ARVAL
BNP PARIBAS GROUP

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

Re: ED/2010/9– Leases

Rueil Malmaison, December 15th, 2010

Dear Sir David

We answer your invitation to comment on the IASB ED/2010/9 “Leases” related to leases and sincerely thank you for giving us this opportunity.
We appreciate the efforts of the IASB and FASB to jointly develop new solutions on how to account for lease and acknowledge the tremendous amount of time and work that went into developing this Exposure Draft.

ARVAL has provided businesses and public organizations with full service operating leases and fleet management solutions for more than 20 years. This activity consists of integrating into one single platform operating leasing and a range of comprehensive services for corporate vehicle fleets.
One of the three leading multibrand car leasing companies in Europe, Arval is a subsidiary of the French bank BNP Paribas and operates directly in 22 countries, with a managed fleet of 704,000 vehicles. In 2010 by the end of year Arval will have purchased and financed 181,000 new vehicles and sold 157,000 used vehicles.
We are therefore concerned in our core business by this Exposure Draft. Our position is in line with that of Leaseurope and of our mother company BNPParibas. It brings into the discussion our specific situation as a fleet lessor and our experience of the operational management of automotive leasing.
While acknowledging that the current model for lessee has long been criticized for failing to meet the needs of financial statements users and agreeing with the Boards’ initial objective to fight activities of pure structuring, we report in our detailed position paper and our answers to the 18 questions asked by the Boards some essential concerns that have to be tackled before any further step. In our view, the case for change still has to be made and the June 2011 convergence deadline should rather be missed than risking weakening the contribution of leasing to the financing of the economy.

Should you have any questions or wish to discuss any of the issues in more detail please do not hesitate to contact Vincent Rupied (vincent.rupied@arval.com).

Yours sincerely,

Xavier VIOLLET	Vincent RUPIED
Group CFO	Director Corporate Relations

Arval is responding to IASB's and FASB's invitation to comment on the Proposed Accounting Standards Update issued on August 17, 2010 and hereafter referred to as the "Exposure Draft" or "ED".

We first want to thank the Boards for providing the opportunity to comment on this important text. Arval is closely involved in the work of Leaseurope and explicitly supports Leaseurope's Comment Letter. Our parent company, BNP Paribas, has submitted a comment letter covering the reactions from a group stand-point.
Our Comment Letter brings complementary views from our specific practice of the full service operating lease of corporate fleets.

ARVAL and the full service operating leasing industry

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The automotive market is closely linked to leasing. In 2009 automotive assets amounted to 54% of the new business generated by the members of Leaseurope, which itself represents 95% of Europe's entire leasing market[1].

In corporate fleets, the use of full service operating lease has been relentlessly growing as an efficient and cost effective integrated solution, firstly in large corporate fleets where it is clearly dominant, then in middle size businesses and now in a growing number of very small businesses. The reasons for this evolution are rooted in the economic business model of full service operating lease:

- <u>a financing of usage, not of acquisition</u>: operating leases are non-full-payout, meaning the full repayment of the lessor's investment is not achieved by the lessee's commitments and the lessor takes the risks on the resale of the car. The dramatic collapse of used car markets in 2008-09 has shown the importance of this feature for lessees.
- <u>a convenient and cost effective all-in solution</u>: fleet lessees receive on one invoice a comprehensive grouping of their mobility costs. More and more services in addition to scheduled maintenance and repair have been added over time, such as insurance, fuel, driver safety programs.
- <u>the guarantee of flexibility</u>: contracts are easily adjustable to the actual usage of cars which is widely unpredictable.

General Comments on the Lease Exposure Draft

An ill oriented anti-abuse norm:
Leasing in general is not a structuring industry in Europe. The deconsolidating abuses that motivated the ED, and that Arval also opposes, are largely concentrated in sophisticated big ticket leases, and in jurisdictions using rule-based rather than principles-based standards. However, it

[1] Leaseurope annual statistic 2009

seems that concerns over abuse have been erroneously extended to the entire leasing industry, ranging from small incidental pieces of equipment to large items of plant and machinery and property. For example we hear repeated references to the off balance sheet treatment of aircrafts while carriers in Europe mainly use finance leases for these assets.

More generally, it makes little or no sense to impose significant increases in the accounting and administrative burdens attached to the millions of medium and small ticket leases which are taken out each year in the interests of business convenience and cost efficiency simply to reduce the structuring opportunities for the small minority of leases by volume that are the focus of the IASB's concerns. Indeed the future of such medium and small ticket leases could be threatened by the ED's overly complex proposals.

This is even more obvious in the case of full service operating lease. Companies use this feature to (i) even out cash flows, (ii) align operating costs with revenues, (iii) eliminate residual value risk and (iv) outsource the administration and execution of maintenance.
In other words, the fundamental reasons for employing operating leases are nothing to do with asset concealment but are clearly for basic business and financial needs. We have already stressed this point in our response to the Discussion Paper (DP) in July 2009 by providing a study carried out by the Corporate Vehicle Observatory (CVO)[2] showing that the two first motivations for fleet operating leasing are

1. a "fixed monthly cost for the whole lease period" and
2. the "integration of all services in one contract".

A strong cost/benefit imbalance

While the project reflects an intellectually bold intent to unify lease accounting, very little has been done to compare the cost of implementation with the added value attributable to the new proposals.

The project seems to have been designed exclusively for the benefit of users (mainly analysts) who may not all have the same requirements, and who generally seem to have managed well using the disclosures required by the existing standard. Over the years analysts have developed and published their own methods of analytical capitalization of lease commitments in the absence of formal lease capitalization requirements and this seems to have served the wider markets reasonably well.
We believe that the community of users who are expected to benefit from the proposals is significantly smaller than the preparers who are adversely affected by them and we do not see how this apparent skew in cost/benefit has been taken into account.

Regarding virtually all other stakeholders, the implied costs of implementation and compliance are extraordinarily high. They involve investments in software, internal control processes and training and are likely to dwarf those incurred by Lessors on the introduction of IAS17 in 2004. The complexity on the lessee side is greatly underestimated, especially for operating leases that currently require a simple accounting process. According to PWC's European Impact Survey 2010[3] only 25% of respondents say they currently have the resources available to implement the new lease standard.

[2] The CVO is an expert platform for all fleet professionals based in 14 European countries (fleet managers, procurement specialists, manufacturers, leasing companies, advisers, insurers, press, public authorities, researchers etc.) that conducts annual surveys and analysis about (i) decision-makers' attitudes on fleets, (ii) main trends of the automotive market and (iii) comparison of trends on the different countries.
[3] PWC / University of Rotterdam 2010 survey on IASB/FASB Lease accounting project

Our own analysis of processes required under the current and the proposed rules shows a seven-fold increase in the number of steps needed to account for an operating lease[4].

	Current	*ED*
carry out a check (*)	5	32
prepare or carry out a calculation	1	38
booking entry	3	17
prepare disclosures (*)	2	15
	11	102

(*) : these tasks can be carried out on groups of contracts

For these reasons we consider the brief evaluation of cost/benefit provided in paragraphs BC200 – BC205 of the ED to be unrealistic and alarmingly deficient.

Due process

Arval has been deeply involved in the Lease Accounting project since its inception and, together with its main international competitors, has delivered a position paper on the Discussion Paper. We are today very disappointed by the Lease Exposure Draft that ignores most of the recommendations of the industry. There were more than 300 comment letters on the Discussion Paper and most warned on the complexity and internal flaws of the proposal.
Despite this groundswell of opinion, the Boards seem to have identified a consensus for the right of use ignoring the views – and advice - of experienced leasing professionals. They have pushed hastily ahead with a complex, one size fits all set of proposals for all leases on the lessee side and, bizarrely, have developed a range of proposals for lessors, one of which seems completely inconsistent with the lessee model.

