



ED Leases Comment Letters
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

22 December 2010

Dear Sir/Madam,

Exposure Draft: *Leases*

Mazars welcomes the opportunity to comment on the Exposure Draft (ED) *Leases*. Our general comments are given below. Answers to the specific questions included in the ED are given in the Appendix.

We acknowledge that the current accounting model for leases has been criticised for failing to present relevant information about rights and obligations arising from lease contracts. Thus, we appreciate the work made by the IASB to improve lease accounting.

However, we would like to stress out that, in practice, we believe that current IAS 17 is well applied by preparers. Furthermore, users of financial statements seem to be comfortable with the disclosures on leases that are currently provided in the notes to the financial statements. Therefore, we are not certain that the development of a new standard on leases is really a priority.

However, we understand the Board's objective to give a response to the criticisms mentioned above and we believe that requiring assets and liabilities arising from a lease contract to be brought to the balance sheet is an appropriate response. We also appreciate the effort made to develop simultaneously an accounting model for both lessees and lessors. Nevertheless, we believe that some key conceptual and application issues have not been thoroughly addressed in the ED and need to be clarified or discussed further. Our most significant concerns are set out below:

1/21

Definition of a lease

As mentioned in our comment letter on the DP, we still believe that the Board should:

- Explain why contrary to a service contract a lease contract is not an executory contract. As a consequence, a conceptual rationale should be developed to distinguish between lease contracts and other contracts considered as executory contracts.
- Provide a more robust guidance on how to distinguish between a lease contract and a service contract. We are not convinced that the proposed criteria mainly carried over from IFRIC 4 provide a relevant and operational distinction for determining the accounting treatment, as IFRIC 4 has always been felt as not enough precise and clear. Without a precise guidance, preparers and auditors will struggle to apply their judgement when distinguishing between a lease and a service contract.

Lessee accounting

We generally agree with the Board's principle to develop a single accounting model in which assets and liabilities arising from lease contracts are recognised in the face of the balance sheet. We also agree that there is a conceptual basis for a lessee to recognise a right-of-use asset representing its right to use the asset and a liability representing its obligation to make lease payments. However, we strongly disagree with the Board's proposals on how such right-of-use asset and lease liability should be measured.

In the ED, the Board defines the lease term as “*the longest possible term that is more likely than not to occur*”. We believe that options to extend the lease that are not reasonably certain to be exercised should not be taken into account. Otherwise, it would lead the lessee to recognise a liability that, in our view, does not meet the definition of a liability as defined in the *Framework* and in IAS 32.

We are also concerned that the proposed accounting model would introduce a large amount of estimation uncertainty, especially when estimating the lease term and contingent rentals. Thus, we doubt that preparers would be able to provide reliable estimates when measuring lease assets and liabilities, leading to a lack of comparability between entities. Hence, we suggest that:

- The lease term should be the non-cancellable period for which the lessee will lease the underlying asset plus any further term for which the lessee has an option to extend the lease period and it is reasonably certain that the option will be exercised at the inception of the lease.
- Lease assets or lease liabilities should not include contingent payments based on the performance of the lessee or on the usage of the leased asset by the lessee.

Lessor accounting

Although we welcome the attempt of the Board to develop in such a short time a complete accounting model for lessors, we believe that the Board's objective to develop a consistent accounting model has not yet been achieved with the proposed "hybrid" model.

We believe that the hybrid model is overly complex as it requires a three-level analysis. Indeed, preparers will have to determine whether a full derecognition approach (i.e. in-substance sale), a partial derecognition approach or a performance obligation approach should apply. In doing so, the Board replicates in a more complex manner the existing model in IAS 17 (i.e. the distinction between finance and operating leases). While its intention was to remove a sharp "bright-line" from lessee accounting, the Board introduces another one into the hybrid model for lessors.

We do not believe that either the performance obligation approach or the partial derecognition approach could be used as a single accounting model for lessors. We have concerns on the impact such models would have on revenue recognition of real estate leases.

We also have concerns regarding the measurement of lease assets and lease liabilities as they will in many cases be based on estimates and judgement.

Contingent rentals based on the performance of the lessee or on the usage of the underlying asset by the lessee may be difficult to measure reliably. Therefore, we believe that such contingent payments should not be included in the measurement of the right to receive lease payments. Indeed, under the partial derecognition approach, any adjustment would have a direct impact in profit or loss. Should the lease receivable not be measured reliably, this would lead to volatility in profit or loss.

