



December 3, 2010

Lise Croteau
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International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

Re: Comments on Exposure Draft – Leases

Dear Sir/Madam:

Hydro-Québec is a major producer, transmission provider and distributor of electricity on the North American market, operating mainly in the province of Québec, Canada. Its sole shareholder is the Québec government.

We generally agree with the IASB's new approach to lease accounting. Our detailed responses to the questions posed in the Exposure Draft are attached.

On behalf of Hydro-Québec, I thank you for giving us this opportunity to respond to the Exposure Draft *Revenue from Contracts with Customers*.

Should you wish to discuss any aspects of this comment letter in more detail, please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Lise Croteau'.

Lise Croteau, FCA
Vice President, Accounting and Control
Hydro-Québec

Exposure Draft

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The accounting model

Question 1: Lessees

- (a) We agree that a lessee should recognize a right-of-use asset and a liability to make lease payments. Essentially, the liability to make lease payments complies with the definition of a liability, and the right-of-use asset corresponds to that of an asset. Not recognizing the liability amounts to off-balance sheet financing. Moreover, the same accounting treatment for the various types of leases will enhance comparability among businesses.
- (b) We also agree that amortization of the right-of-use asset and interest on the liability to make lease payments should be recognized. Subsequent recognition of the right-of-use asset at unamortized cost is consistent with the cost model in IAS 38, *Intangible Assets*. However, we have a reservation regarding the reference in paragraph 20 to amortization in accordance with IAS 38, since the Board considers that a right-of-use asset must be presented as an item of property, plant and equipment in the statement of financial position. We suggest that reference should be made instead to IAS 16 for the amortization of a right-of-use asset.

As for the recognition of the liability at amortized cost using the effective interest method, this method complies with draft IFRS 9, *Financial Instruments*.

Question 2: Lessors

- (a) We do not agree that there should be two possible accounting treatments for lessors while this is not the case for lessees. In our opinion, the comparability of the financial statements is reduced from one lessor to the next as a result.

We prefer the derecognition approach. Since the very definition of a lease (in the Application guidance) implies that a lessee has control of the assets contemplated during the lease period, the partial derecognition approach, as proposed, seems to be the most appropriate for all leases. This also better reflects the fact that the lessee recognizes an asset in property, plant and equipment for all leases.

In the boards' view, in BC25, a single approach to lessor accounting is not appropriate because of differences in the economics of the business models for different lessors. This point of view is adequate but it seems to us that it also applies to lessees, which was not taken into account in the draft.

- (b) Except as regards the answer to Question 2(a), we agree with the recognition of assets, liabilities, income and expenses using the approach applied. The accounting treatment remains nevertheless substantially related to that for lessees.

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Question 3: Short-term leases

We do not agree with the simplified requirement for lessees, but we do agree with the simplified requirement for lessors. We do not understand why the simplified treatment is not the same for both of them. It is our view that the simplified treatment for lessees should be the same as that for lessors. The definition of a short-term lease avoids, in our opinion, most of the possible manipulations since it takes into account the maximum possible lease term, including options to renew or extend.

Definition of a lease

Question 4

- (a) We agree with the definition of a lease. However, since the concept of control is included in the Application guidance to distinguish a service contract from a lease, we would rephrase the definition as follows:

“A contract in which the right to control the use of a specified asset (the underlying asset) is conveyed, for a period of time, in exchange for consideration.”

- (b) We agree with the distinction made between a lease and a purchase or sale. Paragraph B9 should, however, also refer to the draft revenue standard in order to determine if there actually is a sale.
- (c) We agree with the guidance in paragraphs B1-B4. The elements of IFRIC 4 have essentially been retained.

Scope

Question 5: Scope exclusions

We agree with the proposed scope.

Question 6: Contracts that contain service components and lease components

Overall, we agree with the proposals. We were wondering, however, about the significance of the service component. We have reservations about recognizing a whole contract as a lease if the service component cannot be distinguished but it accounts for most of the contract. This could be the case with a service contract that provides for a specific item to be leased. We are aware that this type of contract should perhaps be rare, especially since the service component is non-distinct, but it should nevertheless be stipulated in the standard so that it is not recognized entirely as a lease. This could be done by simply adding an exception to paragraph 6, which could read as follows:

“When the service component is not distinct but represents substantially all the contract, the contract shall be treated as a service contract.”