Similarly, the leases working group that was meant to guide the work of IASB/FASB with professional advice has very rarely been invited to gather.

More generally our constant interaction with our customers, even in the most mature businesses, shows that the overall level of awareness on this project among lessees remains extremely low for various reasons and in spite of an active communication policy with stakeholders from the IASB and FASB. The lessees' limited involvement should in no way be interpreted as a tacit agreement of the proposals.

None of the objectives is fulfilled

All of the four main objectives on the first page of the standard setters' intention "book" are in our view severely hurt by the proposal:

-1- <u>Transparency on all resources invested in the production</u>,
Unclear new boundaries between the newly defined leasing and purchase on one side and service on the other will generate more confusion than under IAS17. While the alluded lack of transparency may be closely linked to nominal bright lines in the American FAS 13, the "substance over form" principle applied in IAS 17 lets economic conditions prevail in the qualification of a lease. In addition, unexpected exclusions from the scope, like for intangible assets, will further harm transparency and add complexity.

-2- <u>Put a stop to specific deconsolidating structured transactions</u>
Sophisticated financial engineering may still be possible because the proposals still contain significant areas of subjective judgment, for example in the assessment of the lease term that is more likely than not to occur and in respect of contingent items.

[4] Full service operating lease – operational and accounting steps under current and new IASB lease standards.

-3- <u>Remedy the complexity of the current model</u>,
Far from being reduced or remedied, complexity (i) has been increased significantly by a highly intellectual approach that lacks pragmatism, (ii) is likely to be impractical for lessees and lessors with high volumes of transactions, and (iii) is a source of additionnal problems adverse to business.

In addition to the extraordinary complexity of the proposed balance sheet mechanisms, the exaggerated weight of disclosures proposed by paragraphs 70 to 86 of the Exposure Draft adds hugely to the burden imposed on preparers and suggests that the new balance sheet elements are decidedly not significantly enlightening.

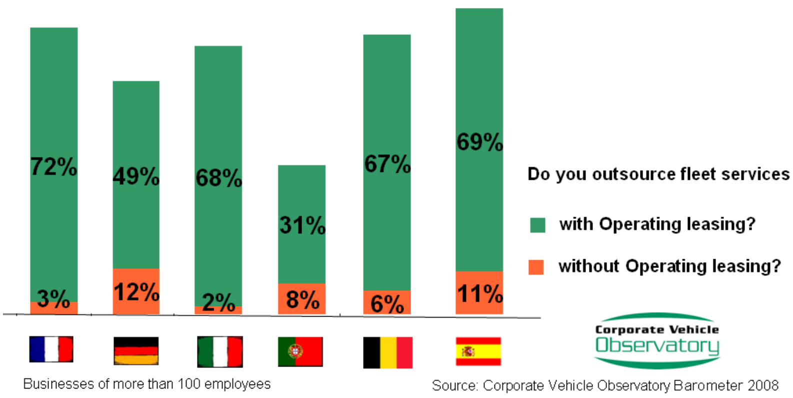
On the Lessor side, the goal of unification was surrendered with the unexpected appearance of the hybrid method, whereby the "risk and reward" principle that logically differentiated different economic business models under IAS17 reappears solely for the lessor and for the Performance Obligation model, in obvious conflict with the model adopted for the Lessee.

-4- <u>Improve the convergence between the European and US standards – IAS17 and FAS13</u>.
We are supportive of this goal, but this does not mean that both sides should suffer from poor compromise or from drastic reforms. The best facets should be taken from each side.

While the bright lines of FAS13 are apparently responsible for opaque and abusive deconsolidations, the principle under IAS17 is economically well-founded.

Similarly, we understand that the Performance Obligation model is mainly proposed because of the preference of the FASB, but it should be made clear that its intrinsic flaws put in doubt the whole construction on the lessor side.

A proposal that ignores current trends of the leasing industry
The Lease accounting exposure starts from the assumption – not a demonstration - that all leases are similar. It is then confronted with the case of full service leases which fully integrate the leasing feature and associated asset management services and which lessees wishing to outsource choose precisely because of this feature.



Under IAS17, operational integration has so far been represented by an integrated accounting treatment as an operating expense, but the new accounting seeks to break down a product widely acclaimed for its integration. We see no merit in this whatsoever.

It is indeed not by chance that operating leases are by far the most popular choice as the basis for full service contracts. The accounting in expenses under IAS17 had a threefold justification:

1. <u>The customer requests a charge for usage, not the financing of acquisition</u>, and does not look for ownership.
2. <u>The economic usage of the asset is likely to provide consistent benefits from one period to another</u>, whether at the beginning or at the end of his contract. Therefore a stable, straight

line profit and loss charge reflects the economic reality, instead of the decreasing profit and loss impact that would result from application of the ED.

3. Being unable to finely forecast his usage, the customer looks for adjustable rentals according to factors such as mileage. The treatment of lease charges as operating expenses facilitates this dynamic adjustment. However, the proposed treatment for the apportionment of reassessment adjustments between past and future periods and changes in contingent rentals add huge complexity to the accounting for flexible practices that are designed to support businesses in changing environments and in our opinion emphasise accounting rigidity and complexity rather than business dynamism.

Unclear boundaries

With the radically different treatments for leases and service contracts proposed by the Exposure Draft, the question of the distinction between lease and service contracts, so far rather secondary, suddenly becomes crucial. Unfortunately the boundary is not the slightest bit clearer. One could easily re-cycle the statement in the Discussion Paper (on leases) that "similar contracts with similar characteristics should be accounted for consistently".

The Exposure Draft attempts to define new lines between:

i) purchases/sales, which would include a big part of current finance leases,
ii) new leases, including certain financial leases and certain operating leases in which the underlying asset is specified,
iii) service contracts, including the service component of operating leases.

These definitions will result in much difficulty in deciding what a lease actually is. This clearly harms the initial aims of transparency and consistency.

General concern for fleet Lessees

We are not convinced that the right of use concept is suitable to our types of contracts

The accounting standard is built around the concept of a right of use to be recognised on the Lessee's balance sheet. While agreeing that this model could be suitable for certain type of lease, we are not sure that it is suitable for our business because we are not sure that the agreements that we are selling can easily find their place in the widened new definition of leases.
Indeed, the provided guidance for distinguishing between leases and service contracts is insufficiently robust given that this will define the frontier between on-balance sheet leases and off-balance sheet service contracts.

Furthermore, as providers of full service operating leases, in the automotive industry, we provide dynamic contract management involving numerous changes in terms and conditions. The proposed on Balance sheet treatment through the right of use is likely to generate

- uneconomical rigidity : the complexity and burdensome treatment of future operational and accounting processes will inevitably damage the current flexibility which are the key features of our contracts and
- volatility in balance sheet : as the consequences of the proposed reassessment procedures

Finally in paragraph 25, the ED requires presentation of right-of-use assets as if they were tangible. In contrast, paragraph 20 (amortization of the right of use) rules that "*the Lessee shall select the amortisation method of right of use and review the amortisation period and amortisation method in accordance with IAS 38 – Intangible assets*". This uncertainty should necessarily be cleared due to its important consequences

Initial measurement of the liability

We absolutely do not agree with the way to estimate the initial measurement of the liability (cf. paragraph 12 to 15 and B11 to B21).

