

AGENDA PAPER

IFRS Foundation Trustees meeting – Due Process Oversight Committee

Singapore

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DPOC: Correspondence with ACCOR, NH Hotels, Rezidor and Melia International Hotels on Leases

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To: The attention of the members of the Due Process Oversight Committee

Paris, November 4, 2011

IASB Project on « Leases »

Dear Sirs,

1. This letter has been written on behalf on many preparers from diverse industries and countries (see list above).
2. All companies that signed this letter are concerned by the implementation of the future new standard developed by the IASB about the recognition of **leases** and anticipate strong impacts in their financial statements. Companies support the efforts of the IASB to improve the Lease Standard, in order to provide to users of financial statements information of high quality and greater relevance. For these reasons, most of the companies got involved in the standard setting due process by answering to the Discussion Paper and to the Exposure-draft published in March 2009 and August 2010 and/or by participating to the outreach sessions on an individual basis.
3. The purpose of this letter is to contribute constructively to the achievement of a standard of high quality based on conceptual rigour and cost-effectiveness.
4. Companies think that this target can be reached:
 - (a) *By respecting the standard setting due process.*
5. There is few years ago, the IASB and FASB decided to add the lease project to their agenda, quite sure that the current principles didn't provided users with a complete and understandable picture of the entity's leasing activities. Effectively, the current Standard presents some gaps and maybe can be improved especially in the context of the convergence with the US GAAP and in order to provide more relevant information.

6. However, **we do not believe that the current standard is deficient to the extent that it requires to be completely redeveloped**, especially regarding the difficulty that the Boards have to develop a standard of high quality based on cost-effectiveness.
7. In August 2010, IASB and FASB published an Exposure-Draft about Leases. The Boards received more than 800 answers to this exposure-draft. A lot of significant concerns were expressed in these letters traducing the complexity of the project, the difficulty to find a fundamental direction and to justify the project, and highlighting a lot of severe inconsistencies.
Many respondents and participants in round tables and workshops urged the boards to focus on providing a high quality standard, rather than focusing on meeting specific project time lines.
8. In the latest months, the Boards have made great efforts to discuss about these views / issues / concerns by organizing a lot of new outreach sessions in London but also in different countries. We admit also that the Boards try to answer to the concerns made about the complexity of the ED by suggesting and thinking about new principles. During last months, the Boards asked the staff to publish a lot of staff papers with a lot of new reflexions, new principles that have been proposed, suggested, discussed, studied in the various IASB and FASB meetings and in the various outreach meetings. During last meetings, the Boards often changed its mind, taking three steps forward, two steps backwards.
9. These changes of direction lead us to a concern that **the two Boards do not have a clear view or common understanding of the objectives of this project**. We have a lot of doubt about the fundamental direction of this project and the justification for it. IASB and FASB have a lot of difficulties to find accounting models suitable to all leases based on cost-effectiveness.

⇒ For this reason, we think that it is now **time to reconsider the objectives of the project and to re-examine its relevance and the reliability of the information that could be provided with regard to the standard setting due process** in order to publish a standard robust and of high quality and to maintain confidence and trust in both the IASB's standard-setting activities and in the resulting standard.

(b) By reducing the complexity of the principles

10. The exposure-draft proposes principles that are extremely complex and costly to implement in particular for all the equipments used by all entities in their day-to-day business as copy machines, laptops, cars, phones... For entities as ours which have hundreds subsidiaries all over the world, it will be impractical to gather and compile leases' information and to determine appropriate discount rate and future lease payments. **It's a Herculean task.**
11. The standard setting due process states that the IASB have to **consider resource constraints** to evaluate the merits of adding a potential item to its agenda. But, **this criterion appears not taken into account by the Boards** in the Boards' discussions whereas it is crucial in order to develop a Standard of high quality that provides relevant and reliable information to the users of the Financial Statements.

