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Comment Letter No. 755

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Sir David TWEEDIE
Chairman
International Accounting Standards Board
30 Cannon Street
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Le Délégué Général

Reform of IAS 17
Exposure draft of the IASB and the FASB
Accounting for "leasing" contracts
Equipment leases, real estate leases, all types of rental

Dear Sir David,

The ASF appreciates the opportunity to join once again in discussions on the revision of IAS 17 and, after its contribution to the discussion paper in July 2009, to provide its comments on the Exposure Draft published in August 2010.

The ASF is the professional organisation which represents, in France, specialised financial institutions, under the Banking Act. Due to the Banking Act, leasing companies are licensed as financial institutions (or, exceptionally, banks). This ASF division includes funding for professional institutions including real estate leasing and equipment leasing. These institutions provide both operating and finance leases. At december 31, 2009, they wrote in such operations € 25.1 billion of new financing and managed a stock of € 77 billion.

Above all, if the goal repeatedly expressed by the Boards of limiting the effects of the structuring of very large listed companies in their consolidated accounts is laudable, **the ASF considers that the current reform of lease accounting, with its operational implications, would mainly result in threatening an entire sector of professional investment.** In Europe, for example, some 5 million in number of contracts for equipment leasing are made each year for an average of 27,000 euros. In France, for both lessors and for their customers, contracts involved are equipment leases, real estate leases, long term rental agreements or lease with purchase options.

From a general point of view, as noted by the French accounting standard setter, the ASF agrees with the analysis on the lack of robustness of the conceptual approach whose goal is not clearly established, the lack of symmetry between the "lessee" and "lessor" models and the legal and practical complexities that impact its implementation. Under such conditions, the costs of the proposed approach greatly exceed its potential benefits.

The reality and diversity of rental operations are not taken into account. This is evidenced in the reduction of certain transactions to simple sales and purchases with debt. It is essential to bear in mind that leasing includes a wide spectrum of economic transactions that are not all reducible to a simple financial transaction. On this subject, the ASF would point out that rental contracts cover short, medium or long term contracts, on "standard assets" or "specific assets" and may include more or less services, which are often a determining factor for customers, even more than the leasing or financing itself. If it is necessary to ensure the transparency of rentals, this should not be at the cost of a distortion of that reality.

Moreover, it appears that the proposed provisions will not achieve the goal of comparability and transparency of company accounts. Indeed, the objective of convergence of FASB and IASB, if it is praiseworthy, seems difficult to reach and it can not be accompanied by a deterioration of the quality of standards.

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On a more technical level, the ASF would like to stress its commitment to the current IAS 17 that does not deserve to be fundamentally changed but could simply be reinforced at the margin to overcome a few disputed treatments in the accounts of a few large companies. It indicates that the points listed below should always be considered to give the reform a chance to lead to positive results from the accounting, commercial and economic points of view :

- The institution of the right of use should not affect leasing transactions involving assets that are fungible and easily replaceable, which are to be equated with service contracts and should be accounted for as such (broadly equivalent to current operating lease), both by the lessor and the lessee.

- The right of use should be calculated only on rentals that are certain, excluding option periods or those dependent on the performance of lessees or the use of the asset (contingent rentals).

- The right of use must be depreciated using the actuarial method, so that the sum of depreciation and interest reconstructs the amount of rents, thus avoiding distortions of income statements from the lessee.

- The 'derecognition' model must be the basic model for lessors, the 'performance obligation' model is contradictory with the reasoning of the right of use and inconsistent with economic reality.

In terms of date of application, this reform, if it were to prosper, given the substantial changes to computer and organisational systems, must be given a reasonable period of at least two full calendar years for its implementation.

Please, do not hesitate to contact us for any questions you may have on our comment letter.

Yours sincerely,

Françoise PALLE-GUILLABERT

Attached : ASF Response to questions in the IASB / FASB Exposure Draft.

ASF's Position on the "Exposure draft " published by the IASB and the FASB in August 2010 about accounting Leases.

Question 1a: Lessees
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?

No, we do not entirely agree with the approach.
The ASF does not exclude that leases can be treated as a "right of use" capitalized by the lessee and balanced by a debt for rents recorded as a liability of the lessee.
However, this model should be significantly simplified, especially by considering a narrower definition of what a lease is, taking better account of the contractual provisions of the contracts.

Question 1b: Lessees
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?

No, we do not entirely agree with the approach.
The ASF is not unfavourable to the lessee depreciating the right of use and recording the payment of interest on debt repayment as part of the decomposition of the rent. However it is important that the depreciation of the right of use capitalized by the lessee (whose depreciation is proposed to be linear) and the debt of rent under liabilities (whose amortisation is proposed to be financial) is unique and is a financial amortisation.

