

Indigo

Books & Music Inc.

December 15, 2010

International Accounting Standards Board
30 Cannon Street 1st Floor
London EC4M 6XH, United Kingdom

Re: IASB Exposure Draft – *Leases* (ED/2010/09)

Dear Sir/Madam:

Indigo Books and Music Inc. (“Indigo” or “we”) is writing to provide our response to the International Accounting Standards Board (“IASB”) Exposure Draft (“ED”) ED/2010/09 *Leases*. While we agree that lease accounting treatment and disclosures could be improved to enhance transparency to financial statement users, we do not concur with all the suggested revisions to the existing standard as presented in the ED.

The Boards’ proposal as it stands would create a significant amount of costs not only for us in the retail sector but in many industries where equipment and other leasing are prevalent. Also, as the Board notes in BC200:

“The objective of financial statements is to provide information about the financial position, performance and changes in the financial position of an entity that is useful to a wide range of users of financial statements in making economic decisions. To attain this objective, the boards endeavor to ensure that new standards will meet a significant need and that the overall benefits of the resulting information justify the costs of obtaining it.”

The standard as proposed will not provide useful information to a wide range of users, as each group of users requires different types of lease information. For example, users who insist on capitalizing operating leases (such as rating agencies) have their own methodologies for doing so using information which is readily available in current note disclosures. It is our belief that, given the amount of judgment and inevitable variability that will arise as a result of this standard, users will in fact erase the effects of this standard and proceed with the models they currently have, resulting in increased cost and effort going forward with no benefit to the users.

In the attached appendix, please find our comments and responses to your questions on the ED. We thank you for your consideration in these areas and appreciate the ability to voice our concerns.

Sincerely,

Kay Brekken
Chief Accounting Officer & Senior Vice President – Finance
Indigo Books and Music Inc.

Chapters

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APPENDIX

Question 1: Lessees

(a) Do you agree that a lessee should recognize 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?

Conceptually, Indigo agrees with the recognition of a right-of-use asset and a liability to make lease payments; however, we believe the model as currently presented requires further consideration. The model as tabled is open to significant management bias, would incur exceptional costs to determine these balances far in excess of any benefit derived and is unlikely to provide financial statement users with the additional lease information they desire.

Financial statement users generally understand leases and are familiar with the current concept of operating and finance leases. As a book retailer, we have a significant number of leased locations across Canada and all of these leases qualify as operating leases. If the IASB's intent is to record leased assets on the balance sheet of the user who will derive the majority of benefits from use of that asset, this may not be the case in our situation given that we are working with real estate leases. The useful life of real estate can far exceed the lease terms for that property. Nor do the owners of the underlying assets intend to transfer risks and rewards to lessees.

We propose that the right-of-use asset and liability only take into consideration the initial term and consideration to be paid which can be easily determined from the lease agreement. Estimates surrounding optional terms, future market rent and contingent payments would prove to be an onerous task to administer and account for each reporting period, as well as provide an opportunity for lessees to understate their intent to reduce any amounts incurred. Our proposal would also serve to minimize discrepancies between values determined by lessees and their lessors.

(b) Do you agree that a lessee should recognize amortization 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?

Indigo does not agree that amortization and interest should be recognized on the right-of-use asset and liability to make lease payments, respectively. We believe the asset and liability should be drawn down in a similar manner to existing accounting guidance for finance leases. We believe this provides for a rational allocation of expenses to the periods in which the lessee benefits from use of the asset.

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?

Indigo does not act as a lessor and therefore has no comment on this issue.

(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?

Indigo does not act as a lessor and therefore has no comment on this issue.

Question 3: Short-term leases

(a) At the date of inception of a lease, a lessee that has a short-term lease (less than twelve months) may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognize lease payments in profit or loss over the lease term. Do you agree that a lessee should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

It is our belief that the cost and effort to comply with the full requirements of the proposed Exposure Draft for short-term leases outweighs the benefit of providing additional information to the users of financial statements. Indigo believes leases in short duration should continue to be recorded in a manner consistent with the existing operating lease guidance.

(b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognize assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognize any portion of the underlying asset. Such lessors would continue to recognize the underlying asset in accordance with other IFRSs and would recognize lease payments in profit or loss over the lease term. Do you agree that 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?

Indigo does not act as a lessor and therefore has no comment on this issue.

Question 4: Definition of a lease

(a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?

Yes, we agree the description is accurate for defining a lease.

(b) Do you agree with the criteria 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?

Yes, we believe the criteria listed are accurate.

(c) Do you think that the guidance for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

As the current accounting for operating leases and service contracts is often similar, determining that a service arrangement contains a lease classified as an operating lease generally does not result in significantly different accounting for the arrangement (i.e., a service arrangement with an embedded operating lease is often accounted for similarly to a service arrangement that does not contain a lease). However, this will not be the case going forward and consequently, we believe that there is a need to further clarify the guidance for distinguishing leases from service contracts.

Question 5: Scope exclusions

The ED proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources. 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?