- Firstly because our understanding of the wording of the Boards makes the definition - "*the longest possible term that is more likely than not to occur*" (paragraph B16) unclear and problematic in its implementation.

  In our contracts there is no contractual option for the Lessee to modify the lease term except the option to early terminate. However, hardly any of our contracts ends at its initial term. They are frequently adjusted due to over mileage as well as informal extensions (while waiting for delivery of the next leased car for example).

  If they were to be considered as contingent, initial measurement will be very problematic for our lessees. Indeed, there is neither a rule nor statistics about the past - giving reliable information about future events - that could help to calculate the probability the Lessee will re-contract in the future.

  Measuring a balance sheet entry by estimating the longest lease term that is more likely than not to occur is practically impossible for a Fleet Lessee. The term "that is most likely than not to occur" is essentially the contractual term, it means, the term during which the Lessee effectively requires – or forecasts he will require - the vehicle.

- Secondly because the elements that are required to be included in arriving at the value of the initial amount of the liability (paragraph 14, a, b, c) do not, from all of them, represent liabilities. We question whether an uncertain outflow of resources meets the definition of a liability as included in the current and new framework

  One will see in our response to question # 9 that we draw a distinction between the several types of contingent rentals. Those that can be avoided by lessees do not meet the definition of liabilities. Including them would be in our opinion inconsistent with Conceptual Framework definitions.

  Although we include in our lease contracts contingent rentals on extra mileage payable at lease term, our "on the form" fixed rentals are highly variables because we frequently adjust them if the effective usage made by the Lessee – always uncertain - requires it. The corresponding amounts can't be determined neither at the inception of the lease because the mileage for example cannot be forecasted precisely (historic data are not always representative of what will occur in the future) nor during the earlier stages life of the contract.

Subsequent measurement and reassessments

Requiring reassessments when "there is a significant change in facts and circumstances" without a better definition of those facts and circumstances seem potentially source of instability and will require the implementation of dedicated processes scrutinizing external and internal events and identifying relevant factors that could change the Lessee commitment.

We ask the board to only require reassessment when rentals become unconditional i.e. an adjustment has effectively and contractually occurred between the Lessee and its supplier.

Disclosures

Disclosures as required in the Lease ED are too burdensome. In order for users to understand the new assets and liabilities that will be shown on the face of the financial statements, the proposed model requires preparers to provide level of information in the notes to the accounts that is unjustifiably detailed and casts a doubt on the real advantage of the required on balance-sheet accounts.

Transition proposed

Lastly, we have concerns about the transition rules and are putting forward a modified retrospective application. After having tested it (see example in our response to question #16), we know the ED proposal will cause a more dramatic effect of the front loading of costs as all leases will effectively be in their early stage just after the application.

We recommend that lessees be granted the choice between a full retrospective approach (that we know could be more expensive in terms of processes and data gathering) and the simplified approach proposed in the Exposure Draft.

General concerns for Lessors

The hybrid model is unjustifiable

- The failure to provide one model for all leases puts into doubt the value and consistency of the whole project.
  In July 2009, we urged the Boards to include lessor accounting within the project because a project of this importance for the economy could not be left half finished, with inconsistent models for lessees and lessors.
  However, for lessors, the Boards have been unable to sustain their initial assumption that "operating and finance leases are similar products". They have re-used the "risk and reward" criterion of the current IAS17 to distinguish the Performance Obligation (PO) model where the lessor retains "significant risks and benefits" on the underlying assets, and the very different De-Recognition (DR) model otherwise. The proposed duality reflects the same differences in the business models that have been denied on lessee side. However the PO and DR accounting schemes show flaws, as we demonstrate here after.

- Heterogeneity reaches extremes when we consider all segments of the leasing market, including the short term rental and real estate sectors as well as mainstream equipment leasing. In total, as pointed out by Leaseurope, the Boards have proposed no fewer than five separate lessor accounting models:
  1. *Short term rental would be as per the current operating lease accounting.*
  2. *The performance obligation (PO) model where the lessor retains 'significant risks and benefits' on the underlying asset – recognizing that asset together with, an additional asset for the lease receivable and a novel PO liability.*
  3. *The de-recognition (DR) model applies to most other equipment leases – recognising the receivable and a separate Residual Asset.*
  4. *A 'scoping out' for cases where both control and 'all but a trivial portion of risks and benefits' are transferred [as in hire purchase].*
  5. *For 'investment property', lessors subject to international financial reporting standards (IFRS) would apply the existing IAS 40 standard unless opting for historic cost accounting."*

  With so many different rules, compliance is unlikely to be consistent and financial reports are unlikely to be comparable.

- The Performance Obligation model is not defensible, for three reasons
  - It is conceptually inconsistent with the lessee's Right of Use: while the lessee is required to show in assets the full amount of the acquired right of use, the lessor would have to show a liability for the not yet performed delivery of the same asset as well as the same asset that the lessee now has control over and is accounting for. A logical contradiction and a consistency problem in lessee/lessor consolidations.
  - The Performance Obligation gives rise to a double asset while the receivable is the only one capable of generating future cash flow. This inflation of the assets has no economic fundament.
  - Furthermore this double counting may have a dramatic impact on capital requirements for Bank-Lessors engaged in leasing activities.

- The De-recognition model is obviously the lesser of two evils.
  - It is technically consistent with the Lessee's accounting model.
  - However we cannot support the De-recognition model as it stands in the ED because it ignores the interest generated by the residual asset and leads to a significant understatement of the lessor's assets. The latter issue results in a significant capital gain

when the lessor resells the asset and is recognized at the end of the lease contract, giving rise to a skewed income recognition pattern that lacks any linkage to the underlying economics of the lease. Typical residual values in our market, can range from 20% to 40% of the vehicle's list price, so this not a "fine–tuning" issue but one which has a material impact on the accounts.. The DR model could only become acceptable when it includes an accretion mechanism that recognizes the accrual of interest revenues on residual assets and brings the income recognition pattern into line with the underlying economic position.

In conclusion, we believe that the economic reality of leasing transactions should be faithfully represented by the accounting. As things stand, the ED's treatment of both lessee and lessor transactions fails to achieve this and also fails to accurately represent the practices of fleet full service operating leasing.

While there are some fundamental flaws on the lessor side of the Exposure Draft, our principal concerns are on the lessee side. We are concerned that lessees have been grossly under-represented in the consultation processes leading up to the ED's publication and remain widely unaware of the proposals and the significant challenges that implementation will bring. We remain unconvinced that the limited incremental benefits that will accrue to the users are proportionate to the huge costs preparers will incur and the added distractions that businesses will face in a period when management time would be much better spent on ensuring that their companies repair the damage inflicted by the recent financial crisis and return to a state of sustainable growth.

Response to the 18 Questions

Q1 (a)	LESSEE	**Accounting model & Recognition** (paragraphs 10 and BC5–BC12) 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?

We do not agree

While supporting the goal of providing full transparency on assets employed and commitments regardless of funding methods, Arval fundamentally disagrees with the solution proposed in the Exposure Draft.
Based on the proposed definition of a lease, the right of use is not applicable in our business.
The simple use of equipment should not require the user to record an asset and liability. The use of the asset in our operating lease contracts is ancillary to a global service where our customers are not simply seeking the availability of a specific asset, they are looking for a convenient and flexible way to fill a business requirement, which may require assets that are readily substitutable, whilst profiting from asset management expertise and residual value underwriting provided by the lessor. Our agreements are designed to avoid our customers bearing the risk related to these assets.