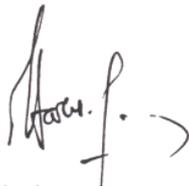
Overall, we are not convinced that the proposed hybrid model is conceptually robust enough to provide relevant information to users. We believe that the current standard on leases provides a better representation of the economic characteristics of lease contracts. Therefore, until the Board develops a more robust accounting model for lessors, we suggest maintaining the requirements of IAS 17 for lessor accounting.

Short- term leases

We do not believe that the simplified accounting model proposed in the ED really provides relief in practice to lessees. We suggest that short-term leases should be defined as leases with a non-cancellable term, including renewal term options at bargain price, that do not exceed a twelve-month period in total. Such short-term leases should follow the accounting model for operating leases in IAS 17.

We would be pleased to discuss our comments with you and remain at your disposal should you require further clarification or additional information.

Yours faithfully



Michel Barbet-Massin
Head of Financial Reporting Technical Support

Appendix to our letter to the IASB on the ED “Leases”. Answers to the specific questions raised in the invitation for comments

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) *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?*

We generally agree with the Board’s proposal to develop a single model where all assets and liabilities arising from lease arrangements are recognised in the statement of financial position. We acknowledge that there is a conceptual basis for a lessee to recognise a right-of-use asset representing its right to use the underlying asset during the lease term and a lease liability representing its obligation to make the corresponding lease payments.

However, we have some significant concerns regarding:

- the measurement of the lease asset and lease liability. The model proposed in the ED implies using significant estimates and judgements when assessing the liability amount. In our view, the measurement of the lease asset and lease liability may thus not be reliable. Following the ED’s proposal, a lessee may take into account additional lease term that might not occur (see for more details our answer to question 8). We believe this will lead to the recognition of assets and liabilities in the statement of financial position that do not meet the definition of an asset or a liability as defined in the Framework.
- the definition of a lease and more precisely the principles proposed to distinguish a lease contract from a service contract. We are of the opinion that the given criteria are not clear enough. We fear that similar arrangements may follow different accounting treatments. Please refer to our answer to question 4 for more details.

We agree that, when applying the right-of-use model developed in the ED, a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments.

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?*

Although we welcome the attempt of the Board to develop simultaneously a principle based accounting model for both lessees and lessors, we do not believe that the objective was achieved.

We do not support the hybrid model defined in the ED for the following reasons:

- we believe the hybrid model to be overly complex as it requires a three-level analysis,
- we believe the hybrid model reintroduces a bright-line distinction that is likely to lead to the structuring of leases. We would thus favour a single model consistent with the model for lessees,
- we do not believe that either the performance obligation model or the partial derecognition approach could be used as a single model. Indeed even if the performance obligation model seems more adapted in most cases, it creates problems for real estate leases for which the recognition of revenues will differ significantly from the one commonly used and understood by users,
- we are of the opinion that the measurement of the lease assets and lease liability is based on too many estimates. We believe some entities not being in a position to value their lease assets and lease liability reliably.
- we are not certain that the way revenue is recognised in both models correctly reflects the economics of many lessors' businesses.

As a consequence we do not believe the hybrid model to be conceptually robust enough. Nor do we think that it provides relevant information to users. In our view, the current lease standard (IAS 17) has proved to be consistently applied by lessors and provides useful information to users. Therefore, we suggest the Board to maintain the accounting model for lessors as set out in IAS 17 until it has developed a workable and robust approach applicable to all kind of leases.

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 profit or loss, 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?

We agree with the practical exemption offered for short term leases, but believe that the simplified accounting model proposed in the ED does not really provides relief for lessees as:

- The “simplification” relates to the accounting of undiscounted amounts to be paid within a year. In practice, these amounts would not have been discounted anyway. Furthermore, lessees still have to recognise a lease asset and a lease liability.
- The definition of short-term leases is overly restrictive “leases with a maximum lease term of 12 months including options to renew or to extend”. We believe that in practice very few contracts will be concerned.

We therefore propose the Board to simply permit the accounting of such leases as operating leases for lessees (as defined in IAS 17) as we are of the opinion that this accounting treatment could in practice provide relief to preparers.

We also suggest the definition of short-term leases to be changed to leases with a maximum non-cancellable lease term of 12 months including only bargain-options to extend or renew the term.

Should the Board disagree with a new short-term lease definition and a new simplified accounting treatment, the distinction between short-term leases and other leases should be removed as the accounting proposal in the ED does not in our view achieve the aim of “simplification”.

