

25 September 2014

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

Dear Hans,

**IASB Tentative Decisions on “Leases”**

We refer to the Project Update on Leases which was issued by IASB on 7 August 2014.

We are disappointed with IASB’s tentative decision to revert to the single model approach for lessee accounting which requires the recognition of interest and amortization in the income statement for all leases recognized on a lessee’s balance sheet.

We had expressed our disagreement and serious concerns on the proposed requirements under the single lessee accounting model in our response dated 20 December 2010 to the 2010 Exposure Draft (“ED”) on Leases. We do not agree with the view that all leases create debt-like liabilities. The single lessee model is overly simplistic and does not take into consideration the real economic differences between different types of leases. Our concern, in particular, is on the accounting treatment for retail property leases. We reiterate that in Asia at least, these lease arrangements do not have any structuring or financing elements. Under retail property lease arrangement, both the tenant and the landlord share the economic benefits and assume obligations over the lease period.

I am afraid that the new proposals from the IASB will render accounting statements for retail companies such as Dairy Farm at the least highly confusing and requiring material adjustment to make them intelligible and useful to any of their users. The economics reflected in the financial statements front-end loading of financing charges will be precisely contrary to the economic reality of retailing where the value of a site increases for an incumbent as it establishes itself. In this respect, it will provide more decision-useful information to users on the operating performance of a retailer if retail property lease payments are classified as part of the operating expenses under one single line in the income statement.

While we accept the proposed principle that an entity should recognize in the balance sheet assets and liabilities arising from all leases, we do not agree with a single model approach to recognize lease payments in the income statement as explained above. We consider that the existing distinction between finance leases and operating leases in the income statement under IAS 17 should be retained for the purpose of income statement classification in order to address different types of lease transactions.

Notwithstanding the above, we supported the Boards’ proposed dual lessee model in the revised ED issued in 2013 as a pragmatic approach to address the different economics of

different types of lease transactions in the financial statements. However, the Board is now backing away from the dual lessee model without properly addressing the issues relating to the accounting treatment for retail property leases or leases of similar economics. This is a major drawback to the proposed new lease accounting standard and very disappointing particularly since it represents a u-turn from the previous ED issued by the Board.

We draw the Board's attention again to our disagreement and concerns on the proposed single lessee model as summarized below. Copies of our comment letters dated 20 December 2010 and 19 September 2013 are attached for your reference.

#### Retail property leases do not contain financing component

- The majority of the retail property leases is executory in nature and do not have any structuring or financing elements. The lease terms are short relative to the useful lives of the properties.
- The owner of the leased asset retains substantially the risks associated with the asset and is entitled to most of the future benefits of the asset including its residual value.

Jardine Matheson's pan-Asian retailing group, Dairy Farm, is a lessee with more than 5,800 property leases. Dairy Farm does not have the intention to own the properties in which its retail outlets are located nor to manage the risks associated with property investment. Most of its leases especially in Hong Kong and Singapore have very short fixed term of three to five years.

#### Sharing of economic benefits and obligations under a retail property lease

- During the lease term, the lessee has an obligation to pay rent to the owner as it receives economic benefit from the use of the property. On the other hand, the owner or the lessor has the obligation to maintain the underlying property in good condition and to ensure proper management of the property for the use of the lessee throughout the lease period.
- For certain retail property leases (such as Dairy Farm's retail outlets in shopping malls in Hong Kong), the rental payment may contain a basic rent and a turnover rent which is determined in relation to the lessee's sales. It demonstrates that the landlord has the incentive and continued responsibility to properly manage the quality of the mall or the tenant mix in order to attract customer traffic and hence, increase overall rental income.
- The lessee will not prepay the rent in full, under normal circumstances, but rather pay regularly as the lessor fulfills its performance obligation during the lease period. There is no financing consideration involved in the payment arrangement.

#### Distortion of financial parameters on performance, leverage and liquidity measurement

- The proposed single lessee model will provide misleading information to the users of the financial statements on the operating performance of a retail business by recognizing front-loaded financing charges to income.
- This is the opposite of the economic benefit generated from a lease which is generally increasing as the store takes time to mature with growth in sales and profit over time.
- For a retail industry, the key ratios used by the investment community are mainly EBITDA which serves as a proxy for the cash flow generated from the business. Under the proposed single model, cash payment for the "principal portion" of the lease liability is classified as financing activity in the cash flow statement. The analyst is still required to make adjustments to the reported financial information so as to strip out the above accounting impact to focus on actual cash flow for operating performance analysis.

#### Higher operating cost and complexity to implement the single lessee model

- It is more complex and costly to account for retail property leases under the single lessee model. Higher cost is required for upgrading system capability in order to keep track of the

numerous lease information required for the recognition and measurement of interest and amortization.

- On the other hand, if the current distinction between finance and operating lease is retained, it will ease implementation and reduce complexity for the retailers.

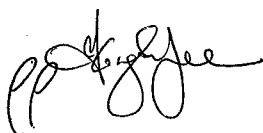
#### Discount rate applied in the measurement of lease liability

- We had requested the Board in our previous comment letters to include guideline on how to derive an appropriate discount rate for entities which are cash rich or have no third party debt. We note that, so far, the Board has not addressed this issue in its re-deliberations.
- Financially strong companies with better credit rating may tend to have lower incremental borrowing rates and may end up with a higher lease liability and right of use asset when compared with companies of weaker credit rating in the same lease transaction. This is counter-intuitive and creates unnecessary distortion of the financial position of companies and detracts from comparability among different companies.

We strongly urge the Board to address the above issues on the accounting for retail property leases before issuing the final lease accounting standard. We believe that the current distinction between finance and operating lease should be retained for income statement recognition and measurement. This will provide not only more meaningful information to the users, but will also ease implementation difficulties and reduce complexity for the retailers.

If you have any questions on the content of this letter, please do not hesitate to contact me.

Yours sincerely,



James Riley  
Group Finance Director

c.c. Hong Kong Institute of Certified Public Accountants

#### About the Jardine Matheson Group

Founded as a trading company in China in 1832, Jardine Matheson is today a diversified business group focused principally on Asia. Its interests include Jardine Pacific, Jardine Motors, Jardine Lloyd Thompson, Hongkong Land, Dairy Farm, Mandarin Oriental, Jardine Cycle & Carriage and Astra. These companies are leaders in the fields of engineering and construction, transport services, insurance broking, property investment and development, retailing, restaurants, luxury hotels, motor vehicles and related activities, financial services, heavy equipment, mining and agribusiness. The Group had revenues (including the revenues of associates and joint ventures) of US\$61 billion in 2013 and total assets of almost US\$64 billion at the end of 2013. It employs some 390,000 people.

Jardine Matheson Holdings Limited is incorporated in Bermuda and has its primary listing on the London Stock Exchange, with secondary listings in Bermuda and Singapore.

Jardine Matheson is one of the pioneers in adopting International Financial Reporting Standards, having first prepared its financial statements in accordance with IFRS in 1990.