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

Oslo, 13 December 2010

Comment letter on Exposure Draft ED 2010/9 Leases

We would like to take this opportunity to provide our comments on the exposure draft on leases (“the proposed standard”, “the exposure draft”).

The undersigned represents NorgesGruppen ASA, the largest grocery retail group in Norway, which holds a market share of over 40% in the Norwegian market. NorgesGruppen is also a significant player in the Norwegian grocery wholesale-, service retail-, and institutional households markets. NorgesGruppen had sales revenues of NOK 53.2 billion (EUR 6.5 billion) in 2009, which positioned NorgesGruppen as the 9th largest group in Norway, based on sales. NorgesGruppen has bonds listed on the Oslo Stock Exchange, and therefore reports in accordance with IFRS.

NorgesGruppen has a number of serious concerns related to the proposed standard. In our opinion, the proposed standard will create significant disadvantages for us on a practical level and also negatively affect the financial information provided by the group. NorgesGruppen is currently party to more than 600 lease contracts for retail premises (as lessee) and more than 700 lease- or sub-lease contracts to external parties (as lessor). NorgesGruppen does not measure investment property at fair value in the balance sheet.

We will in the following describe the main aspects of our concerns.

Significant changes to financial information

The suggested changes to lease accounting will dramatically change the financial results and financial position of NorgesGruppen. Earnings before interest, tax, depreciation and amortisation (EBITDA) will increase by 46 % from NOK 2,861 million to NOK 4,178 million (estimated based on the 2009 financial statements). Correspondingly, interest-bearing liabilities will increase, roughly estimated, from NOK 6,300 million to NOK 16,190 million. This will significantly reduce the group’s equity ratio, from 36 % to 25 %.

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In our opinion, this will materially diminish the value of the financial statements as a decision-making tool for the group’s management and also significantly diminish the value of the financial statements for users. Historical key figures and financial information will be rendered worthless, as the financial information will have changed significantly. Only a very few will understand the financial statements, which entails that other management tools will need to be implemented to replace the financial statements as a basis for decision-making. This will reduce the financial statements to a document that has to be prepared, but that few will use.

Estimation uncertainty

The manner in which our lease contracts are currently reflected in the financial statements requires only limited use of management estimates. The effect on profit or loss arising from the lease contracts reflects what is actually agreed, and the actual payments between independent parties.

The suggested solution would demand a much more extensive use of estimates in the preparation of the group’s financial statements. Lease contracts (both lessor and lessee) are normally based on an initial lease term of e.g. 10 years, with options to extend the lease term for e.g. 10 + 10 + 5 + 5 + 5 + 5 years. Additionally, the rental amount during the lease term will often be based a minimum rental amount as well as an element based on revenues generated by the retail facility occupying the premises. The rental contract is updated on an annual basis reflecting the consumer price index (“CPI”) for the relevant year. In accounting for leases under the proposed model, we would need to estimate the probability of extending the lease term, estimate the revenues on which the rental amount would be based, and estimate future CPI. This would clearly require significant administrative resources, and the uncertainty reflected in the estimates would be considerable. As the amounts are also material in our industry, the estimates will be crucial to determining the financial results of the group. We are opposed to the financial statements depending on estimates to such a large degree.

An extensive use of estimates could also lead to greater differences between companies. Two similar companies may estimate the elements of the lease contracts differently and thus present significantly different results. This notably reduces comparability between various companies within the same industry. Additionally, the opportunity for manipulation would be much greater than under current requirements.

Administrative work-load

NorgesGruppen is as mentioned above currently party to more than 600 lease contracts for retail premises (as lessee) and more than 700 lease- or sub-lease contracts to external parties (as lessor). The contracts must, in the event of the introduction of the proposed standard, to a large extent be evaluated individually and on an annual basis. The probability of all the elements in the contract must be evaluated, and the estimates followed up against actual revenues, renewals based on contractual options and re-negotiations of contracts. New agreements and discontinued contracts will also need to be considered. In our opinion, this will be an enormous administrative burden, which will probably necessitate hiring additional manpower. This is in our opinion, and in relation
to a cost/benefit assessment, not meaningful. As described above, we assert that the new principles will provide inferior financial information and a significantly increased estimation uncertainty. Incurring considerable administrative costs to achieve this is therefore in our opinion not meaningful.

Carrying value of right-of-use vs fair value of property

Our judgment is that the new principles for recognising right-of-use assets will have unintentional effects. In the retail industry, lease agreements are frequently long-term, and many lessees often have the option to extend the lease several times. Given a lease agreement of NOK 1,000,000 over ten years (CPI-adjusted) and the option of extending the lease term for 10+10+5+5+5+5 years (50 years in total), we have calculated that a right-of-use asset of NOK 26.5 million would be recognised, applying an alternative borrowing rate of 5%. If the building had instead been acquired outright, we would probably have to pay approximately NOK 12.8 million, assuming 10% owner costs and a yield of 7%. We would accordingly, in applying the proposed model, end up with an asset with a carrying value that is NOK 13.7 million higher than if we had elected to purchase the property.

In our opinion, this example shows that the financial statements will be more judgmental, and we believe the users of financial information will get lower quality information rather than improved information following implementation of the new principles.

Conclusion

Our view is that the current model contained in IAS 17 is a better basis for accounting for operating leases as e.g. property rental agreements that are clearly operating in nature. The reason for this is, in summary, that it provides more predictable financial statements, a lesser degree of uncertain estimates and a much lower administrative workload. We would like to see that the current model be maintained, alternatively that operating lease arrangements, as e.g. ordinary property leases, be excluded from the model proposed in the exposure draft.

We hope that our concerns will be considered in developing the new lease standard. As described above, we have strong criticisms about the proposals in the exposure draft and the impact they will have on the value of our financial statements as a management tool. We are also very concerned about the increased administrative burden the proposed standard will entail, not only at the time of implementation, but also going forward.

Yours sincerely,

NorgesGruppen ASA

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