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International Accounting Standards Board 30 Cannon Street London EC4M 6XH

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Dear Members of the IASB,

Exposure Draft: Leases

We welcome the opportunity to comment on the exposure draft. InterContinental Hotels Group PLC is a UK-based FTSE-100 company operating in over 100 countries and territories, mainly as a franchisor and manager of hotels under our portfolio of brands. We are primarily a lessee rather than a lessor of assets.

In general terms, we are supportive of the Board's proposals to introduce one model for lessee accounting, thereby removing the current differentiation between finance leases and operating leases. We also support the concept of recognising a right-of-use asset and corresponding liability but have some significant concerns as to how this will be applied in practice. In our view, the proposed model is over-complex requiring the adoption of estimates and judgements that will produce numbers of limited relevance to the users of accounts, at a cost to preparers of accounts that will outweigh any benefits. Our concerns are addressed more fully in the appendix to this letter which sets out our detailed response to the specific questions raised. We also put forward some thoughts as to how we believe the model can be made more workable without losing the benefits that should arise from an improved lease accounting model.

We have not commented on the lessor accounting questions but would make the general observation that the hybrid approach proposed does not appear very satisfactory in that it carries forward one of the major criticisms inherent in the current distinction between operating leases and finance leases i.e. different accounting models are used based on a risk and rewards assessment.















I trust that our response is clear. However, please do contact me if you require any clarification.

Yours faithfully

Richard L Solomons

Appendix

Responses to the detailed questions in the exposure draft

Question 1: Lessees

- (a) Do you agree that a lessee should recognise a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?
- (b) Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

We agree that a lessee should recognise a right-of-use asset and a liability to make lease payments, and should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments. We do however have a number of concerns regarding the practicalities and costs of applying the detailed proposals to more complex leases containing renewal options or contingent rentals. These concerns are addressed in more detail in our responses to questions 8 and 9.

Question 2: Lessors

- (a) Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term, and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?
- (b) Do you agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?
- (c) Do you agree that there should be no separate approach for lessors with leveraged leases, as is currently provided for under US GAAP? If not, why not? What approach should be applied to those leases and why?

See comment in covering letter.

Question 3: Short-term leases

Do you agree that a lessee or a lessor should account for short-term leases this way? Why or why not? If not, what alternative approach would you propose and why?

We agree with the concept of providing simplified accounting for short-term leases but would recommend a further simplification for lessees by proposing that the lease rentals are simply recognised on an accruals basis similar to current operating lease accounting by lessees under IAS 17. Whilst this would remove the requirement to gross-up the balance sheet, we do not see this as an issue in respect of short-term

leases where there is no long-term obligation. We believe this approach will also significantly reduce the burden of complying with the new standard by reducing the effort required in identifying and tracking the large number of short-term leases which many companies are likely to have.

Question 4: Definition of a lease

- (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 have some concerns that the definition of a lease is too broadly defined and without further guidance will be difficult to apply in practice.

We also have difficulty with the concept that a leased asset could be deemed to be purchased under paragraphs B9 and B10. In our view, a leased asset should only switch to becoming an owned asset when the lease term has expired or been terminated and legal ownership of the asset has been transferred to the lessee.

Question 5: Scope exclusions

The exposure draft proposes that a lessee or a lessor should apply the proposed guidance to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources.

Do you agree with the proposed scope of the proposed guidance? Why or why not? If not, what alternative scope would you propose and why?

We are of the view that the accounting for licences of intangible assets and leases of tangible assets should be consistent as these arrangements are economically similar. However, we accept the exclusion of intangible assets as a pragmatic short-term solution whilst the Board considers the accounting for such assets more broadly, but note that this could lead to different accounting answers for economically similar assets.

Question 6: Contracts that contain service components and lease components Do you agree with either the IASB or FASB 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?

From a lessee perspective, we agree with the general principle that service components should be accounted for separately from the lease components. Where it is clear that the service component represents a relatively insignificant portion of the overall contract then we are comfortable with the proposal to apply lease accounting to the combined contract. In other instances, we believe that the lessee should be given the option to estimate the service component so as to avoid a material misstatement of the balance sheet gross-up.

Question 7: Purchase options

The exposure draft proposes that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised. 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 that payments under purchase options should be accounted for at the point the option is exercised as we view such payments as relating to the acquisition of an owned asset rather than a payment relating to the lease term. If it is reasonably certain that the purchase option will be exercised, then the amount should be disclosed as a capital commitment.

Question 8: Lease term

Do you agree that a lessee should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that that a lessee or a lessor should determine the lease term and why?