Question 2a: Lessors
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?

No.
The ASF opposes the "performance obligation" approach which leads to recognition of double assets and strongly suggests the use of the "derecognition" model for all leases with the exception of short term contracts and contracts for investment property subject to IAS 40. For these last two contracts, the current IAS 17 is appropriate for lessor accounting.

Question 2b: Lessors
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?

No.
The ASF has confirmed its opposition to the "performance obligation" model and strongly suggested to use the "derecognition" model.
In the latter case, the ASF suggests that the residual values should be accreted over time, meaning incremented with interest calculated actuarially (see also response to Q12 c)). In addition, options and contingent rentals should not be taken into account in the accounting.

Question 3: Short-term leases
Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

No.
For short term leases, the ASF is concerned that the new proposed accounting treatment does not simplify the task of the lessee because the latter must always include these leases in its balance sheet. The ASF wishes in the case of contract periods not exceeding 12 months that the lessee is dispensed from accounting entries.
In addition, the ASF is concerned that the Boards will not accept a distinction between "core" and "non-core assets" (assets "core business" or not).

Question 4a. Definition of a lease
Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?

Yes.
The intellectual concept underlying the definition of a lease is interesting but would merit deeper analysis.

Question 4b. Definition of a lease
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?

There are differing positions among members of the ASF on this issue.

Question 4c. Definition of a lease
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?

No.
The ASF considers that nothing has been done to address the challenges posed by IFRIC 4 on the criteria for distinguishing a service contract, a lease contract or a rental. This work must continue.
However, the ASF is convinced that professionals are currently able to distinguish and recognize clearly what is covered by services (processed through IAS 18), from what is the provision of rental.

Question 5: Scope exclusions
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?

No.
The ASF would prefer that intangible assets are included in the scope of the new standard.
It is noted that today much software is an integral part of the leased assets.

Question 6: Contracts that contain service components and lease components
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?

No.
For contracts involving both a service component and a component of "leasing" the ASF recognises that if the distinction is known to the lessor, it is not always communicated to the customer, in particular for commercial considerations.
Moreover, it belongs to the lessee who is obligated to estimate the share of services and rentals by using the "best estimate". Of course, in case of difficulty in estimating the lessor may accompany the client to make this estimate if asked.

Question 7: Purchase options
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?

Yes.
On the issue of purchase options, the ASF supports the view that they are taken into account only when they are exercised.

Question 8: Lease term
Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

No.
The ASF considers that the lease term should not result from complicated probability calculations such as those defined by the Boards. The term of a lease is the contract term.

Question 9: Lease payments
Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?

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

No.
The ASF is not favourable for either lessee or for lessor, that contingent rentals and expected payments under options, penalties or residual value guarantees are taken into account in assessing assets and liabilities arising from a contract which caters for technical uncertainties.
The recognition of these elements leads to a disconnection of the contract with economic reality and moves away from the notion of accounting for the provision of a good (and rental services).

Should only be taken into account those contractual elements whose character is certain : mandatory minimum term of the lease, without consideration of options to extend, without taking into account possible penalties, without projected rents because of the difficulties related to the probability estimation and updating of these parameters.
The accounting of contingent rentals charged on the basis of the future amount of a factor that changes other than the passage of time (future revenues, future level of use, future price indices, interest rate market future) is not realistic and introduces too much volatility in the balance sheet and income statement.

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?

No, we do not entirely agree with the approach.
For revaluation of right of assets and rental debts, the ASF considers that it can intervene only in cases where the facts and circumstances show that there is a major event that would fundamentally challenge the original contract.
For lessors under the "derecognition" model, the revaluation should result in an adjustment in the income statement.

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?

No.
The current proposal of the exposure draft refers only to the "performance obligation" approach.
However, in line with our position to question Q1 for the unique "derecognition" approach, the ASF also recommends the application of this approach for the treatment of lease-back transactions among lessors in the case where the transfer of assets by the lessor to the lessee would receive purchase accounting qualification.

Question 12a: Presentation - 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 (paragraphs 25 and BC143–BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?

Yes in part.
For the presentation of accounting operations, the ASF supports the creation by the lessee of a third asset class, in addition to tangible and intangible assets, which would be the category of rental operations to enable the recognition of rights of use of the lessee.
This is justified insofar as the operations are not similar in nature and therefore it would be appropriate to distinguish between assets owned outright and the leased assets.

Question 12b: Presentation - Statement of financial position
Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

No.
If this "performance obligation" approach should be maintained, which we do not suggest in any way, the ASF considers it desirable that the lessor shows only the net value between assets and liabilities as an asset.