Furthermore, as providers of full service operating leases, in the automotive industry, we provide dynamic contract management involving numerous changes in terms and conditions. The proposed on Balance sheet treatment through the right of use is likely to generate

- uneconomical rigidity : the complexity and burdensome treatment of future operational and accounting processes will inevitably damage the current flexibility which are the key features of our contracts and
- volatility in balance sheet : as the consequences of the proposed reassessment procedures

Finally, we find the proposals not only burdensome and complex to apply for preparers but also in contrast to economic reality and ineffective in eliminating structuring opportunities, since its application is subject to the use of judgment in areas that endanger the reliability and the consistency of the information delivered in the financial statements.

Nevertheless, we understand that the Boards are firmly set on forcing lessees to bring operating leases onto their balance sheets. In the absence of any alternative, we do not agree with the measurement of the initial liability and its corresponding right of use asset proposed by the ED

We do not agree with the way assets and liabilities under leases are calculated.

1. Even if their contracts are frequently rewritten according to usage, our lessees will not be able to estimate with any reliability. Therefore they should keep only contractual term as the basis for measurement.
2. In addition, the boards make no distinction between a number of contingent items that have little, if anything, in common. As a result, the liability recognised by lessees under the model proposed includes amounts that do not represent obligations of the lessee or meet the definition of a liability under the conceptual Framework.
3. Furthermore, if preparers effectively follow what is required for initial estimations, there is more chance their workload will increase at the end of each contract. Indeed, if the effective term and usage of the vehicle does not match with the initial estimations of liability and related right of use, there are likely to be end of contract write offs/backs for several assets mainly relating to the lease liability (the RoU asset will have been capitalised and depreciated but the lease liability may be charged with payments that were not anticipated or may not be charged with payments that were anticipated).

For these reasons, we would advocate a basis that eliminates subjectivity and judgment and simply uses the present value of the basic minimum contract terms.

Q1 (b)	LESSEE	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 do not agree

As the Corporate Vehicle Observatory (CVO) fleet repeatedly demonstrates in its annual barometer, the first Lessee motivation for fleet operating leasing is convenience.

By requiring amortisation of the right of use on a straight-line basis and of the liability using the effective interest method, the amortization proposals in the Exposure Draft will result in larger charges to earnings in the earlier years of a lease (amortisation and interest charge will exceed the cash rental paid in the earlier years of a lease).

After having tested the method with several of our customers, we know that those managing a lease portfolio containing different terms will be less impacted than those who concentrate renewals on certain dates. However the phenomenon distorts the balance sheet values (impacting net equity) and creates a front-ended cost pattern that increases in severity the longer the lease term. This mismatch does not reflect the economics of a lease transaction.

In term of impacts, we wanted to point out some reconciliation issues that may occur between Fleet Managers – generally used to accounting in monthly rentals - and their accounting departments who will now record a different P&L impact.

We disagree that the asset should be amortized on a straight line basis while the obligation is accounted for using the effective yield method. We would strongly recommend a linked amortization method for the right of use asset and the lease liability, in order to mitigate this distortion in lease expensing, and hence in profit reporting.

Q2	LESSOR	**Accounting model & Recognition** (paragraphs 28, 29 and BC23–BC27)

(a)		Do you agree that a Lessor should apply - (i) the Performance Obligation approach if the Lessor <u>retains exposure to significant risks or benefits</u> associated with the underlying asset during or after the expected lease term, and - (ii) the De-recognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why

We absolutely do not agree

After the Discussion Paper release, we pointed out that the proposal being exclusively focused on lessee's accounting was a major concern. However, the proposals of the Exposure Draft are likely to result in confusion and inconsistencies and require re-thinking.

The main objective of unification is jeopardized by the Boards proposals
It is very difficult to understand why one model can cover all lease situations from the lessee's perspective but that the lessor needs two different models to deal with the same contracts.
It appears as if the boards did not see any problem with the current "risk and reward" criterion while deciding the accounting rules for Lessors. Indeed, we observe that it is the effective economic difference in the actual two "products" – finance and operating lease – that gives rise to the two model approaches and the Boards have just exchanged the "risk and reward" criterion for the "risk and benefit" one.

Our long experience, magnified by the dramatic used-car sale crisis in 2009 has underlined the essential difference between leases that do and leases that do not free the lessee from residual value risks.
Nevertheless, this is not a justification of the Performance Obligation model whose harmful potential consequences have not been fully assessed and which seems to us to be totally inconsistent with the lessee right of use model. To re-emphasise this point the PO method is not consistent with the basic premise that the lessor has given up the right to use the leased asset, control over which has passed to the lessee over the lease term. If there is a restriction on the leased asset, we fail to understand why this should not be taken into account – and we don't see why there should be any performance obligation at all. In any case the Lessor should not have two assets for the same underlying object.

The current operating lease model is the best to reflect the economics of our contracts. However if the right of use is to be implemented, De-Recognition model is the only one that is consistent with this concept
This model is the only one that is consistent with the lessee right of use model, faithfully reflecting the underlying substance of the leasing arrangement (the lessor's right to receive lease payments) and appropriately measuring the economic benefits retained by the lessor (in the form of the residual asset).
It is the one that will provide users with accurate information on the level of credit risk and asset risk the lessor is exposed to.

Q2 (b)	LESSOR	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 do not agree

While the current operating lease accounting model is the one that really reflects the economics of our lease arrangements, if the ED is to be implemented, the De-Recognition is the least damaging model.
Nevertheless, the Boards proposals, as stated in paragraphs 50, 55, 56(a) and 59, are a step backwards - if not complemented by the accretion mechanism - from the current IAS 17 treatment in that they do not account for the residual asset's economic effects : the proposed method seems to be merely deferring revenue recognition without any basis whatsoever.

Therefore we think that the residual asset should be accreted at the rate implicit in the lease in a way that reflects underlying economics, namely the lessor's rights becoming progressively less encumbered by the lease over the lease term and equating to the residual value by the end of the lease term.

Under IAS17, residuals are effectively accreted over the lease term and the proposed method deferring revenue recognition lacks any justification and reality.

If residual asset accretion is not included, an income recognition pattern heavily skewed to the final year of the lease contract results and this is completely at odds with the underlying economic reality. The following example illustrates the point.

Taking an example of a simple car lease:

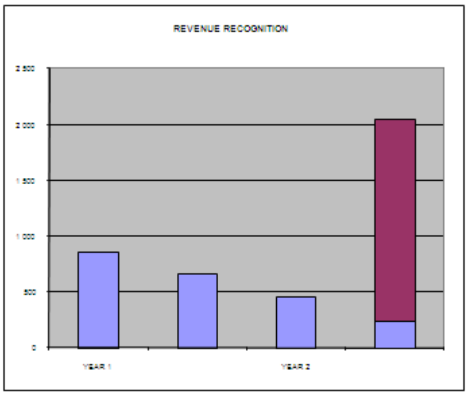
- Initial investment : €18,000
- Contractual Residual Value : €7,650
- Lease term : 4 years
- Customer rental : €8 000, of which €4,409 for services, leaving €3,591 for asset usage
- Therefore, interest rate implicit in the lease : 7.00%
- Sale of the vehicle at the end of the lease : €7,650
- Customer Payment obligation at contract initialization = receivable at the beginning of the lease : €12,164
- Residual asset value: €5,836

Amortization of the receivable:

	opening	interests	amortization	closing
YEAR 1	12 164	851	2 740	9 424
YEAR 2	9 424	660	2 931	6 493
YEAR 3	6 493	454	3 137	3 356
YEAR 4	3 356	235	3 356	-

