Dear Sir,

On behalf of BPCE, we welcome the opportunity to comment on the exposure draft “Leases" published in August 2010.

BPCE is the central institution of the Groupe BPCE, the second largest banking group in France in terms of retail net banking income.

- The ED introduces one accounting model (right of use) for lessees and two accounting models (performance obligation and derecognition approach) for lessors. Therefore, it seems very difficult to understand why one model can cover all lease situations from the lessee’s perspective but that lessors need two different models to deal with the same contracts. **Proposals for accounting for lessees and for lessors appear to be inconsistent.** We would rather support the proposal for a single partial derecognition model.

- 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. We do not agree that amounts related to renewal options and contingent rentals should be recorded as liabilities (for lessees), assets (for lessors). These assets/liabilities fail to comply with the definitions prevailing under the Conceptual Framework. **Only contractual obligations should be recorded.**

- There is **no clear distinction between leases and service.** We fear that firms would be faced with complex judgment calls when determining whether they have a lease contract or a service contract.

- The **overall complexity of the assumptions and calculations** required by the proposals which would increase volatility of the profit and loss account. Costs would arise when implementing the new standard as well on an ongoing-basis when assumptions would need to be reassessed at each reporting period or for any change in the lease contract. We consider that the costs of the proposals would outweigh their potential benefits.
- The ED reduces comparability and understanding in comparison with current rules, due to the fact that a greater proportion of subjective factors is introduced.

- Moreover, we fear that the forthcoming changes to IFRS lease accounting may have unintended consequences on regulatory capital requirements for banks. Both lessees and lessors may face an increase in their risk-weighted assets under the new proposals, although the risks they face remain unchanged.

Accordingly we would greatly appreciate if the Board could take more time for a re-exposure of a revised model taking into account the issues raised above.

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

Yours faithfully,

Eric Filliat
BPCE
Question 1: Lessees

(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?

No. The view of BPCE is that a lessee should not necessarily always recognise a right-of-use asset and a liability to make lease payments.

Leases such as car or photocopier leases will include options to extend the contract or rentals that are based on a contingent factor such as usage of the asset. Such contracts are more like executory contracts than financing contracts.

The current lease accounting model recognises these differences between lease contracts whereas this will no longer be the case under the model proposed in the ED.

The Board does not provide a solid basis for concluding that recognition in the statement of financial position of all lease payments is to be preferred in all cases over a more disclosure-focused approach. The ED fails to provide an obvious rationale to explain why lessees should recognise assets and liabilities for every lease contract other than in BC 7 (c) which states “when a lessee enters into a lease, it obtains a valuable right that meets the definition of an asset. Similarly the lessee incurs an obligation that meets the definition of a liability”.

In B9, a contract represents a purchase or sale of an underlying asset if, at the end of the contract, an entity transfers to another entity control of the entire underlying asset and all but a trivial amount of the risks and benefits associated with the entire underlying asset. The consequence is that a large number of contracts will be treated as a purchase by the customer and not an operational lease as in current IAS17.

(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?

We disagree with the current proposals for subsequent measurement as they imply that lessees will in practice be required to amortise the right of use asset on a straightline basis whereas the liability is accounted for an actuarial approach. This creates a number of significant issues for lessees.

Under the ED proposal, the amortisation and interest charge will exceed the cash rental paid in the earlier years of a lease. This means that lessees will experience significant losses on transition (as all leases will be treated as new leases on transition) but also on an ongoing basis. According to current IAS 17, a lessee often seeks to match its lease expenses and revenues in order to achieve a straight-line P&L. It will no longer be able to do so under the current proposals.

It is urgent to simplify the model by limiting its application to amounts that lessees are contractually committed to pay under a lease in order to lower the costs of its implementation for preparers.
According to §13 a lessee shall determine the *lease term* by estimating the probability of occurrence for each possible term, taking into account the effect of any options to extend or terminate the lease. We are opposed to this estimated term as it needs judgment.

**Question 2: Lessors**

(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?

The ED exposed the principle for when lessors are required to apply one model as opposed to the other, “the exposure to significant risks and benefits associated with the underlying asset during or after the lease”. This notion of “significant risks and benefits” appears to come from the existing concept of significant risks and rewards found in IAS 17 that is used to classify leases as operating or finance leases.

No persuasive justification for having different models for lessors when there is just one model for lessees has been given.

In our view, lessors are either providing a service to lessees or financing a right to use asset. Consequently, if one accepts that there is such a distinction to make for lessors, we think this should have an impact on the accounting for lessees too.

