30 November 2010

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UK

IASB Exposure Draft ED/2010/09 Leases

Dear Sirs,

Thank you for the opportunity to comment on the Exposure Draft ED/2010/09 Leases.

As one of the world’s leading luxury good groups, Richemont has a world wide portfolio of property leases through which it conducts its retailing activities. These lease arrangements are predominately operating leases by nature, and are accounted for as such under the existing standard.

It is important to note that the decision to enter into a property leasing arrangement is taken primarily on a commercial rather than on a financial basis. Lease arrangements are negotiated to provide the appropriate mix of security and flexibility to react to changing business circumstances.

Changes to lease accounting would have a significant impact on our financial statements and it is therefore with interest that we have reviewed and carefully considered the proposals in the exposure draft. Our responses to the questions raised are provided in the attached appendix.

We support the objectives of the IASB to enhance the transparency and comparability of financial statements in general. We also support the concept of recognising right-of-use assets and the related liability in respect of future lease payments.

However in certain areas we consider that the Board’s proposals offer no improvement over the existing accounting treatment and disclosure requirements. Specifically, we strongly believe that the significant judgements required in determining and re-measuring the term of a lease and the long-term forecasting of future contingent rental payments will lead to widely varying valuations of financial position between similar preparers. We believe that such variations will undermine the usefulness of the information to users of the financial statements.

In addition, we consider that the existence of an option to extend the term of a lease arrangement gives rise to a separate asset which should be recognised separately from
the right-of-use asset. Only for arrangements where it is virtually certain at inception that the option will be exercised, due to favourable terms or extensive refurbishment of the asset, should the terms of the option be considered in the value of the right-to-use asset.

Richemont has a number of lease arrangements where future lease payments are contingent on future turnover. The need to forecast location-specific retail sales for periods well beyond the normal forecasting cycles will be both burdensome and unreliable. We are also not convinced that such contingent lease payments satisfy the definition of a liability.

In these two matters – options and contingencies - we support the alternative views expressed by Mr Stephen Cooper.

In conclusion, whilst supporting the concept of recognising a right-of-use asset and the liability to make future lease payments, we believe this must be measured at the level of the non-cancellable cash flows only. Enhanced note disclosures regarding renewal option and contingent rentals in response to users’ requirements would be supported by Richemont.

Yours sincerely,

Gary Saage
Chief Financial Officer

Wolfgang Heimstädt
Group Accounting Director

Attachment
Question 1
(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 a right-to-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 with the principle of recognising a liability for the obligation to make lease payments with a corresponding asset representing the right-of-use.

We agree with the recognition of amortisation of the right-of-use asset and the recognition of interest on the liability to make lease payments.

Question 2
(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?

The Board proposes alternative accounting methods for lessors as they consider that a single approach would not be appropriate for all leases because of differences in the economics of the business models for different lessors. We believe that these differences apply equally to lessees and that the same risk and benefits criteria should also apply to lessee accounting.

Question 3
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?

We do not agree with the proposed treatment of short-term leases. The relief from discounting does little to ease the administrative burden in relation to small non-core operating and administrative items. We do not believe that the users of financial statements are interested in nor benefit from including the impact of these small non-core operating and administrative items. The approach of the current standard, recognising the lease costs on a straight-line basis over the lease term should be maintained for short-term leases.
Question 4
Do you agree that a lease is defined appropriately? Why or why not. If not, what alternative definition would you propose and why?

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?

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 would you propose and why?

We agree with the definition of a lease.

The proposal requires an assessment of whether control will transfer and all but a trivial amount of risks and benefits. This is judgemental and similar to the current requirement to assess whether the risks and rewards of ownership transfer.

The current guidance for distinguishing leases from service contracts is sufficient.

Question 5
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 with the scope of the proposed IFRS. There are many arrangements where the agreement is for the use of a relatively small portion of a much larger asset, such as an area of floor space within a large department store. In such instances there may be many parties entering into similar arrangements for small areas of floor space. It is quite clear that in such arrangements neither ownership nor significant benefits associated with ownership can transfer to the lessee. The rental payment is no more than a form of commission for services provided. The board should look to provide some form of exemption for assets where the benefits transferred are completely insignificant in relation to those of the total asset of the lessor.

Question 6
Do you agree with either approach to accounting for leases that contains 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?