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We were also wondering about point (b)(iii) of Question 6, namely that a lessor who applies the derecognition approach should account for the two components separately, even though the service component has already been qualified as non-distinct. We agree with the FASB's arguments, in particular that this treatment would result in inconsistent measurement for a lessee's payables and a lessor's receivables (BC52). Moreover, the IASB itself stated that it should be rare that a lessor will not be able to identify service components within a contract that contains service and lease components, and the board notes that this treatment is inconsistent with how it proposes that lessees and lessors that apply the performance obligation approach treat non-distinct service components (BC53). Under the circumstances, we do not understand why the IASB allows a different treatment for lessors who apply the derecognition approach.

Question 7: Purchase options

We agree that a lessee or lessor should account for purchase options only when they are exercised, as set out in paragraph 8(b). We further agree that as long as a purchase option is not exercised, the lessee does not totally control the underlying asset, except with regard to the contracts stipulated in paragraph 8(a).

Measurement

Question 8: Lease term

We agree that the lease term should be 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, where applicable. We support the arguments in BC115, since such an approach would be a practical solution considering the problems associated with accounting for options in a lease.

Question 9: Lease payments

For lessees: We 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 using an expected outcome technique. The liability to make these lease payments and the right to receive such lease payments exist at the commencement of the lease, while only the amount is uncertain.

For lessors: We agree that they should be accounted for only if they can be measured reliably because it is more difficult for a lessor to determine the actions of lessees.

Question 10: Reassessment

We agree that assets and liabilities should be remeasured when changes in facts and circumstances indicate that there has been a significant change in the liability to make lease payments or in the right to receive lease payments since the previous reporting period. This approach is easier to apply in practice than systematically reviewing all the leases on each reporting date. Furthermore, we are in favour of not being required to reassess the interest rate at each reporting date because this is consistent with the amortized cost-based approach in IAS 39.

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Sale and leaseback

Question 11

We agree with the criteria for classification of a transaction as a sale and leaseback since the same criteria are used to determine a purchase or sale in B9 and B10.

Presentation

Question 12: Statement of financial position

- (a) We 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 (or investment property), but separately from assets that the lessee does not lease. Furthermore, right-of-use assets should be separated from assets that are not leased because their risk profile is different.
- (b) We disagree that a lessor who applies the performance obligation approach should present a net lease asset or liability. This is inconsistent with the required presentation for a lessee. Moreover, since the board considers that the liability to make lease payments meets the definition of a liability, it must be presented with liabilities and not presented net, unless the criteria for offsetting already provided in the IFRS are met.
- (c) We agree that rights to receive lease payments should be presented separately from other financial assets, and that residual assets should be presented separately within property, plant and equipment, if they are significant. These items are distinct by their very nature.
- (d) We agree that lessors should distinguish assets and liabilities arising under a sublease in the statement of financial position because it is consistent with the presentation of a lessee or lessor who does not have this type of arrangement.

Question 13: Statement of comprehensive income

We think that lease income and lease expense should be presented separately from other income and expense in profit or loss, provided that they are significant.

Question 14: Statement of cash flows

We think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows, provided that they are significant.

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Disclosure

Question 15

In general, we agree with the required disclosure.

Transition

Question 16

- (a) In our opinion, the retrospective approach proposed is very appropriate. A full retrospective application would be highly labour-intensive and costly.
- (b) A full retrospective application could be permitted. It perhaps can be applied more easily for some lessees or lessors.
- (c) We do not have any additional transitional issues.

Benefits and costs

Question 17

For the most part, we agree with the assessment of the costs and benefits in paragraphs BC200-BC205. The proposed model will improve lease accounting. The boards also took into account some comments made in the discussion document, such as conducting a reassessment only if there is an indication of a significant change in the expected lease payments.

Other comments

Question 18

No further comments.