Definition of a lease

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 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?*
- (c) *Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?*

We basically agree with the definition given in the ED: a lease is a contract in which the right to use a specified asset (the underlying asset) is conveyed, for a period of time, in exchange for consideration. Nevertheless, there are a number of concerns we have in respect to the analysis required to distinguish leases from non-lease contracts.

Distinguishing between a lease and a service contract

We still believe the Board should explain why contrary to a service contract a lease contract is not an executory contract. In other terms, how does the fact that a lessee controls the right to use the asset differentiate a lease contract from an executory contract such as an employment fixed-term contract or a purchase contract with multiple delivery? In our view, the guidance provided in the ED does not permit to distinguish between both categories as this guidance (B1-B4) is very similar to the principles set out in IFRIC 4 which has been much criticised by preparers and auditors as being unclear.

In particular, the ED proposes to qualify a contract as a lease when the fulfilment of the contract depends on providing a specified asset and the contract conveys the right to control the use of a specified asset.

We note that the notion of “specified asset” in the ED is a wider notion than “specific asset”, which is the terminology given in IFRIC 4. We think the Board should clarify what is meant by “specified asset” and the distinction it operates with “specific asset”. We fear that without a robust guidance to distinguish a lease from a service contract, the Board will introduce another “bright-line” distinction (lease versus service).

For example we are not certain on how to qualify rent of cars or of copy machines. Would you define those assets as non-specified assets as they can be easily exchangeable and thus qualify this kind of contract as service contracts?

Distinguishing between a lease and an in-substance sale/purchase

Lessee:

The ED considers a contract to be an in-substance sale/purchase if at the end of the contract an entity transfers to another entity control of the underlying asset and all but a trivial amount of the risks and benefits associated with the asset (see paragraph B9). A contract normally transfers control of the asset when it transfers title of the underlying asset to the lessee at its end or if it includes a bargain purchase option.

Under current standard on leases (IAS 17) entities classify leases between operating and finance leases. A lease is considered to be a finance lease if the arrangement transfers substantially all the risks and rewards incidental to ownership. All other leases are classified as operating leases. In practice entities consider that lease contracts classified as finance leases are arrangements that economically correspond to a sale/purchase. We therefore think that, for practical reasons, the criteria for distinguishing between a sale and a lease contract should be similar to the current distinction between finance and operational leases under IAS 17.

We also note that the proposal in the ED is inconsistent with:

- Revenue Recognition ED which only requires the transfer of control to qualify a transaction as a sale. In the present ED, both conditions are required: transfer of control and transfer of the risks and benefits associated to the underlying asset.
- the notion of control as defined in IFRIC 12 “Service concessions”. This interpretation states that the grantor controls the concession asset when it regulates what services should be provided at what price and to whom and it controls any significant residual interest.

We believe it may be very confusing that the notion of control has different meanings depending on different standards or interpretations.

Considering the above, we suggest the Board to carry over current principle and criteria provided in IAS 17 (to distinguish finance leases from operational leases) to operate the distinction between a sale and a lease contract. We believe this approach would remove much burden on preparers as they would be exempted from conducting a new analysis on all existing contracts.

Lessor:

We disagree with the given criteria as we support current accounting model under IAS 17.

Scope

Question 5: 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, 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?

We agree with the IASB that there is no conceptual reason for excluding all intangible assets (see § BC36). We believe that such exclusion is no improvement in itself as current IAS 17 applies to certain category of intangible assets.

We note that the ED does not provide guidance on how current leases of intangible assets accounted accordingly to IAS 17 should be accounted for in the future.

We are also concerned that lease contracts may contain both tangible and intangible assets (we have the case of a lease contract including equipments and software). How should those contracts be accounted for? Should entities split the lease contract, in order to distinguish the lease of the equipment from the lease of the software? How should each component be accounted for?

We believe that in practice entities will account for leases of intangible assets differently, leading to a lack of comparability in the financial statements.

We are of the opinion that the Board should rework on the issue in order to include intangible assets in the proposal.

Should the Board maintain the exclusion of all intangible assets from the scope, the Board should address issues in connection with leases of intangible assets as a separate project or when revising IAS 38.

Question 6: Contracts that contain service components 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, B5–B8 and BC47–BC54).

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

- (a) *the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.*
- (b) *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? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

We agree that, under the accounting model proposed by the ED, a service component and a lease component included in a contract should be accounted for separately when those components are distinct.

We do not agree with the accounting principles proposed by the Boards when the service component in a contract that contains service components and lease components is not distinct.