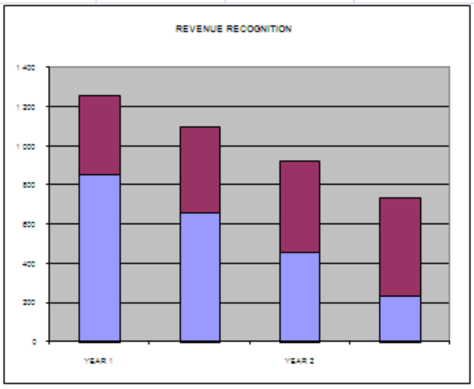
De-recognition model without accretion

Derecognition								
		BALANCE SHEET		PROFIT & LOSS				
PERIODS	Item	ASSET	LIABILITY	AMORTIZATION OF THE RECEIVABLE	NET BOOK VALUE	SALE PRICE	RENTALS INCOME	TOTAL
INITIALISATION	Residual asset	5 836						
	Receivable	12 164						
YEAR 1	Residual asset	5 836						0
	Receivable	9 424		-2 740			3 591	851
YEAR 2	Residual asset	5 836						0
	Receivable	6 493		-2 931			3 591	660
YEAR 3	Residual asset	5 836						0
	Receivable	3 356		-3 137			3 591	454
YEAR 4	Residual asset	5 836						0
	Receivable	0		-3 356			3 591	235
YEAR 4'	Residual asset	5 836						0
	Sale of the vehicle				-5 836	7 650		1 814
	Receivable							0
				-12 164	-5 836	7 650	14 364	4 014



De-recognition approach with accretion

Derecognition								
		BALANCE SHEET		PROFIT & LOSS				
PERIODS	Item	ASSET	LIABILITY	AMORTIZATION OF THE RECEIVABLE	NET BOOK VALUE	ACCRETION	RENTALS INCOME	TOTAL
INITIALISATION	Residual asset	5 836						
	Receivable	12 164						
YEAR 1	Residual asset	5 836				409		409
	Receivable	9 424		-2 740			3 591	851
YEAR 2	Residual asset	6 245				437		437
	Receivable	6 493		-2 931			3 591	660
YEAR 3	Residual asset	6 682				468		468
	Receivable	3 356		-3 137			3 591	454
YEAR 4	Residual asset	7 150				500		500
	Receivable	0		-3 356			3 591	235
YEAR 4'	Residual asset	7 650						0
	Sale of the vehicle				-7 650	7 650		0
	Receivable							0
				-12 164	-7 650	9 464	14 364	4 014



Q3 (a)	LESSEE	**Short-term lease** (Appendix A, paragraphs 64, BC41–BC46) Do you agree that a Lessee should account for short-term leases in this way? (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 Why or why not? If not, what alternative approach would you propose and why?
Q3 (b)	LESSOR	Short-term lease (Appendix A, paragraphs 65, BC41–BC46) Do you agree that a Lessor should account for short-term leases in this way? (i) not to recognise assets and liabilities arising from a short-term lease in profit or loss, (ii) nor derecognise any portion of the underlying asset Why or why not? If not, what alternative approach would you propose and why?

We do not agree with the proposal for lessees

After having pointed out the burdensome nature of the first proposal issued in the DP, the Boards revised their initial guidance and have now issued a modified proposal to deal with short term leases in a way that is not much better than the former version: the revised proposal simply removes the need to discount the rental payments but still requires the grossing up of assets and liabilities.

In our view short term leases are basically service contracts with short term rental payments being expensed directly to profit and loss since the lessees simply wants to benefit from the services the asset provides with no intention of long-term use of a corresponding asset in the business. In our industry such contracts are often entered into when owned vehicles or vehicles subject to longer leases are off the road. In these cases the assets off the road are already on the balance sheet and the short-term hire is simply providing a mobility service when the core vehicle is temporarily out of action. In these circumstances it makes little or no sense to increase the carrying value of assets employed or liabilities.

Not only is this a treatment that is in line with the economic and business reality but it is also consistent with the treatment recommended for lessors. We fail to see why inconsistent models should be applied to lessors and lessees.

We agree with the proposal for Lessor

On the Lessor side, we agree with the proposal that entities providing short term leases should continue to recognise the underlying asset and recognise lease payments in profit or loss over the lease term.

Q4 (a, b, c)	DEFINITION	**Definition of a lease,** (Appendix A, paragraphs B1–B4 and BC29–BC32) (paragraphs 8, B9, B10 and BC59–BC62) – purchase / sale (paragraphs B1–B4 and BC29–BC32) - lease vs service contract (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?

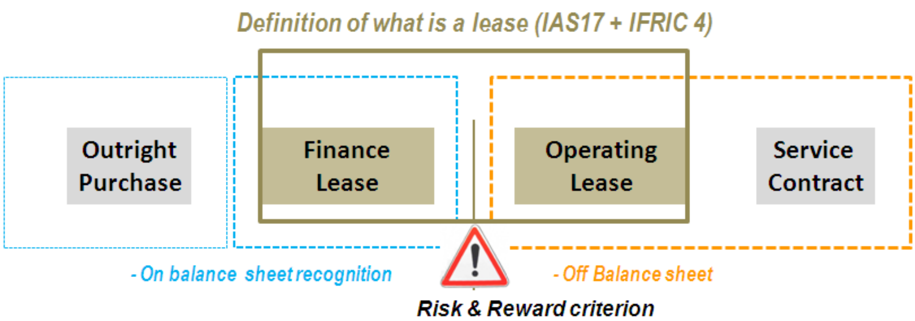
We do not agree.

What we understand reading the lease ED

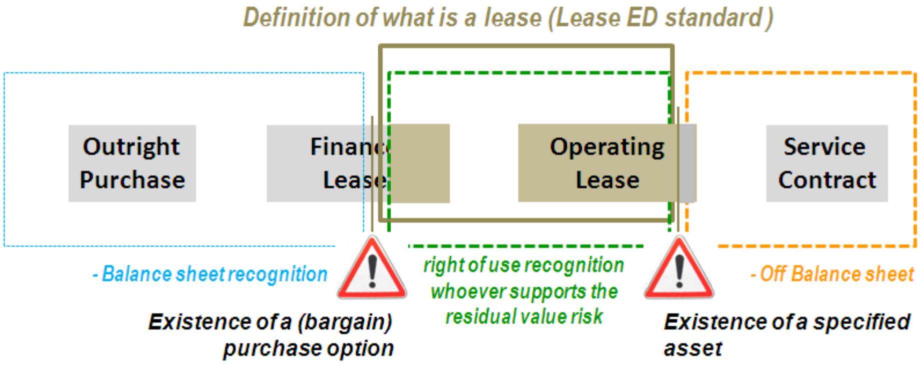
Regarding the existing standards, we do wonder

- whether the new definition of what constitutes a lease could answer existing issues, especially those the Boards is expecting to resolve (bright line)
- in addition whether the new definition of a lease could not give rise to other issues, even if different (bright line differently positioned)

<u>Current definition of lease and related accounting rules</u>:



Future definition of lease and related accounting rules:



Trying to resolve the existing bright line between finance and operating lease, the IAS and FAS Boards are opening two new issues:

- towards what will be considered as purchases / sales by introducing the concept of a “bargain” purchase option. For us, whatever the existence of a bargain purchase option, a lease is and remains a lease until the option is exercised. Introducing this concept will surely give rise to a new bright line
- towards what we consider as service contracts by introducing the concept of the “specified” asset that could be heterogeneously understand

As a result and looking only on the actual operating lease contracts side:

1. Two different types of economic transactions will be accounted for under the same model. Those under which the Lessor supports alone the residual value risk until the end and those under which he does not.
2. Two different accounting rules will be applied for one economic transaction. The one under which the Lessor always supports the residual value but can substitute it without requiring the Lessees’ consent or by requiring it practically.

