

International Accounting Standards Board

Dear Sir

EXPOSURE DRAFT - LEASES

I set out below my comments on the International Accounting Standards Board's Exposure Draft - Leases. I have only commented on the questions raised in the exposure draft where my views differ from those set out therein. In addition, I have included some general comments about the efficacy of the Exposure Draft in relation to what it is seeking to achieve.

General

Clearly, users of accounts need to be able to appraise an entity's use of leases and the resultant impact on financial commitments and income statement. However, at present, users of accounts can do this by adjusting for operating leases as there are adequate lease disclosures required by the existing Standard. Users can unpick the amount and maturity of lease commitments made by the entity relatively easily.

However, bringing these legal lease commitments on balance sheet does not, in my view, further meet the needs of users. The dividing line between lease commitments and other commitments is very arbitrary with respect to what should be on-balance sheet. It is true that lease commitments are legal obligations relating to an asset controlled by an entity, but an entity has a whole range of legal and constructive obligations that will lead to cash outflows in the future in order to continue as a going concern. These include salary costs and commitments to purchase raw materials. Furthermore, where a company has a lot of operating leases, the present value of the lease commitments is not meaningful – leases will have to be renewed at the end of the lease term, as the underlying assets will still be required by the business. A more useful metric for users to understand the entities lease burden is the lease cost charged to income statement, not the present value of the tail of lease payments.

Much of the proposed Exposure Draft is logical within the narrow remit of lease accounting. However, under IFRS there are bigger areas of inconsistency and a purer solution for leases only does not help the users. The current system of operating and finance leases is arbitrary, but it is at least understood by everyone. The new standard results in meaningless liabilities coming on balance sheet because they only represent legal obligations. Furthermore, the administrative burden of both transition and monitoring of every leased asset is significant, burdensome and costly. This would be an acceptable cost if the usefulness of financial statements was being materially increased but is not where this is not the case.

Question 1: Leases

It is my view that the proposal to categorise all operating leases as leases is inappropriate though I agree with the exposure draft's general thrust.

There are a number of assets commonly leased by companies such as photocopiers, printers, computers, forklift trucks and vehicles where a lessor provides a total package to a lessee. The lessor typically manages the population of equipment and is responsible for their service and maintenance. In such a situation it is normally not possible for the lessee to subdivide the service and lease components of the rental payments and to account for the service element as a period cost.

I consider that it should still be allowable to account for the cost of leases that contain a substantial service element as a period operating cost consistent with the existing accounting treatment.

Question 4: Definition of lease

As set out in my response to Question 1, I do not consider that a contract where the service contract represents a substantial proportion of the cost should be classified as a lease.

Question 5: Scope Exclusions

I am not clear why leases between the date of inception and the date of commencement of a lease should be excluded from the scope of the exposure draft if they meet the definition of an onerous contract.

The definition of the date of inception is the earlier of the date of the lease agreement and the date of commitment by the parties to the lease agreement. The exposure draft should provide guidance on what constitutes a commitment.

Question 6: Contracts that contain service components and lease components

The proposed accounting treatment will overstate the right of use asset and the liability to make lease payments where the lease arrangement contains a service component that cannot be separately quantified. As noted above I recommend that arrangements that contain substantial service components should be accounted for as period costs when incurred with no recognition of a right to use asset and liability to make lease payments.

Question 7: Purchase options

The exposure draft proposes that a purchase option should only be accounted when exercised. I recommend that it should be accounted for as part of the lease arrangement if its exercise is considered to be the most likely outcome.

Question 8: Lease term

I do not agree that the lessee or lessor should determine the lease term as the longest possible term that is more likely than not to occur. This is a very subjective assessment and is determined by the terms considered and

probabilities thereof. I would recommend that the definition be amended to the most likely lease term.

Question 9: Lease payments

I agree that contingent rentals and expected payments under term options and residual value guarantees should be included in the measurement of assets and liabilities but I would recommend that they should be included only if they are reasonably likely to be incurred.

Question 10: Reassessment

I consider that the reassessment should be performed at the end of each reporting period.

Question 15: Disclosure

The qualitative disclosures should only be required if they are considered material for a user of accounts to understand the amounts included therein.

Question 16: Transition

The requirement to assess all outstanding lessees as at the date of initial application will be a substantial exercise for large companies and thus I urge that there is at least a year from the approval of the IFRS on leases before companies are required to implement it i.e. if the IFRS is implemented in June 2011 companies should only have to implement it for year ends ending on or after June 2013.

Question 17: Benefits

This IFRS will require additional finance resource to account for leases in the required manner. It is my view that the cost of this additional resource will outweigh the benefits of including right to use assets and lease liabilities in the company's balance sheet. Dairy Crest used to have a department to manage lease accounting when it had substantial finance leases. This department was disbanded when the finance leases expired. Following the implementation of this IFRS additional resource and cost will be required for no benefit to the Company.

Other Points

Discount rate

I would suggest that the rate the lessor charges the lessee should be the default discount rate if that rate can be reliably determined. Only if it cannot be readily determined should the lessee's incremental borrowing rate be applied.

Initial direct costs

They are defined as recoverable costs. Recoverable would appear to be superfluous and I therefore suggest that it is deleted in the definition of initial direct costs.

Yours faithfully

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