



International Accounting Standards Board  
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15 December, 2010 / Mei  
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### **Exposure Draft (ED) on Leases**

Dear Sirs

We very much welcome the opportunity to comment on the above-captioned exposure draft.

#### **General comments**

**Since Holcim does not act as a lessor for third parties, our comments have therefore been restricted to lessee accounting only.**

Leases are a very important class of transactions and source of financing for entities. However, accounting for leases has been criticised over the years, not least by users. Therefore, we support the decision to develop an accounting model to replace the existing IAS 17, provided that the proposals offer an effective improvement over the existing requirements. While there might be conceptual merits in some of the proposals included in the exposure draft, we are **not persuaded that the proposals offer an effective improvement** for a number of reasons, as detailed in our response to your questions below.

More specifically, the **only proposal we can support is the recognition of a liability where an entity has an unconditional obligation to pay rentals** against a signed lease contract, as this meets the definition of a liability under the current *Framework*. Therefore, recognizing an additional liability for the *possibility* of extending a lease under a renewal option sometime in the future is not only conceptually incorrect, but also will result in information which is not reliable, relevant or useful to users of the financial statements.

As a result, Holcim does not believe that the proposals are effective in addressing the concerns about the complexity of lease accounting and comparability of information. Furthermore, we are **not convinced that the proposals result in information that is relevant** to users of financial statements.

Since leases are so widespread, we believe that the IASB should further develop and field-test its thinking and, subsequently to:

- Better define what information users really need;

- Clearly distinguish between what should be recognised in the financial statements and what should be disclosed, the distinction being based on the definition of assets and liabilities; and
- Make a thorough assessment of the costs involved.

We acknowledge that our recommendations may not be compatible with the June 2011 deadline that the Board has set for itself in this project. However, we believe that supplementary time required to make the final standard robust and worthwhile is a matter of months and not years.

## **Holcim's responses to the questions asked in the exposure draft**

### ***The accounting model***

*The exposure draft proposes a new accounting model for leases in which a lessee would recognise an asset (the right-of-use asset) representing its right to use an underlying asset during the lease term, and a liability to make lease payments (paragraphs 10 and BC5–BC12). The lessee would amortise the right-of-use asset over the expected lease term or the useful life of the underlying asset if shorter. The lessee would incur interest expense on the liability to make lease payments.*

### **Question 1: Lessees**

*(a) Do you agree that a lessee should recognise a right-of-use asset and a liability for its obligation to make lease payments? Why or why not? If not, what alternative model would you propose and why?*

*(b) Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on its liability for lease payments? Why or why not? If not, what alternative model would you propose and why?*

(a) On balance, we believe that a right-of-use model provides useful information and satisfies users' needs about recognition of assets and liabilities arising from leases. Therefore, Holcim has concluded that it can support the right-of-use model.

(b) We agree that if the right-of-use model is applied, a lessee should recognise amortisation of the right-of-use asset and interest on the lease liability. We agree that neither the right-of-use asset nor the lease liabilities are required to be measured at fair value.

### **Question 2: Lessors**

Since Holcim does not act as a lessor for third parties, our comments have therefore been restricted to lessee accounting only.

### Question 3: Short-term leases

*The exposure draft proposes that a lessee or a lessor should apply simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term is twelve months or less:*

*At the date of inception of a lease a lessee that has a short-term lease 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 recognise lease payments in profit and loss over the lease term (paragraph 64).*

*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?*

Holcim believes that the main burden for lessees in applying the proposed model to short-term leases is the cost of identifying and tracking a large number of contractual lease payments, rather than the cost of discounting those lease payments. Also, the application of the accounting model for lessees may prove complex, especially when the contract includes contingent rentals. Therefore, we are not persuaded that the simplification proposed for lessees offers much relief in practice.

Holcim agrees that short-term leases are not inherently different from other leases. However, Holcim believes that users mainly criticise the existing model in relation to *long-term* arrangements that involve *core* operating assets. In other words, users do not seem to be concerned about short-term leases of non-core assets such as cars or hotels rooms not being recognised in the statement of financial position.

For this reason, we support an exception to the general model on practical grounds and propose that lessees apply to short-term leases the treatment of operating leases in the existing IAS 17.

#### **Definition of a lease**

*The exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1–B4 and BC29–BC32). The exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59–BC62) and on distinguishing a lease from a service contract (paragraphs B1–B4 and BC29–BC32).*

### 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?*

*(b) Do you agree with the criteria for distinguishing a lease from a purchase or sale in paragraphs B9 and B10? Why or why not? If not, what alternative criteria would you propose and why?*

*(c) Do you think that the guidance provided for distinguishing leases from service contracts in paragraphs B1-B4 is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?*

(a) The exposure draft defines a lease as a contract in which the right to use a specified asset is conveyed to a lessee, for a period of time, in exchange for a consideration. Since the proposal is in line with both IAS 17 *Leases* and IFRIC 4 *Determining whether an Arrangement contains a Lease*, we therefore agree with the proposal.

(b) We agree with the criteria for distinguishing a lease from a purchase or sale in paragraphs B9 and B10.