The new model does not necessarily improve comparability and reliability at all as contract with economical substantial equal terms may be accounted for as either a lease contract or a service contract.

In reality, nothing has been done to resolve existing issues with IFRIC4. It will be very hard in the future to determine the accounting rules the stakeholders will be required to apply. The ED really does not simplify the analysis that has to be made at the inception when determining the accounting rules to be followed.
We fear that those new unclear borders between purchases, leases and service contracts will at least offer new structuring opportunities, jeopardizing the transparency aimed at the beginning.

The definition of a lease contract and a service contract has to be improved because the difference between them will become more important. The existing difficulties with the application of IFRIC4 has to be solved in the new standard

We strongly agree with Leaseurope’s proposal to adapt the definition of a lease to better take account of the economics

1) An entity is only entering into a lease contract when it is acquiring a more substantial use of an asset rather than an ancillary one. In other words contracts involving the incidental or ancillary use of assets should be excluded from the scope of the new standard. (Arval’s customer would never enter in that kind of agreements without the prevision to benefit from services).
2) When a transaction involves the use of generic, easily exchangeable or fungible assets, the Lessee is more likely to wish to obtain a service contract than the use of the asset.

3) The fact that the supplier can replace an asset, even if it does not do so in practice, is also indicative of the fact the client wishes to obtain a service rather than the use of an asset.

The lease versus service boundary must be more clearly defined and scoped and we encourage the Boards to take the time required to develop the definition of a lease along these lines. Otherwise, the difference between a lease and service will be too fine and many contracts that are today considered to be services will be required to be accounted for as leases and vice versa.

Q5	SCOPE	**Scope** (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 do not agree

In line with our remark about definition of leases, we ask for more economic meaningful exclusions
Numerous calls for exclusion of non core or immaterial assets have unfortunately been ignored in the Exposure Draft. This seems to ignore that the overwhelming majority of leases are underwritten for small pieces of equipment like copiers, computers, phones and vehicles. Compared to their average amounts the complexity of the proposed scheme is blatantly disproportionate.

Q6	LESSEE LESSOR	**Service vs Lease component** (paragraphs 6, B5–B8 and BC47–BC54) If distinct : apply the proposals in [Revenue from Contracts with Customers] to the distinct service component If not FASB – LESSEE & LESSOR : apply the lease accounting requirements to the combined contract IASB – LESSEE : apply the lease accounting requirements to the combined contract LESSOR PO : apply the lease accounting requirements to the combined contract LESSOR DE-REC : apply 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 do not agree with the proposal for Lessee application

The IASB has not clarified the distinction between lease and service
Unclear boundaries between service and lease in the ED make the question on service components worryingly complex.

For decades modern outsourcing has developed itself into an inseparable combination of operating lease and services whereby customers are motivated above all by the financing of usage, not acquisition, in an integrated offer of services.
Hence our recommendation for lessees is to keep these contracts under the current accounting model in expenses while providing sufficient disclosures to inform users of their financial impact.

We do not agree with applying the accounting requirements to the combined contract when lease and service are not distinct

While for Lessors it is always possible to break down the pricing of services lease components, it may be more difficult for some Lessees involved in closely interdependent combinations of both. No economic consideration could justify that these Lessees should be penalized by a forced on balance sheet booking.
They should be allowed to assess (make an estimate) the weight of both components through benchmarks with other service less contracts or any other means.
Although highly inadequate for accounting purposes, these evaluations would be made necessary by the imposition beyond reason of an on-balance sheet approach to a product that does not fit to it.

We agree with the IASB proposal for lessors with de-recognition model.

Lessors will always be able to clearly identify service components of their leases as this is part of their business model.

Q7	LESSEE LESSOR	**Purchase Option** (paragraphs 8, BC63 and BC64) *The ED proposes that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised* 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 agree

ARVAL's business is full service operating lease and purchase options are virtually never granted to lessees.
Nevertheless, we agree with the proposal to account for purchase options only when they are exercised.

Q8	LESSEE LESSOR	**Lease Term** (paragraphs 13, 34, 51, B16–B20 and BC114–BC120) Do you agree that a Lessee or a Lessor should determine the lease term as <u>the longest possible term that is more likely than not to occur</u> 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 do not agree

We are opposed to the measurement of assets and liabilities based on assessed likelihood of contract duration
While most of our contracts include an early termination option and are dynamically adjusted to reflect customers' changing needs in terms of duration and mileage, fleet operating leasing does not usually offer an option for the lessee to extend the lease term.
Our widespread experience of contract adjustments leads us to the following comments:

i) Possibility to extend the lease term represents no certainty of expense for the lessee.
ii) Predicting at inception on a lease-by-lease basis the probability of adjustment of the lease term is virtually impossible and in any event totally impractical for lessees contracting large groups of assets. Historical data can usefully be extrapolated by lessors on large scale aggregates of contracts but will be ineffective for individual lessees, even if operating large fleets.

iii) Lessees would have to book unnecessary adjustments if they mistakenly overestimate the lease term (write off of the net book value of the asset, offset by the write back on the liability at the end of the contract).

This variability, which makes balance sheets much more volatile and subjective, is what makes our full service operating leases particularly unfit for on-balance sheet accounting. Nevertheless, if operating leases are forced into balance sheets, we recommend avoiding judgmental assumptions on optional periods and to only consider the committed lease terms.

Q9i	LESSEE	**Lease payments** (paragraphs 14, 35, 36, 52, 53, B21 and BC121–BC131) 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 them ?
Q9ii	LESSOR	**Lease payments** Do you agree that Lessors should include contingent rentals + expected payments under term option penalties + residual value guarantees in the measurement of the right to receive lease payments only if they can be measured reliably? Why or why not?

We absolutely do not agree

This part of the new standard is probably the one that is furthest from the economic reality and the most surprising in terms of complexity for lessees.

We absolutely do not agree because

1. Proposals are at odds with the Boards' own conceptual framework
2. They totally ignore the different types of contingencies
3. The expected outcome technique required to measure assets and liabilities is not suitable or even practical in many cases
4. Implementation will endanger objectivity, transparency and comparability

Not all types of contingent rentals can be considered as liabilities

Contingent rents based on usage do not meet the definition of a liability simply because the lessee controls the obligating event, and contingent rents based on usage in car leases, as in most equipment leases, are designed only to protect the lessor's residual asset. In other words including these contingent rents will almost certainly inflate assets and liabilities.

We urge the Boards to differentiate between two economically distinct kinds of contingent rentals: (i) those based on exogenous items and that the lessee is unable to avoid and (ii) those based on the use of the asset. For the latter, the lessee is only obliged to pay once the contingent event has occurred and he has the discretion to avoid this obligation. Therefore the lessee should not be obliged to recognise such a liability at inception.

A further argument is the difficulty of measurement since the relevant amounts cannot be determined at the inception of the lease because the mileage, for example, cannot be forecast with any accuracy (historic data are not representative of what will occur in the future).

Regarding fleet operating leases, the frequency of recontracting adjustments means that for the majority of contracts, what could be considered as contingent amounts is gradually replaced by non-contingent amounts as periodic rentals are adjusted to reflect actual usage through the lives of the contracts. The adjusted rentals are reflected in the accounts through reassessment adjustments.