We believe that lessees should account the contract according to the standard applicable to the nature of its predominant component. For example, if a contract contains a non-core asset and the service component is the predominant component, we are of the opinion that the contract should be accounted for a service contract as a whole. The fact that the contract contains a non-core asset can be viewed as an indication that the service component is the predominant component.

We believe that lessors should always account for both components separately. As lessors edict prices, they should always be able to distinguish each component of the contract and allocate lease payments accordingly.

Question 7: Purchase options

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

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

We understand that the question only relates to non-bargain purchase options since bargain purchase options qualify the arrangement for a sale and not for a lease contract.

Regarding non-bargain purchase options, we agree with the proposal not to include them in the determination of the lease asset or the lease liability as we do not know how to measure such options.

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 disagree with the Board's proposal for conceptual as well as practical reasons. We believe the proposal will conduct entities to account for liabilities that do not meet the definition of a liability as set out in the framework and in IAS 32. In our view an option to renew a lease is an option in the hand of the lessee. Therefore, until the renewal period is exercised, the lessee has no obligation to make lease payments after the non-cancellable period of the lease.

We are of the opinion that the lease term should be the non-cancellable period for which the lessee will lease the underlying asset, plus any further term for which the lessee has a bargain option to extend the lease term, that is to say it is reasonably certain that the option will be exercised. We consider that current definition of lease term given in IAS 17 is clear and well applied in practice. We see no reason for moving to the new definition given in the ED.

We also disagree with the approach developed in the ED to estimate the probability of occurrence of each possible term. We believe this approach to be overly complex and do not see the benefits associated. We also consider that under this definition entities will have to reassess the lease term more often. Once again, we are in favour of current definition of lease term as set out in IAS 17.

Should the Board maintain the proposed definition given in the ED, we strongly recommend term options included in the determination of the lease term to be restricted to those that are in the hand of the lessee. For example, if a lessee has an option to renew a lease and the lessor has the ability to terminate the lease at any time after the non-cancellable period, the lessee should not consider its renewal option when determining the lease term.

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?

Lessee:

We believe that term option penalties, residual value guarantees and contingent rentals based on a rate or an index should be included in the measurement of assets and liabilities arising from a lease.

Indeed we believe that a distinction should be operated between payments based on the performance or the use of the asset and other contingent payments. In our view payments based on the performance or on the use of the asset should be excluded from the measurement of the lease asset and the lease liability, for the following reasons:

- difficulty to estimate accurately contingent payments based on the performance of the lessee
- in practice the lease asset and the lease liability would be revaluated at each reporting period
- created volatility in indebtedness ratio, that may trigger covenants.

Lessor:

We disagree as we favour the current approach under IAS 17 for lessors.

If the Board decides to maintain the hybrid model, we agree that lessors should only include contingent payments, term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be measured reliably. Contingent rentals based on the performance of the lessee or on the usage of the underlying asset by the lessee may be difficult to measure reliably. As a consequence, we believe that such contingent payments should not be included in the measurement of the right to receive lease payments. We also believe that approach to be particularly necessary for the partial derecognition model as any adjustment would have a direct impact on profit or loss. We fear that the recognition of unreliable amounts would lead to volatility in the statement of comprehensive income.

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 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?

Lessee:

As in our view the lease term is the non-cancellable period plus any additional term that is reasonably certain to occur, the lease term should not be reassessed (unless the lease contract is modified).

We agree with the reassessment due to a modification of contingent payments (subject to our conclusion regarding contingent payments based on performance of the lessee)

Lessor:

As we support current treatment under IAS 17, we do not agree with the proposal for reassessment.

Should the Board maintain the hybrid model, we agree with the reassessment principles of the lease assets and lease liability.

However we have some questions regarding example 4 developed in the ED (see B28) and more precisely on the revaluation of the residual asset when the lease term is reassessed (reduced):

“Example 4 – When the assessed lease term decreases

Entity A enters into a ten-year lease of a machine. The lease includes an option to terminate after eight years. Annual lease payments are CU1,000 in arrears. The rate the lessor charges in the lease is 8 per cent. The fair value of the machine at the commencement of the lease is CU7,000 and its carrying amount is CU5,000. The useful life of the machine is ten years. The lessor initially estimates the lease term is ten years. The lessor further determines that it does not retain exposure to significant risks or benefits associated with the underlying asset either during or after the expected lease term and accounts for the lease using the derecognition approach. The present value of ten years of lease payments is CU6,710. At the end of year 1, the lessor reassesses the lease term and determines that the option will be exercised and the lease will terminate at the end of eight years. The fair value of the machine at the end of year 1 is CU6,250. The present value of seven years of lease payments is CU5,206. At the date of commencement of the lease, the lessor derecognises the portion of the asset transferred to the lessee, recognises a lease receivable and recognises revenue and cost of sales:

