



September 13, 2013

Lise Croteau
Vice President – Accounting and Control
Hydro-Québec
75 René-Lévesque Blvd West, 6th Floor
Montréal (Québec) H2Z 1A4
CANADA

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Sir/Madam:

Re: Comments on Exposure Draft *Leases*

Hydro-Québec is a major North American producer, transmission provider and distributor of electricity, operating mainly in the province of Québec, Canada. Its sole shareholder is the Québec government. In Québec, the transmission and distribution of electricity are regulated by the Régie de l'énergie [energy board], which sets rates on the basis of cost of service plus a reasonable return on the rate base.

On behalf of Hydro-Québec, I thank you for giving us the opportunity to comment on your exposure draft entitled *Leases*.

We agree with IASB's approach that the lessee should recognize a right-of-use asset and a lease liability. However, we do not agree that different accounting approaches should apply to different leases. Attached are our detailed responses to the questions in the exposure draft.

Should you wish to discuss any aspects of this comment letter in more detail, please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Lise Croteau'.

Lise Croteau, FCPA, FCA
Vice President – Accounting and Control

2

Encl. (1)

Exposure Draft ED/2013/6
Leases

Comments to be received by 13 September 2013

Question 1 – Identifying a lease

Do you agree with the definition of a lease and the proposed requirements in paragraphs 6-19 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transition.

We agree with the definition of a lease and the proposed requirements to determine whether a contract contains a lease.

We agree that buying substantially all the production from a specific asset should not be enough to qualify as a lease, as currently defined in IFRIC 4. However, we think there is a lack of guidance, considering subjective judgment is required to determine whether a contract contains a lease. We suggest adding guidance.

The concept of control would need to be in line with the one to be set forth in the revised Conceptual Framework.

Question 2 – Lessee accounting

Do you agree that the recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative would you propose and why?

We do not agree that the recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases. The same accounting treatment for the various types of leases would enhance comparability among businesses. To achieve the stated simplification objective of the Exposure Draft, there should be one model for all leases signed by a lessee.

The Exposure Draft states that most non-property leases should be Type A and most property leases should be Type B, but exception criteria in the Draft can modify this general rule. The distinction is confusing for users of financial statements.

Type A and Type B leases have very different impacts on the EBITDA of a lessee. Type A leases have no impact on the expenses taken into account in the calculation of EBITDA (interest and depreciation), while Type B leases have a major impact on EBITDA (operating expenses).

We suggest that all leases should be Type A for the lessee. A lessee should recognize a right-of-use asset and a lease liability. If the lessee purchased the asset and financed it with debt, impact on the income statement would be an interest charge on the debt and amortization on the asset purchased. Therefore, with a lease, the unwinding of the discount on the lease liability as interest and the amortization of the right-of-use asset are more representative of the recognition in the statement of financial position and the income statement, as in the case of a purchase.

Question 3 – Lessor accounting

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

We do not agree that different accounting approaches should apply to different leases for a lessor.

We have concerns regarding Type B leases for lessors. The lessor would retain the asset in its financial statements, but the lessee would have a right-to-use asset for the same underlying asset. Since the very definition of a lease implies that a lessee has control of the asset contemplated during the lease period, the lessor should not retain 100% of the asset in its financial statements. Type A for lessors, as proposed, seems to be the most appropriate for all leases. This also better reflects the fact that the lessee recognizes an asset in property, plant and equipment for all leases.

However, we do agree that the “performance obligation approach” that was part of 2010 ED should not be included in the Standard, since it would result in a liability for the lessor which does not reflect economic reality. A lessor should not have a liability because of a lease agreement.

Question 4 – Classification of leases

Do you agree that the principle on the lessee’s expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 28-34, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

We do not agree. We find that the requirements in paragraphs 29 and 30 are not consistent.

The term used in paragraph 29 is “insignificant” for both the total economic life and the present value of the lease payments. The term “insignificant” is relevant to determine if the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset. However, for a property to be classified as Type A, the terms used in paragraph 30 are “major part” with respect to the total economic life and “substantially all” with respect to the present value of the lease payment. These are the terms used in IAS 17, paragraph 10.

Although we do not expect IASB to specify a percentage for each term, we believe that using different terms to determine the exception criteria would have an impact on the interpretation of each criterion. Clarification is therefore needed in this regard. We assume that a “major part” would correspond to a smaller percentage than “substantially all,” as in IAS 17. Based on this assumption, how would a 30-year lease be classified for a building that has a 40-year remaining economic life if we considered only the lease term criterion? Is 75% a major part or not? If not, a minimum of how many years would be required to constitute the major part?

Also, why would the requirements be based on total economic life for non-property assets, but on remaining economic life for property, when in fact it is possible to rent used non-property assets as well? We do not understand the need for a different basis for these two types of assets.