While adjustable rentals have always been a distinctive feature of fleet operating leasing, the practice of recontracting has only become more frequent in the last years as a consequence of the uncertainties of the economic crisis.

Our overriding view is that only contractual obligations should be taken into account in the lease liability calculations.

Is the expected outcome technique the most suitable?
The proposed expected outcome technique using probability estimates is far too subjective to provide useful decision-making information for investors or other users of the financial statements because it mischaracterizes the amount of resources necessary for the Lessee to settle its obligations to make lease payments

Contingencies should only be included once formalised in a contractual adjustment.

Real implementation difficulties
The contractual terms of all of our leases are based on the initial expectations about the use of the vehicle made by the lessee. Of course in practice these initial expectations need to be revised for a variety of business reasons but such revisions cannot be foreseen at inception - otherwise they would have been taken as the basis for the original contract terms from the beginning.

Recontracting (amendment of contract terms during the lease term) is therefore a very frequent feature of our business and a core customer expectation. In addition, at the end of the lease term the lessor and lessee may allow the lease to continue informally under the existing rentals and conditions for a few months, often in circumstances where the replacement vehicle is not ready for delivery. Estimating the frequency and duration of such events is impossible on a vehicle by vehicle basis.

Therefore, due to impossibility of doing anything different, we firmly believe that the impact of such contingent events should only be recognized in the accounts when they occur, as is the practice today.

On the lessor side, we again believe that contingent events should only be reflected when they occur

Objectivity, transparency and comparability?
We want to point out that because of differing judgments estimating renewals and contingent rents will create a lack of symmetry between Lessees and Lessors in accounting for the same contract over the years.

Q10	LESSEE LESSOR	**Reassessment** (paragraphs 17, 39, 56 and BC132–BC135) Do you agree that Lessees and Lessors should remeasure assets and liabilities arising under a lease <u>when changes in facts or circumstances indicate</u> that there is a significant change in the liability to make lease payments or in the right to receive lease payments since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

We do not agree

The way the ED is currently drafted (paragraphs 17, 39 and 56) is quite difficult
Basing on our responses about lease term and contingencies (future and avoidable payments should not be taken in the initial measurement of the liability) we believe remeasurement should

occur only when effectively exercised. In our business, that means a new legally binding contract or an amendment of the initial one.
The liability to make lease payments does not change until this new contract comes in effect

Apportionment of adjustment
We have significant concerns over how the reassessment adjustment should be apportioned (paragraphs 17 and 18 for lessees and paragraphs 39 and 56 for lessors).

The ED seems to assume that both a lessor and a lessee will be able to distinguish between the impacts of a lease term change and a contingent item change. However, in vehicle leasing, and possibly in other sectors too, reassessments can reflect both a change in term and consumption in one revised rental and the respective impacts are not easily distinguishable for the lessor and would almost certainly not be available to the lessee.

For a lessee, varying assumptions on how mileage evolves give varying possible outcomes in the apportionment required by paragraphs 17 and 18 but none of them are likely to be materially different, and they are likely to be time consuming to compute.

Therefore we believe that it would be much more pragmatic to have the default position that reassessment adjustments should be booked <u>so as to impact future periods' P&L</u>'s only, by adjusting the right of use asset and not adjust prior periods unless there is a high likelihood that the P&L to date has been materially misstated. This would mirror what happens today when rentals are adjusted prospectively and would make dealing with the reassessments more straightforward. Remember that these calculations would potentially have to be performed for several thousands of assets. We also believe that this treatment would be consistent with paragraphs 36 and 37 of IAS 8.

Under the lessor de-recognition with accretion model we think that the adjustment that has to be made to ensure an income pattern consistent with the underlying economic position is as follows:

1. re-compute lease receivable using new rentals and term
2. adjust accreted RV so that it is now the difference between the balance outstanding on the "asset finance account" and the new lease receivable
3. the difference between items 1 and 2 above to be taken to P&L as interest at the point of reassessment

Perhaps this all boils down to the need for additional guidance, but for us it is a very important point because reassessments are an extremely important facet of our business model and the proposals as drafted could require several detailed calculations for both lessors and lessees to arrive at the proposed treatment.

Q11	LESSEE LESSOR	**Sales & leaseback** (paragraphs 66–67, B31 and BC160–BC167) *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. If the contract represents the sale of the underlying asset, the leaseback would also meet the definition of a lease, rather than a repurchase.* Do you agree with the <u>criteria for classification</u> 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 proposed criteria.

We subscribe to the view expressed by EFRAG in its comment letter, that in a sale and leaseback transaction, the lessee is retaining the right of use of the underlying asset and is transferring to the buyer/lessor the residual asset that would appear under the derecognition approach.

Q12 (a)	LESSEE	**Presentation - Statement of financial position** (paragraphs 25, and BC143–BC145) Do you agree that a Lessee should present liabilities to make lease payments <u>separately</u> from other financial liabilities and should present right-of-use assets <u>as if they were tangible assets</u> within PPE or investment property as appropriate, but <u>separately</u> from assets that the Lessee does not lease? 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?

We do not agree

We do not support the right of use model and would prefer to disclose information in the notes.

Nevertheless, if the model is maintained, because leases are specific types of funding, we agree with the Boards to present the right of use and the liabilities arising from leases separately in the financial statements

Q12 (b)	LESSOR	**Presentation - Statement of financial position** (paragraphs 42, BC148 and BC149) Do you agree that a Lessor applying the <u>PO approach</u> should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, <u>totalling to a net lease asset or lease liability</u>? 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?

We do not support the PO model

Q12 (c)	LESSOR	**Presentation - Statement of financial position** (paragraphs 60, BC154 and BC155) Do you agree that a Lessor applying the <u>DE-REC</u> approach should present rights to receive lease payments <u>separately</u> from other financial assets and should present residual assets <u>separately within PPE</u>? 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?

We partly agree

Yes we agree with the approach that will provide the most useful information to users who will be seeking to understand a Lessor's credit risk on the one hand and its asset risk on the other.
Then, we support the proposal which consists in presenting:
- rights to receive lease payments separately from other financial
- residual assets (which are the remaining rights to leased asset or in other words rights to "future" assets) as a separate class of assets

Nevertheless we consider that residual assets are in nature different to PP&E

Q12	LESSOR	**Presentation - Statement of financial position** (paragraphs 43, 60, BC150

(d)		and BC156) Do you agree that Lessors should distinguish assets and liabilities that arise under a <u>sublease</u> in the statement of financial position? Why or why not? If not, do you think that an intermediate Lessor should disclose this information in the notes instead?

We are not concerned

Q13	LESSEE LESSOR	**Statement of comprehensive income** (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158) Do you think that Lessees and Lessors should present lease income and lease expense <u>separately from other income and expense in profit or loss</u> ? Why or why not? If not, do you think that a Lessee should disclose that information in the notes instead? Why or why not?

We agree

We agree with BC146 that "if considered relevant to an understanding of the entity's financial performance, an entity would present such items in the income statement separately from other income and expenses".

Q14	LESSEE LESSOR	**Statement of cash flows** (paragraphs 27, 45, 63, BC147, BC153 and BC159) Do you think that cash flows arising from leases should be presented in the statement of cash flows <u>separately from other cash flows</u> ? 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?

We agree

For lessors, the Boards should distinguish between lessors whose principal business activity is leasing and lessors whose principal activity is not leasing. For the latter, the information should be given in the notes to the account only because for any entity for which leasing is not the principal activity the faces of the cash flow will become cluttered with lease related items that are probably only incidental compared to its main business activity.