Yes, we agree with the proposed scope exclusions.

Question 6: Contracts that contain service components and lease components

The exposure draft proposes that lessees and lessors should apply the proposals in *Revenue from Contracts with Customers* to a distinct service component of a contract that contains service components and lease components. If the service component in a contract that contains service components and lease components is not distinct:

(a) the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.

(b) the IASB proposes that:

(i) a lessee should apply the lease accounting requirements to the combined contract.

(ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.

(iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements, and the service component in accordance with the proposals in *Revenue from Contracts with Customers*.

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?

Firstly, we believe that if the FASB and IASB are presenting this ED jointly, an agreed-upon position for service and lease agreements needs to be presented. Secondly, we believe the substance of the contract should dictate which accounting rules are applied. If the agreement is substantially a service contract, then revenue recognition policies should be applied. If leasing the underlying asset is the purpose of the contract, then lease accounting policies should be applied.

Question 7: Purchase option

The exposure draft proposes that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised. 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 agree that purchase options should only be accounted for when they are exercised, if at all, due to the uncertainty of transaction timing and valuation.

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 disagree. Estimating an expected lease term at the outset requires significant judgment and estimation which is often not considered until the end of the contractual term. In our experience, real estate leases have an initial term which ranges from 5 – 10 years and renewal options which vary from 2 – 10 years, with the decision to extend or terminate a lease based on conditions at the end of the lease term. As such, making a reasonable estimate of using these renewal periods is extremely difficult.

In our view, the estimation involved in determining probabilities of using any options to extend or terminate a lease would not provide comparability and consistency across multiple companies and could also allow management bias in the treatment.

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 strongly disagree. These payments are dependent on outcomes that cannot easily be estimated. Contingent amounts, based on usage or performance, are not obligations on execution of an agreement but only become an obligation as usage or performance occurs. We believe these payments should be realized and recognized as incurred, as dictated in the current lease accounting model. As noted in Question 8 above, real estate leases can easily be 20 years in length and reasonably estimating costs out to that timeframe would be difficult, time consuming, and could be subject to significant variability over the life of the lease due to outside factors.

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?

As noted in our previous responses, we do not concur with the decision to include optional lease terms and contingent payments in the determination of the assets and liabilities calculated by lessees. Therefore, changes in such conditions would not have an impact on the balances presented in the statements of financial position. As a book retailer with a substantial number of lease agreements, the onus to review each contract, potential term changes and contingent rentals would be an onerous task requiring constant monitoring. The level of work required does not appear to exceed any benefit that would be obtained, given the bias that could be applied to these calculations.

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?

Indigo concurs with the criteria for classification of sale and leaseback transactions. The treatment is considered an appropriate reflection of the intention of the transaction, thus providing transparency to the users of the financial statements.

Question 12: Statement of financial position

(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? 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?

(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, totaling to a net lease asset or lease liability? 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?

(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? 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?

(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

Indigo does not concur that lease assets and liabilities should be presented separately from other financial assets and liabilities on the statement of financial position. We believe this information should be disclosed in the notes to the financial statements. Enhancing note disclosures with regards to lease agreements for companies will improve understanding by financial statement users through increased transparency of leasing activities actively employed.

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? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

Indigo does not agree that lease income and lease expense should be presented separately from other income and expense in profit or loss. If this information is deemed useful to the users we believe this information should be disclosed in the notes to the financial statements.

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? 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?

Indigo does not agree that cash flows arising from leases should be presented separately from other cash flows. We believe this information should be disclosed in the notes to the financial statements.

Question 15: Disclosure

Do you agree that lessees and lessors should disclose quantitative and qualitative information that:

(a) identifies and explains the amounts recognized 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? Why or why not? If not, how would you amend the objectives and why?

We agree that note disclosures should be enhanced to disclose the amounts recognized in the financial statements relating to leases as well as any impact leasing activities would have on future cash flows.

Question 16: Transition

(a) The exposure draft proposes that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach. Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?

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

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

Indigo believes application of any new lease accounting policies should be fully prospective in nature only. If the goal is to provide a clearer impact of leasing activity on a company's future cash flows, historical impact becomes somewhat irrelevant. Further, in order to retroactively apply these principles for all leases of a company would be an onerous task with little benefit to the users.

Question 17: Benefits and costs

Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?

No, Indigo does not agree with the boards' assessment that the benefits would outweigh the costs. As previously discussed, the ED suggests approaches to lease accounting that will be extremely onerous to calculate on a regular basis and, given the level of estimation that management would be required to make in order to fully comply, the suggested approaches will likely be less useful to users than the current standards.

Question 18: Other comments

Do you have any other comments on the proposals?

We believe it is imperative for the FASB and the IASB to resolve any remaining lease accounting matters on which they still do not concur. To make such monumental changes to an existing standard without congruence would not be in the best interest of multi-national users. Furthermore, the proposals do not provide any guidance about accounting for lease incentives, which is an issue that should be addressed.