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

Dear Sirs

Exposure Draft: Leases (ED/2010/9)

We are grateful to have the opportunity to comment on the IASB’s Exposure Draft “Leases”.

We support removing the distinction between operating and finance leases and we agree with the key principle that a lessee should recognise a right-of-use asset and a liability to make lease payments.

We propose that the initial accounting is based on the Company’s most likely assessment of the payments to be made by the lessee. This is approach is more principles-based than the Exposure Draft and less prescriptive as to what is included. We believe this approach will simplify the financial reporting process and still result in appropriate calculations.

We believe that the remeasurement proposals are onerous on preparers of financial information. We would therefore expect that a remeasurement is only recorded when it has a significant impact on the financial statements. We recommend that this is made clear in the implementation guidance to the accounting standard.

In terms of transition, there will be a significant amount of information that needs to be gathered and changes to accounting systems will have to be made. Accordingly, we would recommend that there is a lengthy gap between the issue of the final standard and the beginning of the first comparative period. The gap should reflect that some IFRS preparers will need to prepare four balance sheets for three accounting periods if they have a registration in the United States.

Our more detailed answers attached to this letter address these points and others. If you wish to discuss any of the views, please contact me in writing.

Yours sincerely

Michael Smith  
Group Chief Accountant
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?

Response: Yes – We believe this approach provides a consistent accounting framework that lessees can apply to all lease agreements. It is preferable to the current dual approach of operating and finance leases.

The proposals are broadly consistent with practice among investors whereby the future lease payments for operating leases are, in some format, included in valuation calculations.

(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?

Response: Yes – We agree since there is an element of financing benefit for entities with operating leases, which is not reflected in the current accounting.

The amortisation of the right-of-use asset is consistent with the accounting for similar tangible fixed assets. Similarly, the financing charge for the interest on the liability is consistent with the unwinding of the discount on similar liabilities which are carried at present value, net of discounting.

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?

Response to question 3a: No – We consider that for lessees, all leases should be accounted for on the same basis to ensure that there is consistency and comparability among lessees.

For short-term leases, as for long-term leases, we consider that discounting should therefore be applied in calculating the liability to make lease payments and the right-of-use asset.

Since lessees will already have to prepare data for other leases and modify processes and systems, we do not believe that a simplified approach for short-term leases is necessary or will lead to a significant benefit for either entities or users of financial statements.

Should a lessee judge that the effect of discounting on short-term leases is immaterial then it may elect not to discount short-term leases. This does not need to be an option in the standard.
Question 4:

(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?

Response: Yes – We consider that the definition of a lease, criteria for distinguishing a lease from a purchase or sale and guidance on distinguishing from a service contract to be sufficient and appropriate.

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 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?

Response: No – We believe that lessees should assess the lease period as the most likely outcome and record that as the estimate of the cash payments over the lease term. This will involve an estimate by a lessee but will reflect the information and intentions of that lessee in respect of a lease. The more likely than not methodology may result in a lease term that differs from the lessee’s expectations. We therefore believe that this approach will result in a more accurate assessment of the cash flows associated with the lease.

In practice, a lessee’s assessment of the most likely lease payments will not always be consistent with the longest possible term that is more likely than not. The length of the lease term cannot always be predicted with certainty and it should be re-assessed at each reporting date.

Question 9:

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?

Response: No – We believe that lessees should make an estimate of the most likely cash payments over the lease term. An estimate by a lessee will reflect the information and intentions of that entity in respect of a lease. This estimate should include, but not be limited to, contingent rentals and expected payments under term option penalties and residual value guarantees.

We believe that this approach will result in a more accurate assessment of the cash flows associated with the lease.

Since the cash flows cannot always be predicted with certainty, they should be reassessed at each reporting date.

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?

Response: Yes – We agree with the principle that assets and liabilities should be remeasured by lessees at each reporting date.

A multinational group such as Unilever could have a large portfolio of leases. We consider that remeasuring each individual lease at each reporting date would be too onerous. We would therefore expect that a remeasurement is only recorded when it has a significant impact on the reporting entity’s financial statements. We recommend this expectation is made clear in the implementation guidance to the final version of the accounting standard.

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, 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?

Response: No – this type of sub-analysis should be provided in the notes to the financial statements since an informed reader of financial statements will not require them on the face of the primary statement.
An entity whose primary business activities involve leasing may wish to provide disclosures in the Income Statement but this should not be mandated.

Question 14:

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?

Response: No – this type of sub-analysis should be provided in the notes to the financial statements since an informed reader of financial statements will not require them on the face of the primary statement.

An entity whose primary business activities involve leasing may wish to provide disclosures in the Cash Flow Statement but this should not be mandated.

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 cash flows

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

Response: No – We believe that the proposed qualitative requirements would be onerous and complex to prepare for entities with large lease portfolios, such as ourselves.

The number of leases would mean that information, once gathered, would inevitably have to be aggregated and summarised. The process of summarising would itself be onerous and involve making judgements and assumptions that would reduce the visibility of lease arrangements.

IAS 1 already requires the disclosure of accounting policies and significant judgements and estimates. Information would be disclosed in order that the user of the financial statements will have all the significant information about the assumptions and uncertainties associated with leases.

As an alternative, we would recommend that paragraph 71 is clarified in order that entities can judge what disclosures are required to give an accurate and fair reflection
of their own lease arrangements. This would mean that the disclosure requirements in paragraphs 73 to 86 would be guidance rather than prescriptive. Disclosures would then be more relevant to the operation of the lessee’s business.

Question 18:

Do you have any other comments on the proposals?

Response: Yes – the Exposure Draft requires that cash out flows relating to lease payments are presented as financing activities in the Cash Flow Statement. This contrasts with the presentation in the Income Statement where the charge is split between Operating profit, whilst technically not a GAAP measure, and Finance cost.

We believe that users of financial statements would expect that a significant portion of the cash out flows are operating rather than financing in nature. We believe there should be better consistency in presentation among the primary statements. This improves comparability and understandability of information presented in financial statements.