MEMO

DE / FROM
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À / TO
IASB members, FASB members and lease staff members

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OBJET / CONCERNS
Contingent rents

The purpose of this paper is to present the views of Accor on the recognition of the contingent rents within the framework of the lease project.

Accor, a French hospitality company, is the world's leading hotel operator and market leader in Europe. Accor is present in 90 countries with 4,200 hotels and more than 500,000 rooms. More than 1,475 hotels are managed under lease of which 619 under variable lease without guaranteed minimum.

I ACCOR'S CONTINGENT RENTS

Accor is used to negotiate **entirely variable rents** based on the performance of the leased asset. The rents are usually based on the percentage of revenue or operating profit of the leased asset. There is no guaranteed minimum.

Example: rents of the hotel equal to 14% of revenue without any guaranteed minimum.

At the end of the financial year 2010, Accor had signed **741 contracts of hotels** with variable leased payments of which 619 without any guaranteed minimum.

Why Accor is used to negotiate this type of rents?

⇨ In order to **transfer the risks inherent to the asset and the business to the owner** of the asset.

1. Each party focuses on its own business:
   - Accor manages the hotels without having to worry about considerations linked to ownership ;

   - The lessor manages the asset, the insurance, the maintenance and participates to the result of the asset, receiving variable rents.

2. The lessor shares the risk of underperformance of the business and receives less rent if the business decreases whereas the lessee shares the risk of over performance and pays more rents if the business performs.

⇨ It's like a "partnership", each of the party works hand in hand. It's not a way to finance the asset.

II WHAT IS THE NATURE OF THIS TYPE OF RENTS

As their amount and timing depend on how the business performs, Accor qualifies these variable lease payments as **operating expenses**.

These variable lease payments are **natural hedges** that allow Accor recognizing less operating expenses if the business decreases. It's easier for Accor to fall rental expenses than employee benefits expense when the business decreases.

For example, in 2009 when the business decreased, rental expenses automatically decreased thank to variable rents. During the same year, in order to decrease employee benefits expense, Accor was obliged to engage a plan of voluntary departures but its effects took place in 2010 only.

These variable lease payments **are not disguised minimum lease payments** as we could read in some staff paper (staff paper 5G / 135). It's very hard and difficult to negotiate entirely variable lease payments because it requires a good understanding with the owner, and to work hand in hand. Accor does not negotiate variable lease payments in order to disguise minimum lease payments but in order to share the risks inherent to the asset and the business with the owner.

Witness, **rating agencies do not reintegrate variable lease payments in Accor's adjusted net debt**. Rating agencies consider variable lease payments as natural hedges. They do not see why variable lease payments should be reintegrated in the adjusted net debt whereas other operating expenses as cost of goods and wages are not.

⇨ **The substance of variable lease payments is operating expenses** and not fixed costs. In application of the "substance over form" principle, variable lease payments should therefore not be reintegrated in the debt as futures wages and futures costs of goods are not.

III Measurement of variable lease payments

Even though, although we do not agree to include variable rents in the measurement of the liability and the asset, if we had to make it, **we wouldn't be capable to make reliable assessments of future variable lease payments over a short term as over a long term period**.

1. In order to illustrate this point, we tried to assess the average variable rental expense that we paid over the last six years:

	Average variable rental expense by contract (in € millions)	Change in the average expense
2005	0,403	
2006	0,541	34,4%
2007	0,506	-6,6%
2008	0,599	18,5%
2009	0,416	-30,6%
2010	0,453	9,1%

This chart shows that the average variable lease payments increased by more than 12% between 2005 and 2010 with fluctuations from one year to the other one by nearly more or less 35%.

These assessments show that:

⇨ It's very **difficult and complicated to make reliable assessments of future variable lease** payments over a short term period as over a long term period.

⇨ The assessments will never reflect the outcome that will happen and we shall be brought to publish misleading information.

2. Moreover, Framework § 4.38 states that "*An item that meets the definition of an element should be recognized if:*
(a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and
(b) the item has a cost or value that can be measured with reliability".

⇨ **Variable lease payments cannot be measured with reliability (see par 1) and for this reason mustn't be recognized as liability in order to be consistent with the Framework.**

IV Consistency with the definition of a liability

Our understanding of the lease project is that future rents are considered as liabilities because they are contractual obligations to deliver cash.
IAS 32 § 25 includes in the scope of IAS 32, liabilities that are contingent to an event beyond the control of issuer. Conversely, liabilities that are within the control of the payer (the lessee), should be excluded from the scope of financial liabilities.

Variable rents that Accor, as lessee, pays to the lessors, are within the control of Accor. Indeed, variable rents paid by Accor depend first on the room price set by Accor but also depend on marketing and sales policies and sales promotion launched by Accor. When business decreases, Accor may decide to fall prices for example or to engage sales promotions in order to increase revenue. Conversely, when business performs, Accor may decide to increase prices in order to increase revenue too.

For that reason, **as variable rents paid by Accor are within its control**, **they do not meet the definition of a liability and should be excluded from the measurement of the asset and the liability**. Please, note that the Boards indicated in the introduction of the ED that "the existing accounting models […] omit relevant information about rights and obligations that meet definition of assets and liabilities […]".

V TO CONCLUDE

As the Boards did during last months, by deciding to make an accounting distinction between two types of leases (finance lease and other-than-finance lease), Accor thinks that it will be relevant to make an accounting distinction between two types of rents:

A) Rents that have the substance of fixed expenses and that meet the definition of a liability (corresponding to the fixed costs and the contingent lease payments based on indices or rates)

⇨ Those rents will be included in the measurement of the liability to make lease payments.

B) **Rents that have the substance of operating expenses**, of natural hedges and that do not meet the definition of a liability and cannot be measured with reliability (corresponding to variable rents based on the performance or usage of the asset).

⇨ **Those rents will be excluded from the liability and recognized in profit or loss when the underlying sales on which they are based, are made.**