

Dear Mrs. McBride,
Dear Mr. Watchman,

I'm responsible for the consolidation of the Oosterdam Group (Amsterdam). Oosterdam (a privately owned company) operates in the retail market for girls' and women's clothing via the chains PIMKIE, ORSAY, GRAIN DE MALICE, PHILDAR (clothing and knitting wool) as well via a brand of lingerie ROUGEGORGE. Over the financial year 2015, turnover was 1.146 million Euro (31-12-2014: 1.119 million Euro). At year-end 2015, there are more than 1.500 own stores in 19 European countries. Main markets are France and Germany. The group is a highly decentralized organization. Compared to competitors as Inditex (Zara) and H&M, we are a small company. Competition is fierce and margins are under pressure.

We prepare the consolidated financial statements in accordance with IFRSs, as approved for use in the European Union. IFRSs are the "common accounting language" of the group.

We are currently assessing the impact of IFRS 16. As almost all of the stores are leased (operating leases), impact of IFRS 16 will be extremely significant. Operating Lease Expenses (Buildings and Stores) amount to 186 million Euro in 2015.

To put it in a very schematic way, there are 2 major problems for the implementation of the new standard.

1. The availability, configuration and maintenance of a module for the administrative organization, for the financial and accounting system (and related internal controls) of the lease portfolio.
2. The determination of the lease term, as the lease term determines which lease payments will be included in the measurement of the lease liability.

With regard to the 1st problem, at this moment in time, no such sophisticated module exists. We have been informed that SAP (most of our brands (but not all) use SAP) is currently developing such a module. When this module will be available, interfaces will have to be built with the currently existing software modules used for the operational administration (contract management) of the store leases. As store lease contracts are different country by country (different legal requirements and specific regulations apply), we use different software modules (not SAP modules). Leases other than store leases will have to be integrated also.

Implementation costs will be very significant. We do not agree with IASB's expectation (IFRS 16 - Effect Analysis, January 2016, page 32) that, on an ongoing basis, costs will not be higher compared to applying IAS 17. Accounting for operating leases is simpler than accounting for finance leases. Changes in (store) leases occur much more frequently (a.o. due to CPI changes) than in traditional finance leases and reassessment and remeasurement of the lease liability (and ROU asset) is mandatory when lease payments are revised.

We also do not agree with IASB's expectation that we will be able to use existing systems for the management of balance sheet leases.

Furthermore, since our transition to IFRS (2007), we have been working on reducing as much as possible the differences between statutory accounts and IFRS. Implementation of IFRS 16 will create

again very significant differences between statutory accounts and IFRS, with considerable implications for impairment testing and deferred taxes.

At this stage, we cannot yet quantify the one-off and ongoing costs of applying IFRS 16.

With regard to the 2nd problem, the assessment of the lease term is a critical estimate and is highly judgemental. (IFRS 16, paragraphs 18-21 and Guidance B34-40).

18 An entity shall determine the lease term as the non-cancellable period of a lease, together with both:

- (a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
- (b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

19 In assessing whether a lessee is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease, an entity shall consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise the option to extend the lease, or not to exercise the option to terminate the lease, as described in paragraphs B37–B40.

B40 A lessee's past practice regarding the period over which it has typically used particular types of assets (whether leased or owned), and its economic reasons for doing so, may provide information that is helpful in assessing whether the lessee is reasonably certain to exercise, or not to exercise, an option. For example, if a lessee has typically used particular types of assets for a particular period of time or if the lessee has a practice of frequently exercising options on leases of particular types of underlying assets, the lessee shall consider the economic reasons for that past practice in assessing whether it is reasonably certain to exercise an option on leases of those assets.

“Reasonably certain” can and will mean different things to different people. Location is a key determinant for our stores. As most of the chains are relatively old (70's and 80's), key locations are occupied on average for a very long time. Losing a location to a competitor can mean that we have to wait several years before we can again open a new store.

Almost all lease contracts contain an option to extend the lease after the initial term (legal minimum of 9 years in France, generally 15 years in Germany). In France, the lessee has the right to renew the lease after the lease term and the lessee can terminate the lease at the end of each 3-year period. Please note that in France, due to the lessee's right of lease renewal (a rule of public policy), certain leasehold rights are regarded as having an indefinite useful life and are therefore not amortized.

In Germany no legal right of lease renewal exists. Leases often include an option to renew for a further five years. There is often an option for the lessee to break at five years. Indefinite term leases exist.

Current calculation of off-balance sheet lease commitments is generally based upon the first option for the lessee to terminate the lease. Off-balance sheet lease commitments (undiscounted) amount to 696 million Euro compared to a consolidated balance sheet total of 608 million Euro as at December 31, 2015.

We have started a pilot project in two of our companies. Main goal is to establish the rules and criteria that should be taken into account when determining the lease term. This should then lead to an initial estimation of the amounts to be recognized as financial liabilities.

Based upon what is said above, we estimate that the recognition of off balance sheet leases will be substantially higher than the amounts disclosed in the notes as Off-balance sheet lease commitments.

This will inevitably lead to at least a higher cost of borrowing, if not a problem of access to financing.

At time of transition to IFRS, the choice has been made to use the same accounting principles for financial reporting and management reporting. This reduces complexity and costs of defining and maintaining different sets of rules and financial figures. It facilitates and reinforces communication and coordination between management, finance departments and people in the organization who direct the operations (down to the level of the store).

Implementation of IFRS 16 will force us to reconsider this choice. Compared to IAS 17, IFRS 16 has a counterintuitive impact on the Profit and Loss and Cash Flow Statement, so communication with people without an accounting and finance background will become very difficult.

In this respect, we prefer the US GAAP model, with the straight line recognition of the operating lease expense and the presentation as a single expense within Operating costs in the Income statement and within Operating activities in the Cash flow statement. The advantage of the US GAAP model is also that previous years' comparability of Operating profit, EBITDA, Finance cost and Cash flow statement will not be affected.

For our group, implementation of IFRS 16 will be much more challenging and impacting than the transition to IFRS.

Wouter Janssens

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