Liberté • Égalité • Fraternité
RÉPUBLIQUE FRANÇAISE

AUTORITE DES NORMES COMPTABLES
5, PLACE DES VINS DE FRANCE
75573 PARIS CÉDEX 12
Phone (+ 33 1) 53.44.28 53
Internet http://www.anc.gouv.fr/
Mel patrick.de-cambourg@anc.gouv.fr

Chairman

PDC N° 82

Paris, December 7th , 2016

Mr Jean-Paul GAUZES
Chairman – EFRAG Board
35 square de Meeûs
B1-000 Bruxelles
Belgium

Preliminary Consultation Document regarding the endorsement of IFRS 16 "Leases"

Dear Mr Gauzes,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above-mentioned *Preliminary Consultation Document* issued in October 2016 regarding the endorsement of IFRS 16 Leases. This letter sets out the most critical comments raised by interested stakeholders involved in ANC's due process. Our Board has reviewed and approved this letter on December 2nd 2016.

The detailed responses to the IASB's and EFRAG's questions are included in Appendix A.

ANC welcomes EFRAG's efforts to fulfil the European Commission requirements for performing a true and detailed IFRS 16 impact analysis early 2017. ANC also welcomes the efforts made to promptly carry out the endorsement process. Nonetheless, as regards the due process, ANC believes comments on the *Preliminary Consultation Document* would have been more meaningful if they had been made in the light of the impact analysis conclusions. Hence, ANC draws EFRAG's attention on the fact that the views presented in this letter have been established without having an enlightened opinion of the expected effects of the implementation of the new standard. For this reason, ANC considers that the impact analysis results that will be published in 2017 may lead to the need to reconsider the responses made by ANC's constituents to the EFRAG's *Preliminary Consultation Document*.

ANC also highlights the fact that this comment letter mostly aims at reflecting the positions developed by the preparers and users participating in our working group as the *Preliminary Consultation Document* questions focus more on technical and application issues rather than on conceptual considerations.

Finally, ANC highlights the fact that the detailed comments attached in Appendix A tend to exactly respond to the questions the *Preliminary Consultation Document* raises, without reconsidering the underlying conceptual issues on which the European Commission will have to take a position.

However, ANC believes that some conceptual issues could be further discussed in the final endorsement advice in order to ensure positions taken by the European Commission are consistent with the true and fair view, i.e. all the Accounting Directive provisions, which notably implies focusing on the concept of prudence. ANC also considers that the European Commission should ensure that the new concepts introduced (such as the Right of Use) will have no pervasive impact adversely affecting the national sets of accounting standards, in particular when used by small and medium entities.

Please do not hesitate to contact us should you want to discuss any aspect of our comment letter.

Yours sincerely,

Patrick de CAMBOURG

Appendix A

Comments presented below are a synthesis of ANC's views prepared with ANC's working group participants representing preparers, users and auditors.

APPENDIX 1 – Summary of IFRS 16

Question 1

Do you have any information or evidence on the extent to which leases (that you are party to or otherwise aware of) will be eligible for the short-term and low value exceptions identified in paragraph 24 above? If so, provides details.

If you are a preparer, do you expect to use the exceptions? If so, please:

(i) Quantify the number and annual lease payments for each category

(ii) Indicate the proportion of your leases (by volume and/or value)

ANC's stakeholders have started analysing their lease contracts. However they are still at an early stage of the process. Most entities participating to ANC's working group have decided to use the lease exceptions in order to limit the recognition of a right of use for lease contracts previously identified as "operating lease" and benefit from the cost relief proposed in the standard.

The first step of the IFRS 16 transition projects is to identify and analyse lease contracts that will have to be recognized as an asset and a liability. Preparers (including those at an advanced stage of the transition process) have underlined that they have no evidence of the volume and value of lease contracts that will be excluded and disclosed in the notes to the Financial Statements. Preparers have indicated that:

- Most IT, office equipment and some copiers are expected to benefit from IFRS 16 low value assets exception.
- Since lease contracts usually contain renewal options (more than 12 months), IFRS 16 exception for short term leases is not expected to have significant effects.

