FBF Response to the Exposure-Draft « Leases »

Dear Sir,

The French Banking Federation is pleased to have the opportunity to comment on the exposure-draft « Leases », jointly issued by the IASB and the FASB.

The boards justify the proposals to improve lease accounting because investors are dissatisfied with current accounting as it does not provide sufficient information to analyse financial statements. As we have already mentioned in our comments on to the DP, we have not found any convincing analysis of the current weaknesses of IAS 17 proving that the existing model does not work well. Moreover, we are of the view that the ED does not give a fully adequate answer to these concerns, fails to respect the board’s conceptual framework and does not reflect the economic reality of the leasing transactions.

The ED introduces one accounting model (right of use) for lessees and two accounting models (performance obligation and derecognition approach) for lessors. Therefore, proposals for accounting for lessees and for lessors are not consistent. The Board states in the Basis for Conclusion that "a single approach of lessor accounting would not be appropriate for all leases because of the differences in the economics of the business model for different lessors". We are unclear on these differences in the lessor business model compared to the lessee approach.

Furthermore, the criteria used in the present standards to differentiate operating leases and finance (capital) leases, the transfer of risks and rewards from the lessors, is dropped for lessee’s accounting, but remains to characterize the lessor situation. This is inconsistent. If a criterion is important for a party, it is also relevant for the other.

Sir David Tweedie
Chairman
International Accounting Standards
Board 30, Cannon Street
London EC4M 6XH
United Kingdom
The performance obligation model does not represent faithfully the economics of a lease transaction in the financial statements. It does not reflect the rights and obligations of both parties: the lessee controls the underlying asset and the lessor relinquishes the right to use this asset.

Under the performance obligation, the lessor will account for an asset he has not the ability to use. The IASB fails to justify conceptually that for one physical asset three assets would be created in financial statements: an asset for the right to use the physical asset for the lessee, and a receivable and the physical asset for the lessor. Same cash flows arising from lease transactions could not justify two different assets (a physical asset and a receivable).

The accounting proposals of the model are too complex. They would generate complexity for the lessee when measuring the right of use of an asset (utilising the probability of occurrence for each possible term taking into account renewal and termination options) and the liability (present value of expected lease payments). Therefore, the lessee would likely change behaviour when entering onto a lease contract. This change would also have effects on the lessor. Indeed, the lessee would favour shortening lease terms and eliminating renewal options. Therefore, lessor would be allowed to reduce liabilities associated with leases on the balance sheet. However, as uncertainties related to renewals would increase, rental payment would increase to compensate the lessor for the uncertainty. In addition, expenses related to leasehold improvement for short term leases would have to be amortized over a much shorter period. It would affect the profitability of the lessee.

Moreover, we consider a performance obligation model is not relevant as it results in double counting of the underlying assets. The lessor recognises at the same time the whole asset and a receivable representing part of the future cash-flows that the asset will generate. In addition, it lacks relevance as it is in contradiction with the lessee’s model. When the lessee recognises a right-of-use, the lessor should derecognise a part of the asset. A derecognition model would be preferred as this method provides a symmetric accounting with the lessee "right-of-use" model in reflecting that the value of the “right-of-use” is transferred to the lessee.

Lastly, the distinction between the performance obligation model and the derecognition model appears to be similar to the current distinction in IAS 17 between operating leases and finance leases, which distinction the ED wants to eliminate.

Accordingly, we advocate symmetrical accounting for lessees and lessors and a single model being introduced for the lessor accounting if the boards proceed with their approach. We would support the alternative proposal for a single partial derecognition model and a single right of use model for all leases, that Leaseurope has put forward for the case where the boards did wish to proceed further.

The ED raises concerns related to the Conceptual Framework: the obligation of performance of a lessor is a result of a future action by the lessee of the option to extend the lease. Uncertainty prevails as to whether the option to extend the contract will be utilised or not depending on future business conditions. Therefore the proposals will cause the lessee to recognize a liability to make lease payments and the lessor to recognise a right to receive lease payments with no consideration of definitions of liabilities and assets as provided under the Framework. Indeed, the options would not meet the definition of a liability until the obligating event has occurred. We believe that option to extend should not be included in the valuation of leases for either lessees or lessors. We believe that certain and irrevocable cash flows should be retained and optional cash flows should be excluded. The same reasoning should be applied to contingent rentals.

The ED reduces comparability and understanding in comparison with current rules and leads to greater volatility in the financial statements and particularly in the profit and loss account. A greater proportion of subjective factors is introduced when measuring leases from
either the point of view of the lessee or the lessor. The current problems for qualifying
finance or operating leases will be replaced by complex valuation problems and
measurement issues. The proposals for subsequent measurement by lessees will lead to an
front-loading of lessee costs.
Therefore, fair representation in financial statements of lease business may be jeopardized
by the complexity of the ED.

The boards based their model for lease accounting on an exaggerated fear of structuring
opportunities used by entities and a misunderstanding of the nature and the use of leases.
Therefore the Boards aim to propose a unique accounting model for leases. Accordingly, the
frontier within leases has moved and a new distinction between leases and service
contracts has been created. We do not believe that the proposals set out in the ED to draw
a line between service and lease contracts are satisfactory as they repeat IFRIC 4
requirements which need to be reassessed.

We consider that the costs of the proposals would outweigh their potential benefits as the
complexity of the proposals increases the operational burden for the lessors and the lessees.
Major costs would arise when implementing the new standard as it is a fundamental change
to the existing standard and investment in new systems would be needed.
Costs would arise as well on an ongoing-basis. Steps an entity needs to go through in order
to account for its leases are far more numerous than those required under the existing
standard. Entities will be required to make for each lease they enter into estimations on the
lease term and rental payments. Costs would increase when assumptions would need to be
reassessed at each reporting period or for any change in the lease contract.
We suggest the Board should perform additional work to assess costs and confirm benefits
related to the proposals.

The June 2011 deadline and the aim of convergence may have put undue pressure upon
the Boards to complete the leases project rapidly. As a consequence, the proposals fail to
represent faithfully the economics of lease transactions.
Therefore, we urge the Board to take the time to understand the unintended consequences
of the new proposals, to consider comments received and to be flexible to change direction
when a proposal would not result in information relevant to users of the financial statements.
Therefore, we would suggest the Boards to re-expose a revised model less complex than
the current ED in order to provide fully comments before publishing a new standard. It is all
the more necessary since lessee accounting was only superficially dealt with in the DP which
concentrated on lessee accounting, leading to inconsistencies as mentioned above.

To summarize we are not supportive of the IASB project for the following reasons:

- The inconsistency between lessee and lessor accounting due to a double model for
  lessors
- The non-compliance of the models with the definitions of assets and liabilities under
  the Framework
- The overall complexity of the assumptions and calculations required by the proposals
  which would increase volatility of the profit and loss account and jeopardize faithful
  representation of financial statements.
- The failure to provide a faithful representation of leasing transactions as the
  fundamental change in the lease accounting does not fit to the entities business model.
- The lack of costs and benefits analysis which may have highlighted the operational
  burden for lessors and lessees.
Accordingly we advocate for the Boards to take time for a re-exposure of a revised model based on an agreed approach of a single partial derecognition model and a single right of use model for all leases.

We hope you find these comments useful and would be pleased to provide any further information you might require.

Jean-Paul Caudal