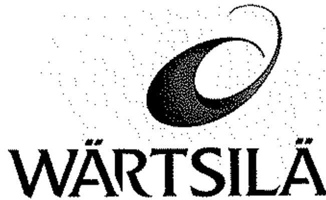

June 15, 2010

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

Re IASB/FASB Discussion Paper on Leases

Dear Sirs,

By way of introduction, we are a group of multinational companies that prepare our consolidated financial statements in compliance with the International Financial Reporting Standards. We are all following the IASB/FASB lease convergence project with great interest, but also with some anxiety, due to the material challenges and questions raised by the current discussion paper.

Our concern is not so much about the financial impact on the financial statements, but rather about the workload and administrative burden the proposed approach will put upon our finance, tax and legal departments, as well as on our affiliates throughout the world.

We understand that the Board is in the process of deliberating on the future lease accounting based on the comment letters received and other input, and we are following the ongoing discussions closely. We do have one significant concern that we wish to emphasise at this stage of the process, as it seems that considerations for cost-benefit implications have not been sufficiently addressed in the ongoing discussions.

Our concern is that a requirement to apply the 'right-of-use' approach to all lease arrangements would mean that the costs and administrative burden would exceed the benefits of the additional information. Consequently, we suggest that the approach should be based on a "business model" mindset supported by a materiality approach.

If we draw on the experience of, for example, the implementation of *IFRS 7 Financial Instruments: Disclosures,* many non-financial companies have experienced significant challenges in complying with comprehensive disclosure requirements that to some extent are mostly relevant to financial institutions, etc. We foresee a parallel inappropriateness if reporting requirements aimed primarily at entities leasing core assets related to principal activities, including real estate, aircraft, railcars, ships, etc., are forced on simple leases with low asset value.

For this reason, we have decided to address you during the deliberation process in order to suggest that greater attention be paid to this issue. Further, we would like to present our view in favour of a more balanced approach.

For the record, we would like to emphasise that we are in agreement with the Board's objective to improve the accounting for leases by enhancing transparency and comparability for users, and by reducing the complexity of the accounting model. We also acknowledge that the existing accounting model for leases has long been criticised for failing to meet the needs of users of financial statements.

Concerns about the right-of-use model

In principle, we support the Board's objective of recognising the rights and obligations arising in a lease and believe that the proposed right-of-use model addresses a number of the criticisms of the current standard and accounting practice.

We are, however, hesitant towards fully supporting the right-of-use approach for *all* lease arrangements including simple and supporting assets. A significant obstacle with the intended "one standard fits all" principle is that extensive recognition and measurement requirements designed to address one type of business, easily place undesirable requirements on other businesses.

One must not forget that the criticism of the current leasing practice is primarily aimed at reporting entities leasing core assets related to principal activities, including real estate, manufacturing equipment, aircraft, railcars, ships, computers and technology.

Thus, from our point of view, it should not be directed against reporting entities with simple none-core leases on supporting assets such as office equipment, auto fleet, coffee machines etc. that, individually or aggregated, are immaterial for the financial position of the reporting entity.

Applying a 'business model' mindset

Due to our significant concerns about the costs overweighing the benefits of implementing and applying the suggested right-of-use model as proposed, we suggest that the Board considers a slightly revised version of the right-of-use model combined with a business model mindset (similar to *IFRS 9 Financial Instruments* from November 2009) as well as a materiality condition in the context of individual lease assets and lease liabilities.

Therefore, we encourage the IASB (and the FASB) to consider the approach suggested below.

Under this model, all lease arrangements are within the scope of the standard; however, with modifications built into the recognition criteria with substituting disclosure requirements for lease contracts which are not recognised in the statement of financial position.

An entity must recognise a lease asset and a lease liability in its statement of financial position when, and only when, the entity becomes party to the contractual provisions of the lease arrangement, and if either of the following conditions is met:

(a) the asset is held within a business model whose objective is to hold assets in order to generate future cash flows (e.g. factories, airplanes, machines and other technical equipment used in either operating or investing activities of the business model); or

(b) the asset is individually material to the entity's statement of financial position (e.g. corporate headquarters or other significant buildings).

If either of these conditions is met, then this and all related lease assets and lease liabilities within that business model must be measured as suggested under the right-of-use model. If these conditions are not met, these lease contracts must be subject to

substituting disclosure requirements similar to those already required under the current *IAS 17 Leases*[1].

In our opinion, this is sufficient for the users of financial statements as they will still receive information in the notes about the total of future minimum lease payments under non-cancellable leases arising from these lease contracts.

An entity's business model does not relate to a choice (i.e. it is not a voluntary designation) but rather it is a matter of fact that can be observed by the way an entity is managed and information is provided to its management. Therefore, a business model is very different from 'management intentions' which can relate to a single asset or lease agreement. Accordingly, this condition is not an asset-by-asset approach to recognition and should be determined on a higher level of aggregation. However, a reporting entity will most likely have more than one business model for managing its assets.

The benefit of this model is that 'supporting assets' such as office equipment, auto fleet, coffee machines and minor IT equipment are not recognised in the statement of financial position, unless embraced in the entity's business model or individually material[2]. Consequently, the reporting entities will be relieved from the significant costs and administrative burdens involved in applying the full right-of-use model to these supporting assets. Further, the users of financial statements are provided with more transparent and relevant information about the entity's statement of financial position and its ability to generate future cash flows out of its operating and investing activities.