Let us assume that, for a 50-year property, Lessee #1 rents the entire property for the first 5 years (Years 1–5) and Lessee #2 rents the same property for the last 5 years (Years 46–50). For two leases of the same length for the same property, the accounting treatment would be different. Why? What is the difference between these two leases? Should a lessee choose a property with a long or a short economic life remaining depending on the type of lease he wants?

Lessee #1 would classify his lease as Type B because it would only cover 10% of the remaining economic life of the underlying asset (5 years/50 years), which means it would not meet one of the criteria specified in paragraph 30.

Lessee #2 would classify his lease as Type A because it would cover the major part of the remaining economic life of the underlying asset, i.e., 100% (5-year lease/5-year remaining economic life), as specified in paragraph 30 a).

Also, a change in relevant factors could change the significant economic incentive to exercise or not an option to purchase the underlying asset. In this case, shouldn't it change the classification of the lease as well? Paragraph 28 specifies that the classification should not change, but a change in relevant factors could have a significant impact on the classification.

We therefore suggest having only one type of lease for the lessee and the lessor, which would solve the issue of the classification of leases and improve the comparability of financial statements.

Question 5 – Lease term

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

We agree that renewal options should be taken into account for the lease term only if the lessee has a strong economic incentive to renew. This is an issue that was present in 2010 ED and it has been addressed.

However, reassessment of the lease term in the case of a change in relevant factors could cause practical issues, since paragraph 28 states that an entity shall not reassess the classification of a lease after the commencement date.

We also believe there is a lack of clarity regarding contracts that can be renewed indefinitely without specified end dates. In the case of a 12-month lease that is renewable automatically unless the lessee or the lessor terminates the contract, for instance, would the lease term be 12 months or more than 12 months?

Question 6 – Variable lease payments

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

We agree with the measurement of variable lease payments for the lessee based on an index or a rate. A lessee and a lessor should not have to make assumptions about future use and future sales in order to assess the present value of the asset and the liability. This is an issue that was present in 2010 ED. However, we don't agree with the reassessment if there is a change in an index or a rate used to determine lease payments.

Consistent with the 2010 Exposure Draft, this Exposure Draft proposes that a lessee should measure lease liabilities, like other similar financial liabilities on an amortized cost basis, as described in IAS 39. Also, the previous (2010) and the present (2013) Exposure Drafts proposed that a lessee should remeasure the lease liability to reflect changes to the lease payments as described in paragraph 44 and changes to the discount rate as described in paragraphs 45–46.

In order to respect consistency with IAS 39, it is relevant to consider that a lease liability with payments that depend on a floating interest rate is in substance a floating rate financial liability. Based on paragraph AG7 of IAS 39, an entity could use a method for subsequent measurement which allows re-estimating the cash flows and re-evaluating the effective interest rate. In this case, with a re-evaluated effective interest rate, the interest charge is prospectively modified. Generally, revising the cash flows and the effective interest rate would not affect the measurement of the liability.

The same thinking can be applied to a lease with payments based on an index such as the CPI. Indeed, the accounting literature allows us to conclude that a financial liability whose payments are based on the CPI is in substance a variable rate debt. We consider a lease with payments that depend on the CPI to be similar to a floating rate financial liability.

Therefore, we think that the *Leases* Exposure Draft should be clarified to consider a lease liability with payments that depend on a floating interest rate or an index like the CPI with the same treatment applied in IAS 39 for floating rate financial liabilities. We recommend that the Exposure Draft clarify the cases where the leased assets and liabilities must be remeasured, and align the treatment with IAS 39 for all liabilities that are essentially floating rate financial liabilities, including those based on an index (CPI).

Question 7 – Transition

Paragraphs C2-C22 state that a lessee and a lessor would recognise and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?

We agree with the transition requirements. A modified retrospective approach is very appropriate because it would be highly labor-intensive and costly to apply a full retrospective approach.

A full retrospective approach could be permitted, since it could perhaps be applied more easily for some lessees or lessors. However, it should not be mandatory.

Question 8 – Disclosure

Paragraphs 58-67 and 98-109 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments; reconciliations of amounts recognised in the statement of financial position; and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

- We do not agree with the disclosure requirements, which could result in disclosure overload. Each exposure draft that results in new disclosure requirements must be carefully examined to avoid disclosure overload. The disclosure requirements for leases, including reconciliations and narrative disclosures, should not be more extensive compared to a situation where an entity finances the purchase of an asset instead of leasing.

Questions 9 to 11: We have not answered these questions given that they are FASB-only.

Question 12 – Consequential amendments to IAS 40

Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

We agree with the consequential amendments to IAS 40. If the leased property meets the definition of investment property, it would be appropriate for it to be within the scope of IAS 40.

Other comments

The *Leases* Exposure Draft should be in agreement with the IFRS Work Plan, including the revised Conceptual Framework, IFRS 9, “Financial Instruments,” and Revenue Recognition.