Q15	LESSEE LESSOR	**Disclosure** (paragraphs 70–86 and BC168–BC183) 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? Why or why not? If not, how would you amend the objectives and why?

We agree with the objectives but do not share the Boards' proposal, finding it too complex and burdensome.

A complex and burdensome process

We disagree with the proposed disclosures in paragraph 77 that require a lessee to present a reconciliation of the right-of-use asset and liabilities to make lease payments by asset class and see little benefit of this disclosure.

As stated above, we generally agree with the thrust of the proposal but believe it to be far too detailed and prescriptive, and the requirements of paragraph 70 and, 73 (i) together with a statement of the impact of contingent items on the lessor and lessee lease related balances, if contingent items are retained in the final standard, should be sufficient.

Otherwise the disclosures will become ludicrously complex and if such disclosures are really required by companies to give a true and fairl view then they should surely be given under the current general guidance, for example as disclosures under contingent liabilities notes.

Q16 (a, b, c)	LESSEE LESSOR	**Transition** (paragraphs 88–96 and BC186–BC199) The exposure draft proposes that Lessees and Lessors should recognise and measure all outstanding leases as of the date of initial application using a <u>simplified retrospective approach</u>. (a) 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?

We do not agree

Big impacts for Lessee

For lessees, our calculations show that the simplified retrospective approach negatively influences future profit and loss accounts compared to a full retrospective approach.

Taking the example of the existence of several contracts as followed:

	Capital onvestment	Beginning	Ending	Annual Rentals
Contract 1	18 000	01/01/2011	31/12/2014	3 348
Contract 2	18 000	01/01/2013	31/12/2016	3 348
Contract 3	20 000	01/01/2013	31/12/2016	3 720
Contract 4	19 000	01/01/2014	31/12/2017	3 534
Contract 5	21 000	01/01/2014	31/12/2017	3 906

The date of the implementation is the 01/01/2015

As is situation

PERIODS		PROFIT & LOSS			
		Amortization	Interest	General Expenses	TOTAL
2015	*Contract 2*			-3 348	-14 508
2015	*Contract 3*			-3 720	
2015	*Contract 4*			-3 534	
2015	*Contract 5*			-3 906	
2016	*Contract 2*			-3 348	-14 508
2016	*Contract 3*			-3 720	
2016	*Contract 4*			-3 534	
2016	*Contract 5*			-3 906	
2017	*Contract 4*			-3 534	-7 440
2017	*Contract 5*			-3 906	
		0	0	-36 455	-36 455

Simplified approach

Right of use / Payment Obligation						
PERIODS	BALANCE SHEET		PROFIT & LOSS			
	Asset	Liability	Amortization	Interest	General Expenses	TOTAL
Intialisation	34 815	34 815				
2015	20 921	21 526	-13 894	-1 218	0	-15 113
2016	7 027	7 440	-13 894	-421	0	-14 316
2017	0	0	-7 027	0	0	-7 027
			-34 815	**-1 640**	**0**	**-36 455**

Full retrospective approach (same contracts)

Right of use / Payment Obligation						
PERIODS	BALANCE SHEET		PROFIT & LOSS			
	Asset	Liability	Amortization	Interest	General Expenses	TOTAL
Initialisation	33 475	34 815				
2015	20 153	21 526	-13 322	-1 218	0	-14 540
2016	6 832	7 440	-13 322	-421	0	-13 743
2017	0	0	-6 832	0	0	-6 832
			-33 475	**-1 640**	**0**	**-35 115**

Even if full retrospective application will almost certainly be more administratively onerous than the ED proposal, we advise the Boards to give companies a choice to use either a full retro approach or the simplified retrospective approach.

For Lessors, We wanted to point out that giving the fact that de-recognition model is the only acceptable one, Lessors will be required to establish current fair values of second hand assets (at the present value of the future fair value of the asset at the end of the lease term).

Sufficient time and optional choice between the two methods should be given to Lessees

Due to the differences of impact between retrospective and prospective treatments we believe that many lessees, particularly those with several long leases will opt for retrospective application. However this will require the gathering of much data - which may not be readily available - to enable them to complete their calculations and disclosures. Indeed many lessees may ask lessors for their help with this task and this could put additional strain on lessors' own preparations.

In addition, most businesses are likely to have to make significant changes to a number of their IT systems and this will be both time consuming and costly.

Therefore, if this new standard is to be implemented, which is not our preference, we believe that a 3-to-5 year period before application of the final standard is required to give businesses - especially our customers who are not specifically equipped to address the change - adequate time to prepare their organizations and absorb the associated costs.

Q17	LESSEE LESSOR	**Benefit & costs** (paragraphs BC200-BC205) 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 absolutely do not agree

An assessment that still needs to be addressed

We disagree with the Board assessment of the cost/benefit considerations, although the factors mentioned in paragraph BC203 and BC204 are correct.

Assessing the costs/benefit of a new requirement impose to consider all relevant underlying factors :

1. The direct financial costs: the changes will affect corporate financial ratios and metrics and could have consequences on debt covenants.
2. The indirect effects on the tax treatment of leasing transactions
3. The implementation and compliance costs: significant education, tools development, analysis and follow-up to implement.
4. The cost of on-going operational, accounting and reporting processes : lessees are likely to experience a general increase in costs due to the significant changes in IT systems and internal processes and controls that will be engendered by the new proposals
5. The possible impacts on the industry (aka the "behavioral impact") and as a consequence on the million of companies that have recourse to lease as a funding opportunity.

So far, we have read nothing about that kind of rigorous cost/benefit analysis

The last question: would investors prefer the new information?

Regarding the global complexity and the subjective features it relies on, questions are pending:

- Would some understand how the new account figures will be calculated and what they really mean?:
- Would analysts find the new information more useful than that currently available in the notes to the accounts?

We really wonder whether corporate analysts would find the Exposure Draft proposals useful.

In conclusion, the cost / benefit analysis has still to be made to justify the extraordinary complexity of the proposal for Lessees & Lessors and advantages for analysts and users must be proved.

Therefore, we consider that no further step should be taken on this project before a thorough cost/benefit review is undertaken.

Conclusion

- The proposed model for Lessees is unnecessarily complex while redefined disclosures would have efficiently covered the abuses that were at the ground of the project.
- The definition of a lease is not clear and will put strain to determine whether a transaction is or not a lease
- The definition of a lease adding to the scope of the Lease ED could oblige Lessees to apply three different accounting models for some contracts that contain lease, service and intangible components.
- The accounting approach for Lessee - initial and subsequent measurement - does rely on any economics
- The hybrid system for Lessor blatantly contradicts the initial objectives of unification of all lease forms
- If not a nonsense, the model for Lessor is unfinished,:
  - the performance obligation option is flawed and unacceptable
  - the de-recognition model, as it is, rejects the measurement of assets at their historic cost and generates a "residual asset" at a lower amount than the contractual residual value. It is therefore unacceptable without the accretion mechanism is implemented because it do distort the Lessor revenue recognition while the current operating lease model does not.

The improvements to the financial information provided are now considered to be small in the perception of preparers: lack of symmetry between Lessors and Lessees in the same lease and lack of comparability among Lessors, as well as among Lessees due to the lack of objective and reliable measures
This change will simply serve to discourage leasing while we have not seen any statements indicating that the Boards want to discourage leasing as a policy matter.

Lessee capitalization of operating leases should not proceed unless the Boards can come up with more appropriate solutions on the Lessor accounting side.

Finally it should be recalled that accounting should reflect and represent economic realities in a way that makes it both manageable for preparers and transparent and usable for users.