The separation of service costs from lease costs introduces another area of judgement resulting in inconsistency and a lack of comparability.

For some arrangements, the service element could be greater than the lease element. This would particularly apply to those arrangements described in the response to question 5. As noted, these rental payments are no more than a form of commission for services provided.
Question 7
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. However, this leads to an inconsistency between the treatment of purchase options and the treatment of renewal options. We therefore support the separate recognition of all option elements of lease contracts.

Question 8
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 a 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 with this proposal. Please see our response to question 7.

In addition, the negotiation of leases with renewal options is a commercial activity to provide the lessee with the flexibility required to meet operational needs. Considering lease renewal periods in the initial determination of the liability to make lease payments introduces further judgement. Inconsistency between preparers will lead to reduced comparability and confusion for users. We therefore support the recognition of separate financial assets for all option elements of lease contracts. Enhanced disclosure of renewal options and assessment of the likelihood of exercise could be provided in the notes with some sensitivity for various possibilities.

Question 9
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 do not agree with this proposal. We do not agree that contingent rentals satisfy the definition of a liability. A liability is a present obligation and a contingent rental is dependent upon a future event. It cannot therefore be considered as a present obligation and should be excluded from the valuation of the liability. Greater details on contingent rents could be provided in the notes with some sensitivity for various possibilities.

We support the alternative view expressed by Mr Stephen Cooper.
Question 10
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?

Please see our responses to questions 8 and 9. We do not agree that lease renewal options and contingent rentals are included in the liability to make lease payments.

Question 12
(a) 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 BC 143 – 145)? 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?

(b) 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, BC 148 and BC 149)? 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?

(c) 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, BC 154 and BC 155)? 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?

(d) Do you agree that a lessor should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC 150 and BC 156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

(a) We agree – For Richemont, we estimate that these new assets and liabilities will be significantly greater than any other existing items, including equity. We therefore believe that their separate disclosure is essential for users' understanding.

(b) and (c) Refer to our response to question 2. Should the alternative method be retained we agree with the separate disclosures proposed.

(d) We agree.
Question 13
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, BC157 and BC 158)? 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 with the comments in BC 146: disclosure in the notes would generally be sufficient for users.

Question 14
Do you think that cashflows arising from leases should be presented in the statement of cashflows separately from other cashflows (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?

We agree with the proposal of separate disclosure. However, we do not see these as finance cashflows. These transactions are of an operating nature and the cashflows should remain as such.

Question 15
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 cashflows (paragraphs 70-86 and BC 168-183)? Why or why not? If not, how would you amend the objectives and why?

We agree with the proposal for enhanced note disclosures.

Question 16
(a) The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as at 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?
(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 agree. However, we note that this will result in higher finance costs being recognised on some leases if the full retrospective method had been adopted.
Appendix – IASB Exposure Draft ED 2010/09

Question 17
Paragraphs BC 200- BC 205 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 proposal would outweigh the costs? Why or why not?

We do not agree with the Board’s conclusion.

There are many areas in these proposals which require significant judgement and continual monitoring and re-measurement. This has a considerable time and cost impact which we do not believe will result in more consistent and comparable information. The fact that such information is neither readily available nor already used by those responsible for assessing performance and making decisions on the allocation of resources confirms that this is not key to our commercial operations.

We are also concerned that users will continue to make their own adjustments to information in respect of leases, but will now be starting from a non-comparative basis due to the differing judgements made by preparers.

Question 18
Do you have any other comments on the proposal?

We support the objective of the proposed standard. However, in its current form we believe that the many areas requiring significant judgement will result in a wide spectrum of valuations resulting in less comparability than is currently available. We believe that users will continue to make adjustments to presented figures in respect of leases, but these will now be based on inconsistently determined valuations.

Considering our comments regarding renewal options and contingent rentals, we cannot agree with the IASB’s conclusion on the cost-benefit consideration. With a large number of leased retail properties, the requirement to forecast rentals by individual property for periods well beyond normal budgeting cycles will be extremely onerous. In addition, such forecasts can never be reliable and will therefore require constant re-measurement resulting in higher costs, financial position volatility and ultimately confusion for users.

We note that the Board has yet to address the topic of lease incentives offered by the lessor. This is of interest to retailing organisations and we would urge the Board to address the issue as part of this project.

Compagnie Financière Richemont SA
30 November 2010