We consider that there is a link between the lessee and the lessor. If only one accounting model is applied for lessee, only one model should be applied for lessor. We think that the derecognition model should apply as the general model for all leases. This is because only the derecognition model is consistent with the right of use model for lessees and will result in a coherent overall model for leases. This is appropriate as it is consistent with the view that the lessee has acquired a right of use.

(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 ED describes the “performance obligation approach” as an approach where the underlying asset is viewed as the lessor’s economic resource. It argues that a lease contract creates a new right and a new liability and that the lessor does not lose control of the leased property for the lease term. Therefore, it continues to recognise the leased item. However, during the lease, it is the lessee that controls the leased asset. So the lessor cannot make use of the asset during the lease term, it has given up this right to the lessee. This would be misleading to the users of the lessor’s financial statements as it is the lessee that is consuming that economic benefit (and is reflecting this in the subsequent measurement of its right to use asset) and not the lessor. From a conceptual point of view, no justification has been (or can be) given for the fact that, while there is only one physical asset in the “lease system”, generating one stream of economic benefits, a lessee would have an asset for the right to use
the physical asset and the lessor two assets: a receivable and the physical asset. Under this approach, the lease has created three assets out of one initial asset. The lessor does not have a continuing performance obligation to permit use of the leased asset throughout the contract and therefore cannot recognise a liability for such an obligation (as it does not exist).

The “de recognition model” is conceptually consistent with the right to use model for lessees. It reflects the fact that a lease creates a transfer of rights from one party to another. It is the only model that appropriately reflects the economics of a lease transaction. It can be applied to all leases and does not require the creation of artificial categories of contracts such as a distinction between leases/sales or de-recognition and performance obligation leases.

Question 3: Short-term leases

The exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A, as leases for which the maximum possible lease term, including options to renew or extend, is twelve months or less.

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?

Lessee: We consider that the so-called concession for lessees of short term leases does not provide this type of solution as the only simplification made is the omission of a present value calculation. We consider that the only meaningful simplification for lessees would be to allow them to continue to apply existing operating lease accounting. While some may argue that treating contracts under 12 months differently to others has no conceptual basis, we see this as being a pure cost/benefit trade off.

Lessor: On the lessor side, we agree with the proposal that entities providing short term leases should continue to recognise the underlying asset and recognise lease payments in profit or loss over the lease term. Again, we think that conceptually the de-recognition model can be applied to these leases but that the costs involved in de-recogising extremely small fractions of the physical asset, recognising receivables at the present value of rental payments, accounting for interest, etc. in such cases would be disproportionate to the benefit in information for users of accounts.

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?

No. BPCE considers that the definition provided in the ED i.e. “a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration” is too broad.

This definition has simply been imported from the existing leases standard without due consideration as to whether it remains applicable in the context of the new accounting model. The fact is that under the new standard much more strain will be placed on making the
determination between what is a lease and what is an executory contract as the accounting for these two types of contracts will be very different (cancelation of the operating leases model). Today however there is no such strain as the accounting for an operating lease and a service contract is very similar, to the extent that it is possible that many do not consider “rental” contracts to be leases but rather “service” contracts.

When a transaction involves the use of generic, easily exchangeable assets, the entity entering into the transaction is more likely to wish to obtain a service contract than the use of an asset – the asset’s use is likely to simply be a vehicle allowing it to obtain that service.

(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?

We note that the IASB identifies purchases/sales in those arrangements that transfer the control of the underlying asset and all but a trivial amount of the risks and benefits associated with the underlying assets. The wording indicates that both conditions have to be satisfied. However, we note that the two criteria indicated in paragraph B10 (automatic transfer of title and existence of a bargain purchase option) only deal with the transfer of control and not the exposure to risks and benefits.

We are concerned that the proposal is not fully consistent with the Revenue Recognition ED which only requires the transfer of control as a condition to recognise a sale. We believe that in some circumstances (for instance, when contingent payments exist) a transaction would not qualify for as a sale under the Leases proposals but may qualify as such in the Revenue Recognition ED.

We think that a large number of existing finance lease contracts would likely qualify as sales under this definition. This would have a number of practical implications: under the lessor model currently proposed, although the criteria for distinguishing between de-recognition leases and performance obligation leases are not necessarily clear, it could be that in reality there will be very few cases where de-recognition effectively applies (leaving a sales model and the performance obligation model as the de facto accounting approaches for lessor).

(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?