Question 12c: Presentation - Statement of financial position
Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

No.
As currently presented in the exposure draft, the ASF cannot agree with the proposal to separate the right to collect rents and the residual values (where the remaining asset is defined as the asset that is remaining after partial derecognition of the leased asset in the approach to derecognition supported in Question 1).

Indeed, in current practice, contractual rent cards are based on both the rent and residual value. Thus, rents and residual values are both carriers of interest. In other words, to calculate the outstanding of the lessor, the discount includes both the rent and residual values.
Said otherwise, the residual value is determined by a formula taking into account the debt in the amount of rent, which is determined by discounting contractual rents, which implies that the amount of residual assets is a discounted amount.
The condition for acceptance of separate recognition of the right to collect rents and the remaining assets is, firstly, that the two elements can, one and other be discounted and, secondly, that the residual value can be "accreted" each year. The discount / accretion of the residual value must then impact the income statement.

But, in the ED, the residual asset is not revalued but only frozen during the lease period.
The remaining assets is only classified and valued as a capital asset and not as a financial asset, which does not reveal the effects of accretion, delaying until the date of sale of the asset (or collection of residual value) the recognition of delayed accretion revenue.
For consistency with the initial recognition of the remaining assets for a discounted amount, the ASF calls for recognition as a result of accretion (by symmetry).

Moreover, assuming that the "derecognition" is retained, the ASF is favorable that the residual assets (residual value of leased property) are also presented in a separate class of assets on the balance sheet of the lessor.

Question 12d: Presentation - Statement of financial position
Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

Yes, but subject to the condition that institutions are free to make the distinction between assets and liabilities from subleasing depending on the significance of sub-lease operations in the overall activity of the institutions.

Question 13: Presentation - Statement of comprehensive income
Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

Why not, but subject to the condition that institutions are free to present separately lease income and rent expense from other income and expenses based on the significance of operations.

Question 14: Presentation - Statement of cash flows
Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

Yes in principle on the idea of separating cash flow from rentals from other flows without prejudice, however, to the choice by institutions of the method of preparation of cash flows applicable, either by direct or by indirect method. Subject to this, the ASF agrees with § 45 a) and b) and § 63 a) and b) of the exposure draft.

Concerning the presentation of information for both lessee and lessor, the ASF has a preference for presentation in the annexes relating to leasing transactions but does not exclude a presentation directly in cash flow tables. It is also essential that institutions remain free to present directly in the cash flow tables if they wish.

Question 15 Disclosure
Do you agree that lessees and lessors should disclose quantitative and qualitative information that:
(a) identifies and explains the amounts recognised in the financial statements arising from leases; and
(b) describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows (paragraphs 70–86 and BC168–BC183)? Why or why not? If not, how would you amend the objectives and why?

No.
Consistent with his answers to questions Q2 b) and Q9, ASF believes that the elements subject to uncertainty should not be included in the balance sheet.

Question 16a Transition
The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186–BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?

No.
During the transitional period of implementation of the new standard, the ASF wants to avoid any proposal, even simplified retrospective method, which seeks to impose, in a too restrictive manner, for lessee to find, measure and record differences in their contracts and for lessors to engage in a reassessment of second-hand assets.

Question 16b Transition
Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?

Yes, but still aiming to the goal to alleviate the difficulties outlined in the responses above.

Question 16c Transition
Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

The ASF does not comment at this time.

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?

No.
The ASF believes that the expected benefits of reform do not outweigh the costs it generates.
The results of a survey conducted by PwC and Erasmus show that a significant majority of survey respondents (70%) consider that the costs of the new method will exceed its benefits.
Moreover, the reform introduces too much complexity that will impact significantly in terms of costs both lessees and lessors.
It is also not demonstrated that the information in balance sheets and income statement will be read and used.
Finally, and most importantly, the reform introduces a considerable volatility in the balance sheet which is neither desirable nor acceptable from the standpoint of security and overall financial stability.

Question 18 Other comments
Do you have any other comments on the proposals?

Yes.
Further comments to question 17, it is clear that the proposed reform does not take into consideration the different dimensions of leasing, neither from a legal, nor an economic stand point. The considerable difference between the proposed accounting and economic and legal reality is very unfortunate and unacceptable from the standpoint of security and stability of business.

This reform is not efficient and does not deal, with the necessary common sense, with leasing transactions which are not by nature sales and purchases.
Under these conditions, the institutions will continue to manage two sets of accounting standards rather than applying this reform.

In terms of time of application, this reform, if it were to prosper, given the substantial changes to computer and organizational systems, must be given a reasonable period of at least two full calendar years for its implementation.

ASF – le 15/12/2010