

# NEW LOOK RETAIL GROUP LIMITED

Registered in England No. 05810406

14 December 2010

International Accounting Standards Board

Dear Sir/Madam

## **Response to Exposure Draft August 2010 – Leases**

Thank you for this opportunity to comment on the Exposure Draft August 2010 Leases. I write to you on behalf of the New Look Retail Group Limited Group and its subsidiaries (“the Group”).

Historically the Group has not chosen to take the opportunity to comment on exposure drafts, but believes it is appropriate to do so on this occasion due to the counter-productive nature of what is being proposed. The level of extra administrative work anticipated from the implementation of this new standard will be a significant burden on the resources of the Group and at best will result in minimal added value for our stakeholders who use our financial information.

We have chosen not to answer each of the 18 questions individually but instead describe to you the practical challenges we foresee the proposed changes to lease accounting being imposed on the Group and the additional investment of resources (people, processes and systems) required to ensure compliance each reporting period end when our key stakeholders already take account of our operating leases through an EBITDAR adjustment for valuation purposes.

The Group’s operating lease portfolio is in excess of 1,100 leases, primarily made up of leases for retail stores in the UK and overseas but also includes plant and machinery, office equipment and company vehicles. The Group is continuously negotiating leases as a means of financing without increasing capital expenditure limits beyond banking covenant headroom.

Endorsement of this exposure draft will require the Group to review in detail all of our existing leases to identify the additional information that this draft IFRS requires to be measured and disclosed. In addition to this, further investment in systems and processes will be required to implement and maintain the added controls surrounding monitoring and tracking of initial judgements each reporting period end. Whilst the exemption from discounting is proposed for short term leases we will still need to take the time to consider the necessary and most appropriate measurement requirements for them. We therefore do not believe this to be of any benefit.

We currently ensure that we have a database that tracks the key information extracted from the lease documents necessary to prepare the operating lease commitment note to the Group’s consolidated financial statements at any given point in time. Measuring the present value of lease payments payable will require a significant investment of resource to revisit the information in our existing leases and applying management’s estimates for the probability of future decisions for contingent rentals, residual value guarantees and term option penalties. We find it difficult to justify this added cost aside from complying with the new IFRS.

The Group will also need to ensure it has the necessary IT systems and internal controls in place to manage the Group’s lease portfolio to ensure accuracy, completeness and consistency of

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management's judgements and measurement of leases across all territories will require significant investment and in the current challenging market conditions, cost control is tight.

We would expect that additional disclosures will be required to explain to users of the financial statements how management have determined their estimate for the incremental borrowing rate, the rate at which contingent rents will impact the value of the liability for lease payments in future years, why impairments have occurred and how the value of the right-to-use asset has been adjusted year on year for changes in management's assumptions.

This demonstrates the level of subjectivity and complexity involved in accounting for leases under the new draft standard and there is no more material value to users than if they were extracting data from the operating lease commitment note to the financial statements which forecasts with reasonable certainty the expected rent outflows over the terms of the leases without discounting.

Rent payable is a significant cost included in the calculation of EBITDA for retailers whose traditional means of acquiring stores is through operating leases. By replacing rent with amortisation of the right-of-use asset, which falls below EBITDA, EBITDA increases significantly. From an operational and commercial perspective this does not reflect the true operating costs incurred by the business in generating sales. Without the stores we would be unable to sell our product. Not only that, but EBITDA is an alternative measure of a business's underlying cash flow generation and one which removes any volatility from differing capital structures to give a consistent and comparable metric. Under the proposed standard, EBITDA will not reflect the true cash generating ability of the business. The gap between EBITDA under the proposed standard and EBITDA used currently in existing debt covenants, annual bonus schemes and other KPI models is increased, therefore requiring additional reconciliation between the two or time taken to amend to new benchmarks. Key stakeholders who take EBITDAR as a key measure of our business already make the necessary adjustment to statutory reports prepared under existing IFRSs and as there is no cash impact, there is little additional value in making these proposed changes.

Of particular concern is the impact that this new accounting standard will have on the Group's debt covenants. In addition to EBITDA, cash interest paid and net debt will be impacted. EBITDAR will be the same as EBITDA causing further confusion. These potential changes will generate uncertainty and will require further investment to update our covenant models and legal financing documentation in order to maintain financial covenant headroom.

We strongly question where value is gained from grossing up both assets and liabilities for leases using a measurement methodology which is based on numerous subjective assumptions. Key stakeholders and users of our financial information will not be able to compare with similar entities' information as including such factors as the probability of exercising purchase options or right of renewal options in 5 years time could vary significantly across a sector.

The additional disclosure in the balance sheet for right-to-use asset and the lease liability provides limited additional information already provided by the operating lease commitment note aside from the fact that under the new IFRS, the value of the lease commitment has been discounted to its present value, which if important could be addressed through a relatively minor change to the existing standard. Disclosing the uncertainty of cash outflows that result from contingent rents, lease renewal options may be considered an enhancement to the current standard but again these

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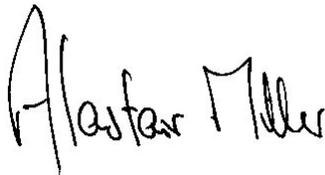
will be an amalgamation of management's subjective assumptions forward looking 5 to 25 years into the future depending on the terms of the leases.

The Group sublets a small number of our stores to third parties to cover the idle costs of exiting a store before a lease ends. This would require the application of the lessor model and given its complexity and the discrepancies found in the results it provides would place additional demand for time and cost. We are not in favour of implementing a model which does not add value for users of our financial information.

Whilst we are opposed to the proposed changes, if the IASB were to proceed, we would like to suggest that consideration be given to alleviating some of the additional pressures on resources, by refining the scope of this IFRS to focus on 'core' business assets. From our perspective we would consider the operating leases on our stores to be our core business assets and key in management's operational decision making for the business. Where as, the Group's operating leases for vehicles, mobile phones/blackberries, photocopiers and other office hardware would not be considered integral in commercial and economic decision making and as the value of these leases is not material and as a percentage of the total portfolio is very small, the value added from including them would not exceed the effort and work required. Whilst we know inherently that the value of the leases relating to non-core business assets is material, there will be time and cost associated with proving immateriality to our external auditors.

Thank you for the opportunity to comment on the exposure draft and for your consideration of the significant administrative and resource (people, processes & systems) challenges facing the New Look Group, both now and in the future, to ensure our ongoing commitment to comply with all reporting regulations, including IFRS.

Yours faithfully



**Alastair Miller**  
Chief Financial Officer

For and on behalf of New Look Retail Group Limited