No, we do not think this guidance is sufficient. Generally speaking, we consider that importation of the existing IFRIC 4 concepts into paragraphs B1 – B4 has not provided preparers with the additional guidance needed to make the determination between a lease contract and a service contract.
We are not convinced that the criteria indicated in IFRIC 4 *Determining whether an Arrangement contains a Lease* (that have been in substance carried forward to the Exposure Draft) will provide the necessary robust and operational distinction required to determine which (very different) accounting treatment is appropriate and most meaningful for each specific transaction. We believe that the criteria give excessive weight to physical delivery or access to the asset, while it should be important to identify the business purpose of the transaction. In other words, when the lessee is mainly interested in receiving a service - and is indifferent as to the specific asset used - the transaction should be treated as a service arrangement.

We disagree with the way the proposals define the notion of specific. We think that a key feature is whether the asset used is easily exchangeable or replaceable by another that can provide substantially the same goods or services. When transactions involve non-specialised assets or assets that are not strictly related to the activity of the entity, those transactions are more likely to be entered into to obtain a service rather than the right to use the underlying asset.

**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?

We do not agree that leases of intangible assets should be excluded from the scope of the new standard. In our opinion, this represents a step backwards from the existing scope of IAS 17.

We agree with the paragraph BC36 of the ED that there is no conceptual reason to exclude lease of intangible assets and we think that this exclusion may lead to a different accounting treatment of transactions that have similar economic substance.

We support the proposed specific requirements for investment property valued at fair value in accordance with IAS 40 *Investment Property*. We agree that measuring these assets at fair value provides relevant information to users so it is appropriate to maintain this option.

**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?

Many lease contracts contain service elements in addition to the right to use the leased item. In some cases, the service component may be rather incidental to the right of use component and in others it will be much more significant. The “lessee” effectively outsources all asset related needs and costs to the “lessor” in exchange for a single, convenient invoice. In such cases, it will be extremely burdensome for preparers to identify and separate service and lease components, if not impossible.

These types of contracts are becoming more and more popular as firms choose to focus on their core activities and tend to outsource those asset needs that are auxiliary to their business. In fact, the service package can often be the decisive factor in opting for a contract that takes
on the form of what would today be called a full service lease instead of another product or several, separate products.

When services cannot be purchased separately, lessees are unlikely to have information to allocate payments reliably. Therefore, we agree that it would not be appropriate to force a lessee always to separate the contract into the different components.

On the other hand, we believe that lessors are generally able to determine this information even when there is no market for these services because they need the information on the cost of all service components to price their contracts and handle a much larger volume of transactions than lessees. We think that this is true regardless of the accounting model that the lessor applies.

**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?

We do not see a conceptual reason to treat options to purchase and options to extend a lease differently. We do not agree with the argument presented in paragraph BC64 of the Exposure Draft that the exercise price of an option is not a lease payment. We think that a purchase option is as integral to the agreement as an option to renew.

We are concerned that the proposals regarding purchase options result in very different accounting for scenarios that are similar. Under the proposals, the presence of a bargain purchase option results in treating the arrangement as a purchase; but when the option is not considered a bargain purchase option, then it is to be ignored until it is exercised. This difference in treatment is likely to give rise to application issues.

**Measurement**

**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?

We do not agree. Our view is that the Boards’ decision to adopt a single asset and liability approach for leases, and in particular to take into account renewal/extension options on the basis of the longest possible lease term that is more likely than not to occur, is not appropriate. Under this approach lessees will be required to recognise assets and liabilities they do not have. Lessors will recognise assets and potentially revenue that they do not have. We consider this approach to be unlikely to provide users of accounts with better information and a significant source of complexity for preparers.

The approach, which requires preparers to make assessments of the likelihood of exercising options at the start of a lease, will be extremely burdensome to apply. Entities choose leases
with optional features precisely because they do not know for how long they will need to use an asset. This flexibility should not be underestimated as it is one of the key reasons why companies choose to lease instead of buy (or lease with a fixed term) and can be an inherent part of their company's operating model.

Including amounts payable and receivable in extension periods requires the lessee and the lessor to assess the likelihood of the exercise of the option. This is complex and judgemental for both parties because the lessee may not have reliable information at every reporting date about future market rentals for the asset and therefore be unable to assess if the option is favourable or not and the lessor may not be aware of lessee's decisions that may impact the likelihood of the renewals and including these amounts increases volatility because they are likely to be reassessed; and may reduce comparability because entities in similar situations with similar leases may end up accounting for them quite differently.