Whilst recognising the concern over structuring opportunities, we do not support the Board's proposed approach on the grounds that we believe the process of assigning probabilities to the likelihood of renewing options will involve such a level of 'guess work' that the numbers produced will have limited relevance to the users of accounts. We also note that others have questioned whether the proposed accounting is consistent with the definition of a liability. We would therefore propose that the lease term should only include the optional periods that are reasonably certain to be exercised, which is similar to the current approach for determining a lease term. We believe our recommendation would result in proposals which are more practical to implement and also lead to less frequent changes in estimates, thereby reducing the burden on preparers of accounts.

Question 9: Lease payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease

should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual guarantees and why?

Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be measured reliably? Why or why not?

We agree that contingent rentals and residual value guarantee payments should be included in the measurement of lease assets and liabilities, provided they can be measured reliably, but do not agree with the proposed 'probability weighted' approach to their measurement. In our view, the probability weighted approach described in the exposure draft is unduly complex, will be costly to implement and by definition will result in amounts that will not be paid. Instead, we would propose a 'best estimate' approach for calculating the contingent rentals and residual value guarantee payments.

In our view, payments under term option penalties are closely linked to the assessment of the lease term and should only be included in the calculations if it is reasonably certain that the lease will be terminated early.

Question 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

In principle, we agree that there should be reassessments of both the lease term and contingent payments when there has been a <u>significant</u> change in facts or circumstances. However, we do have major concerns regarding the burden that will be created by both the complexity and potential frequency of the reassessments as proposed in the exposure draft. Adoption of the suggestions included in our responses to questions 8 and 9 would help to deal with the complexity issue. In terms of frequency, we would recommend that reassessment should only be required based on specified triggering events and, at minimum, on an annual basis.

Question 11: Sale and leaseback

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

We support a 'partial asset' approach as described in BC 161. Under this model, all sale and leaseback transactions would result in the recognition of a right-of-use asset and related lease liability, and the derecognition of the original asset at a profit (or loss). The profit (or loss) would be allocated between the residual rights transferred and the rights retained; the profit (or loss) relating to the residual rights transferred would be recognised in the income statement and the profit (or loss) relating to the rights retained would adjust the carrying value of the right-of-use asset. Additionally, transactions conducted other than at fair value would result in an appropriate adjustment between the profit (or loss) recognised and the carrying value of the right-of-use asset.

Question 12: Statement of financial position

Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment or investment property as appropriate, but separately from assets that the lessee does not lease? 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 agree that the right-of-use asset and lease liability should be shown separately on the face of the statement of financial position, if significant. If not significant, these disclosures should be made in the notes to the accounts.

Question 13: Statement of comprehensive income

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss? 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 that a lessee should present the amortisation of the right-of-use asset and interest expense on the lease liability separately from other amortisation and interest expenses, either on the face of the profit and loss account (if significant) or in the notes to the accounts (if not significant).

Question 14: Statement of cash flows

Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows? 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?

When the cash flows relate to leases which have a related liability recorded on the statement of financial position, then we agree that they should be shown separately on the face of the cash flow statement, within the financing section. However, we believe it is more appropriate to record the cash flows relating to short-term leases within operating cash flows, with separate disclosure of the amounts in the notes to the accounts.

Question 15: Disclosure

Do you agree that lessees and lessors 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 general principles for disclosure as set out in paragraph 70 and repeated in the question. However, the list of disclosure requirements in paragraphs 73 to 86 is extensive and we believe that it should be made clear that these are not mandatory. Preparers should be allowed to exercise judgement in determining which of these disclosures are required to meet the general principles for disclosure.

Question 16: Transition

- (a) the exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach. 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 needs to consider? If yes, which ones and why?

We welcome the simplified retrospective approach but also believe that companies should be allowed the option of full retrospective application in order to mitigate the relatively high profit and loss account charge that initially arises under the simplified retrospective approach.

Question 17: Benefits and costs

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?

The benefits of the proposals as currently drafted do not, in our view, outweigh the costs due to the significant burden that will be placed on the preparers of accounts. We believe that the alternatives we have recommended will result in an accounting standard that is considerably more workable without losing the benefit to users of significantly enhanced lease accounting.

Question 18: Other comments

Do you have any other comments on the proposals?

We can see that the impairment testing of right-of-use assets will present certain technical challenges and we would appreciate further guidance in this area. In particular, the asset is very closely related to the lease liability and it is not clear if and how this inter-relationship should be considered when performing the impairment assessment.

We are also aware that in our industry it is possible, in respect of a long lease, that the initial value of a right-of-use asset could exceed the market value of the underlying hotel. We would find it a very strange outcome if this resulted in an immediate impairment charge.

Question 19: Non-public entities

Should any of the proposed guidance be different for non-public entities (private companies and not-for-profit organisations)? If so, which requirement(s) and why?

We do not believe there should be any difference in the recognition and measurement criteria for non-public entities applying the leases standard.