As regards the 5 000USD threshold mentioned in the Basis for Conclusions:

- Preparers have indicated that some of them will develop Group's accounting policies for leases similar to tangible and intangible assets (IAS 16, IAS 38) accounting policy. It means that contracts below the 5 000 USD threshold will benefit from the exception. For contracts over 5 000 USD, some preparers are planning to define in their accounting policies a higher materiality threshold (by assets' category), as long as the cumulative effect of this threshold remains immaterial.

- Preparers have underlined the fact that vehicles' fleets will not be included in the definition of small value assets and will be accounted for in accordance with IFRS 16.

Question 2

If you are a preparer which approach to transition do you expect to take? Please explain your reasons for this decision.

It results from the discussions held at ANC's working group with preparers that a majority of their Executive Management has not yet decided which transition method will be used.

Decisions will probably depend on:

- The desire to provide users with comparative data. Entities considering that they need to provide comparative financial data in their financial communication will likely use the full retrospective method. Those entities consider that preparing pro-forma financial information is not an acceptable method as the comparative figures will not appear on the face of the balance sheet.
- Whether entities consider they do not need to disclose comparative information, in which case they will focus on the following criteria to choose their transition method:
    - Impact on the Financial Information presented and on Alternative Performance Measures (impact on the total debt and EBITDA presentation and subsequent period amortisation costs). It has to be noted that the higher the amount of liabilities recognized are, the higher the EBITDA will be. However non-cash subsequent periods amortisation costs will affect the operating income. Hence, the presentation of the statement of Profit and Loss will be modified and will require users to adjust the way they read the financial information.
    - Costs / benefits: Depending on the nature and number of lease contracts, efforts to be made and the cost relief proposed by the simplified method are variable. The burden will be specifically difficult to cope with for entities having the following characteristics:
        - Multiple sites or entities
        - High number of medium size lease contracts (e.g. plant equipment, elevators....)
        - Complexity to determine the historical borrowing rate to use (resulting from the need to identify renewal options, contracts modification...).
        - For the full retrospective method entities have highlighted the fact that it may be difficult to determine the applicable borrowing rate (lease implicit interest rate or when unavailable lessee's incremental borrowing rate) at inception of the contract.

In ANC's view, it would have been appropriate to provide an alternative approach permitting entities to prepare their financial statements with comparative figures using the simplified method.

Preparers have reported that it would be worth providing the endorsement advice early enough to enable preparers apply by anticipation IFRS 16 in conjunction with IFRS 15.

APPENDIX 2 – EFRAG's technical assessment of IFRS 16 against the endorsement criteria

Question 3

Are you aware of :

(i) Any contracts that you consider to be leases that would not be classified as leases under IFRS 16; or

(ii) Any contracts that you consider to be service contracts (or other non-lease contracts) that would be classified as leases under IFRS 16?

If so, please provide details of these contracts and why you consider that the classification would not be appropriate.

It appears from the discussions held at ANC's working group level that most entities do not anticipate difficulties to apply the provisions replacing IFRIC 4 in the new IFRS 16 standard. However, entities currently applying IFRIC 4 will need to scrutinize those contracts to check if their accounting treatment shall remain the same after the transition date or not.

ANC's stakeholders underline the need for EFRAG to present in detail the issues raised during the 2016 second quarter field test performed by EFRAG's staff, evidencing for instance the following points:

- The existing differences and the potential impacts of the different definitions of control (IFRS 10/15/16) are neither identified nor discussed in the Preliminary Consultation Document.
- Some IFRIC 4.9 criteria, used to determine if an arrangement conveys a right to use the asset, have not been introduced in IFRS 16. Actually, IFRS 16 focuses specifically on the right to obtain economic benefits from use of an asset and the right to direct the use of an asset, but does not refer to the price a purchaser would pay for the output. ANC agrees with this approach. However ANC underlines the fact that, in this regard, differences between IFRIC 4.9 and IFRS 16 may arise.

