenue from Contracts with Customers". In fact, while the Exposure Draft "Revenue from Contracts with Customers" abandons the concept of "risks and rewards" in favor of the concept of "control" to determine the transfer of the goods or services, the ED continues to mention the criterion of "risks and rewards" in conjunction with the criterion of "control" to distinguish a lease from a purchase/sale. Notwithstanding the fact that the definition of "control" ("the ability to direct the use of, and receive the benefits from the good or service") is coincident in the two Exposure Drafts, we point out the following:
- under the Exposure Draft Revenue from Contracts with Customers, the retention of risks by the entity as a result of a contract does not preclude the sale but rather it results in a performance obligation, a reduction in revenue, or a provision, depending on the nature of the risk, while
 - under the Exposure Draft Leases, in order to determine a sale, it is required that the entity has transferred control of the asset and the majority of the risks and rewards.

These differences could lead to difficulties in interpretation, in particular with regard to the "derecognition" approach for the lessor, since we cannot see what might be a circumstance in which the lessor transfers most of the risks and rewards of the underlying asset, and such transaction does not represent a sale. Therefore, we would suggest the IASB to clarify this point and to provide with an example.

- b) We generally agree with the proposal.



Question 3: Short-term leases

The exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is twelve months or less:

- (a) At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognise lease payments in profit or loss over the lease term (paragraph 64).
- (b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognise assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit or loss over the lease term (paragraph 65). (See also paragraphs BC41–BC46.)

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?

Response:

We believe that the recognition of assets and liabilities on short-term lease contracts that start and end within the operating cycle (usually 12 months) does not represent additional useful information for users of financial statements.

Hence, we believe that true short-term leases should be excluded from the ED's scope.

Question 4

- (a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?
- (b) Do you agree with the criteria for distinguishing a lease from a purchase or sale in paragraphs B9 and B10? Why or why not? If not, what alternative criteria would you propose and why?
- (c) Do you think that the guidance provided for distinguishing leases from service contracts in paragraphs B1-B4 is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

Response:

- a) We agree with the definition of a lease.
- b) As we have already stated in the answer to question 2, the criteria proposed by the ED for distinguishing a lease or a sale from a lease, are not satisfactory; we believe that the inclusion of the condition of the transfer of "risks and rewards" in addition to the transfer of the "control" is clearly inconsistent with the Exposure Draft "Revenue from Contracts with Customers" and could generate confusion in the application.
- c) We believe that the guidance for distinguishing between leases and service contracts is not exhaustive. In particular, we invite the IASB to clarify the case in which the entity transfers the right to use an asset for which the replacement is expected during the contract period (paragraphs B2 and B3). In this case we need to understand what is meant by "similar asset". For example, can be considered as a service the provision for a certain period with photocopiers where the contract specifies the features of the equipment but does not identify each single machine?



Question 5: Scope and scope exclusions

The 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, 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?

Response:

We do not agree with the exclusion of intangible assets from the scope of the ED, especially in the light of the "right-of-use" model for which the entity must recognise an asset that represents the right to control the use of a specific asset.

This concept is certainly applicable also to an intangible asset (e.g. a license with an exclusive use for a specified period of time) that could meet the conditions stated in par. B4 to determine whether the right to control the use of a specific asset is conveyed or not.

Question 6: Contracts that contain both service and lease components

The exposure draft proposes that lessees and lessors should apply the proposals in Revenue from Contracts with Customers to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B6-B8 and BC47-BC54).

If the service component in a contract that contains service components and lease components is not distinct:

- The FASB proposes that the lessee and lessor should apply the lease accounting requirements to the combined contract.
- The IASB proposes that (i) a lessee should apply the lease accounting requirements to the combined contract; (ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract; (iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements and the service component in accordance with the proposals in Revenue from Contracts with Customers.

Do you agree with either approach to accounting for leases that contain service and lease components appropriate? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

Response:

We agree that entities should assess if services are distinct using the criteria stated in the final Revenue Recognition standard. However, as we have expressed in our comment letter on the Revenue Recognition Exposure Draft, we believe that only an entity's own ordinary course of business shall be considered for determining whether a good or service is distinct. This would result in an easier application and would be consistent with the commercial substance of an arrangement.



Question 7: Purchase options

The exposure draft proposes that a contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus a contract is accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraph 8 and BC63 and BC64).

Do you agree that a lessee or a lessor should account for purchase options when they are exercised? Why or why not? If not, when do you think that a lessee or a lessor should account for a purchase option and why?

Response:

Yes, we agree with the proposal. The proposed approach reflects more appropriately than current IAS 17 the nature of leases that represents for the lessor an alternative way to market products rather than discontinuation of assets.

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?

Response:

We strongly disagree with the proposal. We suggest that only the contractually committed term of the lease should be taken into consideration. We believe that a company can decide, within the legal terms, to extend or not a lease contract, depending on a number of factors that might change over time. We believe that the use of estimates in determining the lease term introduces elements of subjective evaluation which may undermine the information comparability among different entities. The same estimates might vary over time and create potential problems of comparability of financial statements within the same entity.