**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?

We do not agree with the proposed approach for accounting for contingent rentals and expected payments under residual value guarantees. This approach implies that lessees will recognise obligations they have the discretion to avoid and lessors will recognise assets they do not control.

We consider the proposed treatment to be disproportionately complex for preparers to apply. Preparers will still have to shoulder the burden of analysing a wide range of different scenarios and associating probabilities to these scenarios.

For lessors, we consider that the appropriate approach would be to continue to apply the principles in the existing leases standard, where both lessee and third party provided residual value guarantees are included in the lessor's receivable.

**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?
We think that it would be onerous to require a periodic reassessment of changes in the obligation or receivable arising from changes in the lease term or contingent payments.

As mentioned in the replies to Question 8 and 9 above, we do not support the proposal that options to extend the lease term and contingent rentals are included in the measurement of lease receivables and payables as proposed by the IASB.

Reassessment is required under the current proposals precisely because of the issues surrounding unreliable measurement and judgments and they introduce yet another source of complexity for users.

To require reassessment is necessary only when facts and circumstances indicate there is a significant change in the lessee’s liability or the lessor’s asset. This is not a simplification because preparers will still need to go through the difficult exercise of considering whether facts and circumstances have changed and whether there would be any significant impact. Entities will also have different views on what a “significant” change is.
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?

Paragraph BC162 of the ED states that the IASB proposes to use the same criteria for a sale as those used to distinguish between sales/purchases and leases. However, IASB has added in paragraph B31 examples of conditions that the parties must assess to reach a conclusion on whether the transfer is a sale. We wonder whether the additional conditions in paragraph B31 of the ED imply that sale and leaseback transactions have to satisfy a higher threshold to qualify as sales than separate lease transactions that are subject to paragraphs B9 and B10 of the ED. If this is not the IASB intention, we suggest moving all examples of conditions to paragraph B9. This would clarify that there are no additional criteria to be met for sale and leaseback transactions to qualify as sales.

Based on B 31j, any sale and leaseback transaction where the seller/lessee is a parent company or an investor, and the buyer/lessor is a subsidiary or an associate would always be treated as a financing transaction in the separate accounts of the seller/lessee.

We agree that when the seller/lessee has the right to a significant portion of the appreciation of the transferred asset the transaction normally would not qualify as a real sale. However, we are not convinced that it is appropriate to conclude that any transaction between a parent and a subsidiary is a financing transaction.

Presentation

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 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?

Leases are distinct instruments with specific characteristics. As a result, we are in the view that they should be shown on a separate line of the balance sheet, on both the asset and liability side (if significant).

(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, 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?

We do not support the performance obligation model for lessors.

We are not convinced by the presentation requirements for lessors applying a performance obligation approach. We think that the proposals reflect the ambiguity of the approach.
(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, 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?

We recommend that leases be treated as a separate category for lessors too (if significant). If not, a distinct information will be given in the notes.

Question 13: 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?

We support the presentation requirements in the Exposure Draft and believe that it provides useful information.

Question 14: 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?

We agree with the proposals and believe that it provides useful information (if amounts are significant).

Disclosure

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?

This list of information is not only burdensome and costly for entities but also does not permit users to distinguish key information for users. We urge the IASB to enable entities to move from a compliance exercise toward a real principles-based disclosure focused on key information for users.
Question 16
(a) 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?

We agree that mandatory full retrospective application would be onerous for long-term leases, and welcome the relief given to preparers. The simplified retrospective approach effectively treats the lease portfolio at the initial date of application as if the entire portfolio were new leases at that date.

(b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?

We do believe that it should be precluded. Opening an option for those willing to undertake this exercise will prevent comparability.

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

There is no guidance for transactions like lease back and transactions in substance sales and purchases previously accounted for as leases.

Benefits and costs

Question 17

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?

The proposed model is complex and will be costly to implement while its potential benefits for users still remain to be clearly established. Preparers will bear major costs in terms of information systems for both measurement and disclosure purposes, internal controls and training. These costs will not be only initial but also ongoing, as recurring estimates will have to be produced over time.

Conversely, users are already provided with the information they need as they are already in a position to adjust the financial statements of lessees. In addition, we are not aware of any specific request from users concerning the lessor accounting. We do not concur with the assumption made by the IASB that the proposed model is the single appropriate response to the needs of users. In any case, we do not share the view that the recognition of assets and liabilities in the balance sheet is always the only adequate response to respond to the needs of users.

The proposals are also likely to impact financial ratios and debt covenants of entities. This may affect capital requirements based on local regulation and possibly increase the cost of capital for some entities.