la SOCIÉTÉ FRANÇAISE
des ANALYSTES FINANCIERS

September 13th 2013

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Exposure Draft: Leases

Comments by the French Society of Financial Analysts (SFAF)
Financial Analysis and Accounting Commission

Dear Sir,

The French Society of Financial Analysts, SFAF (Société Française des Analystes Financiers), is pleased to submit its contribution as part of the consultation undertaken by the International Accounting Standards Board (IASB) on its Exposure Draft Leases.

SFAF represents more than 1,600 members in France and is itself a member of the European Federation of Financial Analysts Societies (EFFAS) which comprises 27 member organizations representing more than 16,000 investments professionals. Its Accounting and Financial Analysis Commission intends to represent analysts and fund managers in the debate on accounting standards. Financial analysts are among the principal users of corporate financial statements and therefore wish to express their opinion on the implementation of new or revised accountings standards.

For this reason, our Society, through its Accounting and Financial Analysis Commission, is keen to respond to your consultation on this subject. Please note that our Society has already made some comments on the previous Exposure Draft on Leases in December 2010, to which you may refer.

We agree with IASB that Leasing Accounting should be properly addressed, especially when considering the size of the leasing activity (US$ 800 bn of new leases in 2011 according to the World Leasing Yearbook 2011).

As a general comment we understand, as users of financial statements, that the current IAS 17 with the distinction between financial leases and operating leases is not easy to apply and is, as stated by IASB, sometimes a source of heavy structuring in order to avoid recognizing assets and liabilities, and even in some cases, completely abused. In such situations, financial statements might not reflect properly the underlying economic situation. As a consequence, we are pleased to see the Board reviewing the current standard.

We consider however that a lot of drawbacks of the current IAS 17 standard would be properly addressed by improving the current IAS 17 standard in establishing a more robust frontier between both kinds of leases and by improving current disclosure (e.g. value of future rentals, disclosure about optional or contingent rentals).

We have carefully reviewed the Exposure Draft and would like to make the following comments, being uncomfortable with the IASB proposal.

We firstly disagree with one of the main argument for the review (BC 3a)): the fact that users are making adjustments does not mean that the current standard is not working properly: Indeed, analysts and investors are simply making their own judgments when making these adjustments.

Regarding the underlying principle in the Exposure Draft, most of us are rather uncomfortable (as in the previous ED) at least compared to the current IAS 17. For us, the underlying principle of IAS 17 was to put all assets controlled (=financial leases) on the balance sheet, with the corresponding debt. The focus was to give a fair image of the assets required for operating a business. With the latest ED, the underlying principle is more or less to include everything that one could consider as a debt, i.e. the focus is on the liability. We are not convinced that this approach is an improvement, and we are rather uncomfortable with this new “right of use” asset.

Regarding the main new feature of the latest exposure draft, i.e. the introduction of the Type A and Type B classifications, we have difficulties with this proposal, as we do not understand what is different in a lease of a machine and a lease of an office. We believe the wish to simplify (and to reduce costs) the project as stated in BC50 ended in an unconvincing, and largely unsubstantiated classification.

As a consequence, we have difficulties in understanding why the accounting treatment in the income statement of these two types of leases can be different. Very specifically, we are very uncomfortable to recognize a liability in the balance sheet for Type B leases and, at the same time, not recognizing any interest expenses in the income statement. And at the same time if the company has a payable (for a supplier of a good to be sold or for a supplier of an asset) with a maturity longer than twelve month it should recognize an interest component. This inconsistency between the balance sheet and the income statement is for us a major flaw in the ED. Moreover, users of financial statements will be uncomfortable with the ROCE and, symmetrically, with cost of debt, calculated from an income statement that is inconsistent with the balance sheet and will have to make restatements (not because of “judgments” as stated above but because of “inconsistency”). It is amazing that in its Basis for Conclusions (page 118), IASB recognizes that the ROCE ratio may need to be adjusted and that “for Type B leases, (..) part of the lease payments is not reported as interest, whilst the lease liability is a financial liability”.

In addition, when the lease on a property is for a long period of time (20 years...), it is then treated as a Type A leases. We believe this is inconsistent and that introducing a sub-classification based, more or less, on the former IAS 17 is inconsistent and it opens a dangerous door for arbitrage-structuring.

The fact that capacity based leases (fiber optical example, ED 11) are not recognized as leases is, for most of us, rather surprising.

We also underline that lease liability as defined by the new ED excludes payments in optional periods, “unless significant economic incentive to exercise the option”. We think that this wording regarding optional payments may result in opportunistic behaviors from lessors’ management, and strengthen exercise of judgment by issuers of financial statements. Indeed, recognition of an additional liability could be avoided including some subtlety drawn-up period options in lease contracts.

Finally, we believe that the exposure draft opens a very significant number of possibilities to structure lease contracts so has to provide an impact in the financial statements that could differ materially from the underlying economic substance:

- Distinction between less than 12 months / more than 12 months;
- Distinction between service and lease components in a contract;
- Distinction between Type A and Type B;
- Distinction between short & medium term and long term leases on property;
- The notion of an option having a “significant economic incentive”;
- The fact that “real” variable leases payments are not taken into account.

It thus seems that the current exposure draft if full of arbitrage/structuring opportunities, and we fear that the current weaknesses of IAS 17 will simply be transferred elsewhere through new structuring. We fear also that some companies may reduce the length of a lease so as to reduce the impact on the liabilities, thus making them more vulnerable (in particular to any renegotiation of the lease). If the goal of the Board is to improve the image given to users under the current IAS 17, we believe that the proposed leases accounting might, in fact, fail.

In addition, we anticipate that users of financial statements will still make adjustments.

Our understanding is that the choice made by the Boards intends to have a mirror accounting in the lessors financial accounts. But finally, the Boards accept an unsatisfactory classification in the lessee’s account depending whether or not it is a property. We stress that the main goal of this Exposure Draft should be to present an acceptable accounting treatment for leases in the lessee’s accounts.

As a conclusion, we consider that the proposed approach which aims at accounting both finance and operating leases under the same accounting methods doesn't prove to be a convenient solution for users of financial statements. It adds some potential judgment in the value of assets and liabilities to be added on the companies' balance sheets and opens numerous windows for arbitrage / structuration, while it doesn't differentiate between the different natures of finance lease as compared to operating lease. We believe IASB would better help users of financial statements by improving the current IAS 17 standard in establishing a more robust frontier between both kinds of leases and by improving current disclosure (value of future rentals, table of future rentals detailed, year by year, disclosure about optional or contingent rentals…).

We thank you for the opportunity given to us to provide our view on such important aspects of financial reporting and remain available for any further information.

Yours faithfully,

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