  Our comments refer to IFRIC 4.9.c stating that *"Facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than an insignificant amount of the output or other utility that will be produced or generated by the asset during the term of the arrangement, and the price that the purchaser will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit* of output as of the time of delivery of the output".

  At this stage, previous IFRIC 4 complex contracts are still under review and impacts have not been assessed yet.

Question 4

EFRAG is interested in understanding whether leases of intangible assets (other than rights held by a lessee under licensing agreements within the scope of IAS 38) are common. Do you have any information or evidence as to how frequently such leases of intangible assets arise in practice? If so, please provide information about the types of intangible assets that are subject to leases and the significance in operating and monetary terms.

Once licensing agreements have been excluded, we have not identified at this stage significant other leases on intangible assets. However, it appears that there are still discussions aiming at determining whether or not certain assets such as wave length or hertzian frequencies have a physical substance. Based on the fact that wave lengths are measurable, some consider they have a physical substance. However, if such assets are analysed as intangibles assets, they will probably benefit from the IFRS 16 option.

More generally, ANC agrees with the IASB comments presented in the Basis for Conclusions specifying that the exclusion of intangible assets has no conceptual basis and encourages the IASB to keep on investigating what is the best accounting representation of leased intangible assets in the future.

APPENDIX 3 –Assessing whether IFRS 16 is conducive to the European Public Good

Question 5

Do you have any comments on the comparison of IFRS 16 with IAS 17?

ANC does not have additional comment on the IFRS 16/IAS 17 comparison.

Question 6

Do you have any views or information on how IFRS 16 can be expected to affect the behavior of investors and/or lenders? If so, do you have any views or information on whether and how IFRS 16 could, for European companies that apply IFRS, positively or negatively affect:

(i) The overall cost of capital

(ii) Access to finance and cost of credit?

Please provide any available evidence.

Question 7

Do you have views or information on how IFRS 16 might affect entities' use of leasing? For example, do you expect lessees to:

(i) Reduce their use of leases with a corresponding increase in purchases of assets;

(ii) Reduce their use of leases without a corresponding increase in purchases of assets;

(iii) Seek to change the terms of new or existing leases?

Please provide any available evidence

Question 8

Do you have any additional information or views on how the endorsement of IFRS 16 can be expected to affect the leasing industry in Europe? EFRAG is particularly looking for views from the leasing industry.

Please provide any available evidence.

Responses to questions 6 to 8:

ANC has no evidence on how IFRS 16 will exactly affect investors' / lenders' behavior. However, ANC presents below the views expressed by stakeholders during ANC's working group discussions.

- The fact that leases are accounted for as assets and liabilities in the balance sheet may change the arbitration between purchased assets and leases performed by some lessees.
  Some entities are planning to change their investment strategy and increase the number of acquired assets while reducing the number of operational leases. However, it has been underlined that operating leases also tend to reach other objectives such as flexibility or access to financing. Entities anticipate monitoring flexibility and financing requirements through the use of lease contracts.
- One entity has identified the accounting impact of IFRS 16 approach to lease contracts denominated in foreign currency to be an issue as regards its implementation.
  In fact, assets and liabilities of a lease contract denominated in foreign currency will not be symmetrically re-measured in the subsequent periods. On the debt side the effects of the exchange rate variations will be reassessed and booked in the statement of profit and loss.

Conversely, exchange rates variations will not lead to IFRS 16 right of use reassessment, generating an accounting mismatch and increasing the profit and loss statement volatility.

- Some entities are planning to review the lease term and renewal options available in their contracts before implementing IFRS 16. Certain preparers may expect lessors to charge additional costs due to the renegotiation of some contracts (change of the term of the contract, of renewal options...).