(c) By respecting the Conceptual Framework and in particular the definitions given by the Conceptual Framework and others standards;

12. We aware that the Conceptual Framework is not an IFRS and do not override any specific IFRS. But, the purpose of the Conceptual Framework is to assist and guide the Boards in developing harmonised accounting standards of high quality with the aim to reduce the number of alternative accounting treatments permitted by IFRSs. The Conceptual Framework is the backbone of International Financial Reporting Standards and we think that **Conceptual Framework's principles have to be consistently applied and followed in the development of all the new standards.**
13. **The two characteristics of useful financial information are *relevance* and *faithful representation*.**

In its Agenda Consultation 2011" paper, IASB stress the quality of the IFRSs to be developed, the faithful representation and the reliability of information that could be provided.

But, as suggesting treating all leases as a financing transaction, the Boards do not respond appropriately to the different economic circumstances of different arrangements, which consequently would be not faithfully represented in the financial statements.

Indeed, in most cases, entities sign leases, not for financing reasons, but to benefit from flexibility in case of temporary decrease or increase of business, to concentrate on their core business without having to worry about considerations linked to ownership such as maintenance, insurance or disposal of the asset, to have the opportunity to renew the leased assets, thereby ensuring that they can benefit from the latest available technologies and remain competitive...

It is crucial to develop distinct accounting principles for the two types of leases (leases which reflect financing transactions and leases which reflect other than financing purposes) **and to propose accounting model appropriate for both types of leases in order to represent faithfully the substance of the lease transactions as stated by the Conceptual Framework.** We think, as EFRAG does, that the model of the right of use is not appropriate for arrangements that are not financing transactions and those arrangements should be dealt with service arrangements and remain off balance sheet.

14. The conceptual framework sets down definitions and criteria of recognition

One of the role of the conceptual framework is to set down definitions of asset and liabilities (§ 4.4) and their criteria of recognition (§4.38). It seems for us essential to respect these definitions and these criteria to develop harmonised accounting standards of high quality.

- ⇒ As suggesting including variable lease payments and payments under options in the measurement of the right of use and of the liability, **the Boards do not respect the conceptual framework.** Indeed:
- Variable lease payments (and especially entirely variable lease payments) do not meet the criteria of recognition developed in §4.8 (they cannot be measured with reliability especially when the term of the contract extends beyond the foreseeable future of the companies' projections); and
 - Payments under options do not meet the definition of a liability developed in §4.4 as there is no present obligation.

As we said above, the Conceptual Framework is the backbone of International Financial Reporting Standards and we think that it's crucial that its **principles are consistently applied and followed in the development of all the new standards.**

(d) By respecting the consistency of the principles developed, in particular between the different projects of new Standards

15. The projects of Standards “Revenue recognition” and “Leases” have common issues and in particular the measurement and the pattern of recognition of the variable considerations.

16. In the framework of the Revenue Recognition Project, the Boards have to develop principles about the pattern of recognition of revenue for royalties.

17. Royalties and variable lease payments have similar drivers based on commercial performance, on the fact that no royalty or no lease payment should be received / paid if there are no underlying sales.

⇒ In order to develop standards of high quality that provide relevant information, we think that it’s crucial that the **principles proposed by the Boards in the Revenue Recognition project and in the Leases project are consistent** on those subjects as if existing guidance already existed.

We thank you by advance for the attention that you will bring to this letter. As you understood by reading this letter, **we do not believe that the current standard is deficient to the extent that it requires to be completely redeveloped** but if IASB and FASB want to improve the current standard, we think that it is important to help them to produce a Standard based on sound conceptual basis, on consistent principles and on a practical approach in order to develop high quality accounting standard that brings better-quality information for users as for preparers.

We think that this objective can be reached only by **reconsidering the objectives of the project and by re-examining its relevance and the reliability of the information that could be provided with regard to the standard setting due process.**

Please, do not hesitate to contact us if you require any further explanation or comment on this topic.

Yours sincerely,