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 contract should be included in the measurement of lease assets and lease liabilities 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 can only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the lease receivable if they can be measured reliably? Why or why not?

Response:

We agree that contingent rentals and other similar components that are specified in the lease contract for the legally committed lease term, should be considered in the measurement of lease assets and lease liabilities using an expected outcome technique. Instead, contingent payments during optional periods should not be taken into consideration.



Question 10: Reassessment

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 obligation or receivable arising from changes in the lease term or contingent payments since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

Response:

We disagree with the proposal. We believe that by considering only the legally committed term of the lease and the related payments, it would not be necessary anymore to periodically remeasure the assets and liabilities. Therefore, we recommend that reassessments be performed only upon exercise, modification or cancellation of a renewal term that was included in the initial determination of the lease term.

Question 11

Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?

Response:

We agree with the proposed accounting model for the sale and leaseback transactions. However, we believe that a further explanation is necessary (by providing examples) for the adjustments required to the lessor and the lessee if the consideration for a sale or a purchase or the lease payments specified by the leaseback are not at fair value.

In addition, the ED provides that such adjustments should be made on the basis of current market rates for such transactions, but it gives no indication in the case such rates can not be derived from market information.

Question 12: Statement of financial position

(a) Do you agree that a lessee should present its liability to make lease payments separately from other financial liabilities and present right-of-use assets as if they were tangible assets within property, plant and equipment, or investment property as appropriate, but separately from other assets that the lessee does not lease (paragraphs 25-27, 42-45, 60-63 and BC142-159)? Why or why not?

What alternative presentation do you propose and why?

(b) Do you agree that a lessor applying the performance obligation approach should present its underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? What alternative presentation do you propose and why?

(c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? What alternative presentation do you propose and why?

(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease separately (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?



Response:

- a) We believe that a separate presentation of right-of-use assets and liabilities to make lease payments in the statement of financial position should be requested only if the related amounts are material. Furthermore, although we support the view that the right-of-use assets are intangible assets, we agree with the proposal to present right-of-use assets as if they were tangible assets within property, plant and equipment.
- b), c) Overall we support the proposed recognition of assets, liabilities, income and expenses as this seems to be consistent with the proposed model.
- d) We believe that it is better to require a separate disclosure of assets and liabilities that arise under a sublease in the notes because the presentation of such information in the statement of financial position could be misleading for the users of financial statements. Furthermore, we believe that a net presentation of head lease and sublease assets/liabilities would improve the disclosure.

Question 13: Statement of comprehensive income

Do you think that lessees and lessors should present lease income and expense separately from other income and expenses in the statement of comprehensive income (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)?

Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

Response:

We believe that lessees and lessors should present lease income and expense separately from other income and expenses in the statement of comprehensive income only if they are material.

Question 14: Statement of cash flows

Do you think that cash flows arising from lease contracts should be presented on the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)?

Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

Response:

We believe that cash flows arising from lease contracts should be presented separately, only if they are material in their amount, under the section cash flows from financing activities because lease represents an alternative way of financing an asset.



Question 15

Do you agree that lessee and lessors should disclose quantitative and qualitative information that:

- (a) identifies and explains the amounts recognised in the financial statements arising from lease contracts; and
- (b) describes how lease contracts may affect the amount, timing, and uncertainty of the entity's future cash flows? (paragraphs 70-86 and BC168-BC183) Why or why not? If not, how would you amend the objectives and why?

Response:

We want to highlight that the new standard requires a significantly increased volume of disclosures, with respect to those of the standard currently in force, that we deem excessive.

In addition, we believe that the proposed disclosures would involve for the preparers of financial statements costs in excess of the related benefits.

Furthermore, we agree in principle with the Boards' proposal in relation to information reflecting how leases may affect the amount, timing and uncertainty of the entity's future cash flows'. However, we believe that the information to be disclosed should be reduced.

Question 16

The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88-96 and BC186-BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?

Do you think that full retrospective application of lease accounting should be permitted? Why or why not?

Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

Response:

In principle, we agree that a simplified approach should be applied, because a mandatory full retrospective application would be onerous in particular given the large number of contracts and the complexity of long-term leases. In order to further simplify the limited retrospective method, we propose to apply the new standard only to the existing contracts that will expire later than a certain period of time after the application date (i.e. at least 3 years). This limitation would avoid the accounting under the new standard of leases that have an expiring date close to the application date and the resulting recognition of lease assets and liabilities of non material amount.

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 outweigh the cost? Why or why not?

Response:

We want to highlight that, at this stage, it is difficult to do an estimate of the costs to be incurred in adopting the new standard. However, based on our preliminary analysis, we are not convinced that the benefits of the proposal would outweigh its costs. Therefore, we invite the IASB to continue its outreach in order to gather additional information on the costs related to the implementation of the proposal and the expected benefits for users of financial statements.



Question 18

Do you have any other comments on the proposals?

Response: No, we do not.