  Even though the implementation of IFRS 16 is not expected to lead to breaches of covenants, entities are anticipating additional costs when renegotiating covenants.
- ANC does not have any data providing information on the potential effects on access to and cost of capital (due the changing apparent leverage) or on expected modifications of the pricing by lessors.
- Participants of the lease industry have indicated that they are expecting lessees to ask lessors for more detailed information on lease contracts.

Question 9 Do you have any information or views on how the endorsement of IFRS 16 can be expected to affect SMEs in Europe? Please provide any available evidence.

- In France, IFRS are not mandatorily applicable to entity's consolidated financial statements that are not listed on a regulated market. They are prohibited in statutory annual financial statements. In addition, ANC does not expect IFRS 16 to have a material impact on the few French SMEs voluntarily applying IFRS for their consolidated financial statements.
- ANC has relied on Banque de France statistical database to perform a pre-analysis of the potential impact of IFRS 16 on SMEs. The information provided relates to non-financial entities reporting under IFRS. Banque de France has identified 705 entities disclosing financial information under IFRS (as of 25.10.2016).
  - Amongst these 705 entities, 152 entities are identified as non-listed entities and for 175 entities Banque de France does not have the information evidencing if they are listed or not. Amongst the 327 entities, 30 entities have a total balance sheet below 50M€[1] and only 8 entities are below 20 M€. Amongst those 30 entities only 4 entities disclose information on operational lease contracts and lease contracts commitments.
  - Out of the 705 entities, the 378 remaining entities are listed entities (including Public Interest Entities). 39 entities have a total balance sheet below 50M€ and 9 below 20M€. Amongst those 39 entities, 9 entities disclose information on operating leases.

[1] The total balance sheet threshold for SMEs in the Accounting Directive is set at 20M€. Due to the low number of SMEs matching the Accounting Directive Balance Sheet threshold, indications have also been provided for entities below 50M€.
It must be underlined that the Banque de France information only provides information on the total balance sheet, but does not provide information on turnover or number of employees (two other Accounting Directive's threshold for SMEs).

Hence it means[2] that:

- For non-financial entities having a total balance sheet below 50M€ and reporting under IFRS (listed and non-listed) only 13 disclose information on operating leases and lease contracts commitments.
- For entities having a total balance sheet below 20M€ and reporting under IFRS only 3 of them disclose information on operating leases and lease contracts commitments (those 3 entities are listed entities).

For those limited cases, this may imply either (i) that there is a limited number of operating leases or (ii) that a specific effort will be required to identify all operating leases and apply IFRS 16.

Question 10

Do you have any information or views on whether IFRS 16 is likely to endanger financial stability in Europe?

Please provide any available evidence.

In ANC's view, interactions between the accounting effects of IFRS 16 and financial stability should also be analysed as regards prudential ratios.

The banking sector has highlighted the fact that the prudential impact of IFRS 16 is expected to be material for their lease activities as lessees (notably for Groups having a wide network of bank agencies). Therefore, ANC shares the concerns raised by the financing sector as regards the prudential ratios calculation methodology that still needs to be determined by the Basel Committee. ANC's view is that the simultaneous recognition of an asset and a liability shall not lead to an unintended imbalance for prudential purposes.

Question 11

What is your view on the relative costs of applying IFRS 16 and US GAAP? Do you have any other views as to the advantages or disadvantages of IFRS 16 compared to US GAAP?

Please provide any available evidence.

It is generally felt that applying US GAAP may prove to more complex, and therefore possibly more costly.

From a general standpoint, preparers have underlined the following accounting differences regarding operating leases:

- Under US GAAP, the lease cost is steady over the lease term whereas IFRS 16 leads to higher costs in early years (declining interest costs+ straight line depreciation);

[2] The main limit of this analysis is that the Banque de France database excludes some entities (notably banks and insurance) and is not complete. However, this database is, to ANC's knowledge, the more accurate database available in France.