(c) We agree that the guidance provided for distinguishing leases from service contracts in paragraphs B1-B4 is sufficient.

## **Scope**

### **Question 5: Scope and scope exclusions**

*The exposure draft 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, biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33-BC46).*

*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 agree with the proposed scope.

### **Question 6: Contracts that contain both service 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 (paragraphs 6, B6-B8 and BC47-BC54). If the service component in a contract that contains service components and lease components is not distinct:*

*The IASB proposes that a lessee should apply the lease accounting requirements to the combined contract.*

*Do you agree with the approach on accounting for leases that contain service and lease components appropriate? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?*

Holcim disagrees with the rule to apply lease accounting to the whole contract if it includes both a lease and a non-distinct service component. We believe that entities should rather consider the economic substance of the transaction. To do so the lessee should assess what the predominant component is, then treat the whole contract accordingly. Identifying the predominant component requires identifying the relative fair values of each part, which we believe can be reliably estimated in most cases.

### **Question 7: Purchase options**

*The exposure draft proposes that a contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus a contract is accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraph 8 and BC63 and BC64).*

*Do you agree that a lessee or a lessor should account for purchase options when they are exercised? Why or why not? If not, when do you think that a lessee or a lessor should account for a purchase option and why?*

We agree that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised.

### **Measurement**

*The exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that:*

*(a) assumes 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 (paragraphs 13, 34, 51, B16–B20 and BC114–BC120).*

*(b) includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21 and BC121–BC131). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be measured reliably.*

*(c) is updated 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 (paragraphs 17, 39, 56 and BC132–BC135).*

### **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?*

Holcim disagrees with the proposal and believes that the lease term should be based on the unavoidable terms of the signed contract. Therefore, any options to extend or terminate the lease should only be considered when they have been exercised by the lessee. Further, rentals payable during an extension period under an option which has not yet been exercised does not meet the definition of a liability based on the Conceptual Framework as the lessee does not have an unconditional obligation to pay it.

### **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 contract should be included in the measurement of lease assets and lease liabilities 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?*

We believe that contingent rentals, expected payments under term option penalties and residual value guarantees that are specified in the lease contract should not be included in the measurement of lease assets and lease liabilities since these amounts cannot be reliably measured at the inception of the contract. Therefore, including such amounts in the balance sheet would not result in financial statements presenting a true and fair view.

### **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 obligation or receivable arising from changes in the lease term or contingent payments since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?*

As mentioned in the replies to question 8 and 9 above, Holcim does 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.

However, if the IASB were to proceed with their proposals above, then Holcim would disagree with the requirement of periodic reassessment since this would create an unduly onerous burden for companies to follow. Consequently, we believe that the costs of implementing and sustaining such a process would far outweigh any benefits to be received from it.

### **Sale and lease back**

*The exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents the sale of the underlying asset, the leaseback would also meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66–67, B31 and BC160–BC167).*

### **Question 11**

*Do you agree with the criteria for classification as a sale and leaseback transaction? Why or not? If not, what alternative criteria would you propose and why?*

We agree with the criteria for classification as a sale and leaseback transaction.

## **Presentation**

*The exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25–27, 42–45, 60–63 and BC142–BC159).*

### **Question 12: Statement of financial position**

*Do you agree that a lessee should present its liability to make lease payments separately from other financial liabilities and present right-of-use assets as if they were tangible assets within property, plant and equipment, or investment property as appropriate, but separately from other assets that the lessee does not lease (paragraphs 25 and BC143–BC145)? Why or why not? What alternative presentation do you propose and why?*

We disagree with the above proposal and believe that a separate disclosure note is preferable.

### **Question 13: Statement of comprehensive income**

*Do you think that lessees and lessors should present lease expense and lease income separately from other income and expenses in the statement of comprehensive income (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? 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 disagree with the above proposal and believe that a separate disclosure note is preferable.

### **Question 14: Statement of cash flows**

*Do you think that cash flows arising from lease contracts should be presented on 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 disagree with the above proposal and believe that a separate disclosure note is preferable.

## **Disclosures**

### **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 lease contracts; and*

*(b) describes how lease contracts 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?*

Holcim welcomes the requirement in paragraph 71 of the exposure draft that an entity should consider the level of disclosures appropriate to satisfy the objectives in paragraph 70. The list of disclosure requirements is rather extensive and we believe that the IASB should state even more clearly that they should not be regarded as mandatory in all situations.

## **Transition**

### **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?*

*(b) Do you think that full retrospective application of lease accounting 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?*

We consider that a mandatory retrospective application would be very onerous for companies to follow and therefore believe that the transition rules should be fully prospective only.

## **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 outweigh the cost? Why or why not?*

Holcim believes that the costs of implementing and sustaining the proposals in the exposure draft will far outweigh any benefits to be received. As such, we encourage the IASB to expand its outreach activities to collect additional information on the costs associated with the implementation of the proposals and their potential benefits.

## **Other comments**

### **Question 18**

*Do you have any other comments on the proposals?*

We have no other comments on the proposals.



We thank you for the opportunity to submit our contribution to your due process.

If you would like further clarification of the points raised in this letter, either of the undersigned would be happy to discuss these further with you.

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