We believe that the proposed model meets the cost-benefit tests for both users and preparers of financial statements.

Individual materiality condition

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[1] IAS 17,35 Disclosures for operating leases.

[2] *IFRS 8 Segment Reporting* requires identification of operating segments on the basis of internal reports that are regularly reviewed by the entity's chief operating decision-maker. An entity shall report a measure of profit or loss and total assets for each reportable segment. By doing so, the Standard seeks to align the external reporting of financial information with the internal reports. Introduction of a category of 'supporting assets' could be seen as a continuation of this path.

The objective of financial statements is to provide information that is useful in making economic decisions. To be useful, information must be relevant to the decision-making needs of users and thus able to influence the economic decisions of users[3]. As outlined in the previous section, it is our firm conviction that we will fail to meet this basic requirement if the right-of-use model is required on all lease arrangements.

Taking a business model approach could support the objective of focusing on core assets that primarily contribute to generating revenue and cash flow. Other supporting assets such as office equipment, auto fleets, coffee machines, etc., where the net asset value is close to zero and the asset's value is clearly immaterial compared to the total asset value, could be excluded. This argument is supported by the fact that such supporting assets are clearly not included in an investor's valuation of a company as they do not materially affect, for example, the Return on Invested Capital (ROIC) key ratio.

To avoid any misuse of such an exception from the general 'right–of-use' approach, consideration could be given to keeping the current disclosure requirement in IAS 17 to allow users of financial statements to evaluate the judgement made by management.

Learning from generally accepted accounting practice evolved for small items of capital expenditure on plant and equipment, it is possible to apply a materiality approach without imposing an actual materiality threshold in the Standard.

We suggest that the Board, e.g. in a Basis for Conclusion (BC) appendix to the Standard, acknowledges that it is a generally accepted accounting practice not to capitalise small items of capital expenditure on plant and equipment on materiality grounds. It would be inherent that a parallel practice would be used for lease arrangements and thus it would be acceptable not to apply the right-of-use approach on supporting assets on materiality grounds.

Furthermore, we suggest that the Board, perhaps in an Application Guidance (AG) appendix, provides some guidance or suggestions as to possible short-cut methods that could be used to determine which lease arrangements could be excluded on materiality grounds. This is to avoid a requirement to carry out most of the work that would be necessary for applying a right-of-use approach.

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[3] cf. the Qualitative characteristics of financial statements in the IFRS Framework

Reassessment of leasing terms at each reporting date
In the discussion paper, a reassessment of the lease terms at each reporting date is required. We support the proposal that the lease term should be reassessed at each reporting date on the basis of any new facts or circumstances, because we think such an approach is likely to provide users with more relevant information.

However, to keep down the administrative burden, we recommend more clarity as to what, if anything, the lessee needs to do if there are no obvious indications that there have been any changes with material impact. *IAS 36 Impairment of Assets*[4] lists examples of indications that an asset may be impaired. We recommend a similar approach with examples of indications where reassessment of leasing terms, as a minimum, is required.

Exemption for short-term leases
We are very supportive of the fact that the majority of the Board members appear to agree that an exemption for short-term leases should be provided, even if an exemption is limited to leases with a contractual term less than one year without an option to renew the lease. From a practical point of view, an exception with limited disclosure requirements would reduce the administrative burden.

Summary of recommendations
The preliminary views expressed in the discussion paper address many of the criticised areas of the current lessee accounting and appear to have solid standard-setter support. However, from the viewpoint of preparing financial statements, we find that the costs and the administrative burden resulting from the current proposal – which requires the recognition of *all* leases on the balance sheets – in many cases clearly exceeds the benefits for the users of the financial statements if no exclusion of simple leases of supporting assets is accepted.

In contribution to the ongoing deliberation of the lease convergence project, we recommend that the Board consider a cost-benefit perspective. Furthermore, we recommend that the upcoming exposure draft:

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[4] IAS 36,12

- Apply a business model mindset to limit the requirements for supporting assets to disclosure in the notes.
- Support a materiality approach similar to the generally accepted accounting practice evolved for small items of capital expenditure on plant and equipment.
- Confirm that a reassessment of leasing terms is only applicable upon trigger of 'reassessment indications'.
- Confirm the exemption for short-term leases with a contractual term less than one year without an option to renew the lease.

We would like to emphasise that it is in our great interest to enhance transparency and comparability for users of our financial statements by reducing the complexity of the accounting model. However, we are very concerned about administrative burdens that exceed any benefits for the users of the financial information.

We believe that a new standard on leases will achieve a better balance between costs and benefit implications should our recommendations about a business model mindset supported by a materiality approach be accommodated.
As preparers of financial statements, we trust that you will find our views and recommendations helpful.

Yours sincerely,

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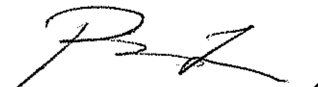

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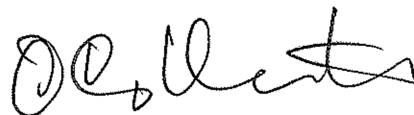

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