- Under IFRS, both lease costs (interest + depreciation) are outside of the EBITDA.

Some preparers have mentioned to ANC that the perceived advantage provided by US GAAP in having a steady lease cost, is somewhat compensated under IFRS by the classification of lease costs below EBITDA.

ANC acknowledges the fact that:

- Under IFRS 16 the income statement will split the impact of depreciation and interest between operating costs and finance costs.
  In a similar approach, the cash flow statement may present separately interests and principal, the first ones being presented either as operating or financing activities and the principal reimbursement as financing activities.

- In US GAAP, former off-balance sheet leases will be presented as a single expense in the income statement (operating costs will encompass depreciation and interest).
  The cash flow statement will present the expense as operating activities and there will be no impact on financing activities.

In this regard, preparers have indicated they believe that comparing financial statements established under both sets of accounting models will be difficult. Preparers are expecting users to ask for additional information to be able to reconcile the two models and perform comparison between entities within the same industry. If such anticipation is confirmed, additional costs are expected to arise.

Question 12

What is your view on the one-off and ongoing costs for preparers? (Please indicate whether you are (a) a lessee (b) a lessor (c) both a lessor and a lessee (d) neither a lessor or a lessee).

Will preparers that already report finance leases have lower costs than preparers without finance leases?

Please provide any evidence you have on the expected magnitude of the costs.

Most preparers have launched or are currently launching their lease projects. Most of them are still at an early stage of IFRS 16 implementation and unable to assess the total expected cost of IFRS 16 transition or of future on-going costs.

Preparers however underline the fact that there will be a cost to acquire or develop an IT tool able to fulfil IFRS 16 requirements.

Question 13
If you are a user, are you aware of any costs in addition to those identified by EFRAG in § 116 to 118 of Appendix 3? Please quantify if possible and provide any available evidence.

Users have reported in ANC's working group that even though considering IFRS 16 to be useful as regards the additional information provided on lease contracts, they may, in some instances, need to keep on adjusting data provided in compliance with the new lease standard, in particular as regard EBITDA and its interpretation.

Question 14
If a lessee has to develop new systems to support the accounting for leases, to what extent do you, as a lessee, expect internal benefits from the information provided by the new information? Please quantify to the extent possible. Do you agree with the benefits for users and preparers identified above? Are there any additional benefits for users and preparers? Please provide any available evidence.

- No significant internal benefit is expected.
- At this stage, preparers have underlined the fact that there is no IT tool available to process lease contracts in accordance with IFRS 16. Hence if the transition process and lease contracts follow-up need to be manually performed or if entities need to develop their own IT tools, transition costs may be material. In addition, the fact that no standardised IT tool exist will require strengthened internal controls to ensure Financial Statements are accounted for in accordance with IFRS principles.
- In some entities, internal control processes are expected to change (on-going follow-up of lease contracts in accordance with IFRS 16) as well as authorisation processes for operating leases (OPEX versus CAPEX decisions)

And finally...

Question 16
Are there any issues that have not been raised in the Preliminary Consultation Document that should be considered by EFRAG? Please explain your view.

In ANC's view, EFRAG's Preliminary Consultation Document should assess true and fair view as defined in the Accounting Directive, which implies complying with all Accounting Directive provisions and more specifically with the concept of prudence. It must be noted that the concept of prudence is not defined as *"caution in conditions of uncertainty"* (Appendix 2 §183) in the Accounting Directive.

In ANC's view, the IFRS 16 conceptual position leading to recognize lease contracts as an asset and a liability in the balance sheet relies notably on a widened definition of control and a specific vision of the economic substance of a lease contract. ANC suggests that this context be usefully recalled in

EFRAG's conceptual analysis in Appendix 2 (§21-22) and Conclusion (§85) in adding: *"Introducing the Right of Use related to operating leases is relevant on the basis of the emphasis put on economic reality and commercial substance which is justified, in EFRAG's view, for those financial statements prepared under IFRS".*