Dr lease receivable CU6,710
Dr cost of sales CU4,793
 Cr underlying asset CU4,793 (CU5,000 × CU6,710 ÷ CU7,000)
 Cr revenue CU6,710

At the date of commencement of the lease, the lessor recognises a profit from the lease of CU1,917 (CU6,710 – CU4,793).
At the end of year 1, the lessor recognises receipt of a lease payment and interest on the lease receivable:

Dr cash CU1,000
 Cr lease receivable CU1,000
Dr lease receivable CU537 (CU6,710 × 8%)
 Cr interest income CU537

Following these events, the carrying amount of the residual asset is CU207 (CU5,000 – CU4,793) and the carrying amount of the lease receivable is CU6,247 (CU6,710 – CU1,000 + CU537).
At the end of year 1, the lessor reassesses the lease term and reinstates a portion of the asset, recognises an adjustment to lease receivable, revenue and cost of sales:

Dr revenue CU1,041
Dr residual asset CU34 (CU207 × CU1,041 ÷ CU6,250)
 Cr cost of sales CU34
 Cr lease receivable CU1,041 (CU6,247 – CU5,206)

The net result of the reassessment of the lease term is a loss of CU1,007 (CU34 – CU1,041).
After making this adjustment the carrying amount of the lease receivable is CU5,206 representing the present value of the seven remaining CU1,000 lease payments and the carrying amount of the residual asset is CU241 (CU207 + CU34).
At the end of year 1, the net amount recognised in profit or loss is income of CU1,447 (initial lease income of CU1,917 plus interest income of CU537 less CU1,007 loss from reassessment)."

We do not understand the rationale of the calculation to revalue the residual asset. We note that using a 8 years lease term assumption from the beginning leads to a different valuation of the residual asset as compared to the one revaluated in the example.

Indeed using a 8 years lease term assumption from the beginning leads to the following:

- Present value of 8 years lease payments: CU 5,747
- Portion of the underlying asset to be derecognised: CU 4,105
(5,000 * 5,747 ÷ 7,000)
- Residual asset: CU 895 (5,000 – 4,105)
- Interest Income at the end of year 1: CU 460 (5,747 * 8%)

We have summarised in the following table our calculations:

| | Exposure draft example | | | MAZARS | Difference |
|-----------------------------|---|--|-------------------------|--|------------|
| | Initial assumption : 10 years lease term | Reassessment of lease term to 8 years Adjustment | Result after adjustment | Initial assumption reviewed : 8 years lease term | |
| BALANCE SHEET | | | | | |
| Lease receivable | 6 247 | -1 041 | 5 207 | 5 207 | 0 |
| Residual asset | 207 | 34 | 241 | 895 | 654 |
| INCOME STATEMENT | | | | | |
| Revenue | 6 710 | -1 041 | 5 669 | 5 747 | 77 |
| Cost of sales | -4 793 | 34 | -4 759 | -4 105 | 654 |
| <i>Net income</i> | 1 917 | -1 007 | 910 | 1 642 | 731 |
| Interest income | 537 | | 537 | 460 | -77 |
| Net cumulated income | 2 454 | -1 007 | 1 447 | 2 102 | 654 |

We do not understand why the measurement of the residual asset is not the same:

- Assumption 1: lease term of 8 years, residual asset of CU 895
- Assumption 2: lease term of 10 years. Reassessment of lease term at the end of year one (8 years instead of 10 years) and reassessment of the residual asset (reinstatement of a portion of the asset). Residual asset revaluated at CU 241.

Sale and leaseback

The exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents the sale of the underlying asset, the leaseback would also meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66–67, B31 and BC160–BC167).

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?

We do not agree with the criteria given in the ED for classification as a sale and leaseback transaction.

We believe that the determination on whether the underlying asset has been sold or not should be based on the same principles as developed in the Standard on revenue.

We remind you that we are not either convinced with the control definition as given in the ED Revenue from Contracts with Customers. However, we believe that the assessment to determine whether a transaction qualifies for an in-substance sale or not should be consistent from one standard to another. Indeed no matter what the legal form of the transaction may be (e.g. a lease, a sale and leaseback, a construction contract...), the aim remains the same: is the transaction an in-substance sale? When should revenue be recognised?

We note that the proposal in the ED Leases is a mixed approach based on a control (see B9-B10) and risks and benefits (see B31) analysis. Indeed, the examples given in paragraph B31 to determine whether the transferred asset has been purchased or sold are referring to a risks and benefits analysis. To be consistent with the ED Revenue from Contracts with Customers, the Board should develop an approach based on control only.

Presentation

Question 12: Statement of financial position

- (a) *Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment or investment property as appropriate, but separately from assets that the lessee does not lease (paragraphs 25 and BC143–BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?*
- (b) *Do you agree that a lessor applying the performance obligation approach should present 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? If not, do you think that a lessor should disclose this information in the notes instead? 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 should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?*
- (d) *Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (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?*

Lessee:

Yes, we agree with the Board's proposal.

Lessor:

As we support the accounting model in IAS 17, we support the presentation in the statement of financial position as defined in current standard on Leases (IAS 17).

Should the hybrid model be maintained we agree with the Board's proposals.

Question 13: Statement of comprehensive income

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

Lessee:

We agree with the Board's proposal as we think that lessees should have the choice to present lease income and lease expense either in profit or loss or in the notes (see § 26 of the ED) as:

- Entities using a presentation of comprehensive income by function could not present lease income and lease expenses separately from other income and expenses
- Entities using a presentation of comprehensive income by nature might consider that presenting lease income and expenses separately from other income and expenses would unnecessarily increase the number of items to be presented.

Lessor:

As we support the accounting model in IAS 17, we support the presentation in the statement of comprehensive income as defined in current standard on Leases (IAS 17).

Should the hybrid model be maintained we agree with the Board's proposal.

Question 14: Statement of cash flows

Do you think that cash flows arising from leases should be presented in 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?

Yes, we agree with the Board's proposal.

Disclosure

Question 15

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

- (a) identifies and explains the amounts recognised in the financial statements arising from leases; and*
- (b) describes how leases 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?*

We think that disclosure should provide qualitative and quantitative information to identify and explain the amounts recognised in the financial statements arising from leases and describe how leases may affect the amount, timing and uncertainty of the entity's future cash flows.

Yet, we note that the ED requires a more extensive bound of information than currently required under IAS 17. As the proposed model aims at providing a faithful representation of leases transactions by recognising all leases in the statement of financial position, we would have expected less disclosure. We are concerned that requiring additional disclosure could be a significant burden put on preparers.

We understand that due to the complexity of the accounting model proposed in the ED and more precisely on the determination of the lease asset and lease liability, the Board requires extensive information on judgements and assumptions made by entities. As we propose to identify lease assets and lease liabilities based on present obligations and rights, not using a "probability" or "expected outcome" technique and using few estimates, less disclosure should be required under our approach.

We welcome the requirements given in § 71 of the ED to ask an entity to consider the level of detail necessary to satisfy the disclosure requirements and the opportunity given to aggregate or disaggregate disclosures. Considering the amount of lease arrangements some entities may have, it is necessary to allow preparers to aggregate information regarding lease contracts with similar characteristics.

Transition

Question 16

- (a) *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?*
- (b) *Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?*
- (c) *Are there any additional transitional issues the boards need to consider? If yes, which ones and why?*

Yes, we agree with the Board's proposal.

No, we do not see additional issues the Board needs to consider.

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 have not conducted a cost-benefit analysis but from our discussions with entities we have listed costs that are likely to incur:

- Education of preparers
- Upgrade of accounting systems
- Implementation of new process & controls
- Analysis of all existing contracts
 - Reassessment of the status of each contract

- How to determine lease term for each contract?
- How to determine contingent payments for each contract on a timely basis?
- Reassessment of contingent rentals
- Impact on financial ratios / debt covenants
- ...

We fear that the costs mentioned above may outweigh the benefits associated with the proposed new standard.

Other comments

Question 18

Do you have any other comments on the proposals?

We believe the Board should provide guidance on the following issues:

- How should lessors apply IFRS 5 to leased asset that are to be sold, distinguishing the approach for each model (partial derecognition and performance obligations models)?
- Lessors of investment properties using the performance obligation approach: how should the leased asset be impaired?
 - Should the leased asset be impaired on a net basis, that is to say considering property, the lease receivable and the performance obligation as a whole and apply IAS 36?
 - Should the leased asset be impaired on a separate basis, that is to say apply IAS 39 to the lease receivable and IAS 36 to property?