Leaseurope

The Voice of Leasing and Automotive Rental in Europe

Sir David Tweedie, Chairman
International Accounting Standards Board

Brussels, 31 January 2011

Dear Sir David,

Leaseurope, the trade association representing the European leasing and automotive rental industry, welcomes the opportunity to comment on the International Accounting Standards Board's **Request for Views on Effective Dates and Transition Methods**.

Our response focuses on the future Leases standard. Of the standards within the scope of this Request for Views, we consider that the Leases standard, should it remain unchanged compared to the Leases Exposure Draft, will be amongst those that will generate the highest costs for preparers of accounts, without bringing about much improvement for users of accounts. With the extremely high level of feedback the Board has received from other constituents echoing this view, we would expect to see a number of fundamental changes made to the proposals. In our opinion, re-exposure of the proposals is necessary and may obviously change the views expressed herein on the costs that preparers would incur as a result of implementation of the standard as well as on its wider financial reporting and economic impacts. However, as the proposals stand, we do not consider that the IASB has achieved a reasonable cost/benefit balance.

Regarding the implementation timetable, we consider that if a new Leases standard is issued, it should be implemented at the same time as other key standards (Revenue Recognition, Insurance, Financial Instruments and Fair Value Measurement). The effective date of this group of standards should be no earlier than 1 January 2015. However, this date does not provide any buffer for delays that may occur in standard development, finalisation and implementation. Therefore, and particular in light of the pervasive nature of the standards in question, we consider that 1 January 2016 would be a more realistic effective date. Should any delay in finalising these standards arise, their effective dates will have to be pushed back accordingly.

We thank you for taking the time to consider our response and remain at your disposal to discuss any of the issues raised in this letter further. Please do not hesitate to contact us or Leaseurope's Senior Adviser, Jacqueline Mills (j.mills@leaseurope.org, +32 2 778 05 66) for any additional information you may require.

Yours sincerely,

Tanguy van de Werve
LEASEUROPE DIRECTOR GENERAL

Mark Venus
CHAIR, LEASEUROPE ACCOUNTING COMMITTEE

Question 1. Background information

Leaseurope is responding to this Request for Views as the representative body of the European leasing and automotive rental industry. The firms represented through our membership[1] provide leases and related services to businesses in Europe and are preparers of accounts under IFRS. They are subject to prudential regulation in many countries. Our client base is composed of both large corporates as well as SMEs, in all industry sectors, who apply IFRS or local GAAPs depending on their profile.

As representatives of the lessor community, our response focuses on the IASB's Leases project, which we expect will have significant impacts on our business as well as our clients.

The companies represented via our member associations granted new leasing volumes of over €209 billion in 2009, of which 88% were for leases of equipment and vehicles. In terms of numbers of contracts, this represents well over 5 million individual deals, with an average size of approximately €27,000 per deal. European lessors are responsible for financing approximately 20% of total equipment investment in Europe[2]. During the recession, leasing has been a key external funding source for businesses, with the use of asset finance having increased substantially over recent months. In the second half of 2010, 55% of larger firms and 34% of SMEs in the Eurozone made use of asset finance products, up from respectively 35% and 27% in the first half of 2009[3].

As the above figures show, leasing makes a significant contribution to the European economy and is a vital source of finance for many businesses. Any changes made to the accounting for leasing should take this into consideration and must be designed in such a way so as not to disrupt the important economic role leasing plays.

Question 2. Description of costs for preparers

We consider that the new Leases standard will be amongst those new standards that will generate the highest costs for preparers of accounts, without necessarily bringing about much added-value for users.

Given the current status of the Leases project, it is extremely difficult to answer question 2 of the Request for Views with a great deal of precision. Indeed, the Leases Exposure Draft (ED) comment period has only just recently been completed and it is likely that a substantial number of changes will need to be made as a result of the consistent, critical feedback submitted to the Board on the most fundamental aspects of the proposals. Considering the level of criticism the Board will have to address, in our opinion re-exposure of the proposals is necessary and would obviously influence the views expressed below. We encourage the Board to take into account the feedback

[1] Leaseurope brings together 45 member associations in 32 European countries representing leasing, long term and/or short term automotive rental firms. In 2009, these associations represented more than 1 300 leasing firms and 780 short term rental companies. The scope of products covered by our members ranges from hire purchase to finance leases and operating leases of all asset types (automotive, equipment and real estate) and also includes the rental of cars, vans and trucks. It is estimated that Leaseurope represents approximately 93% of the total European leasing market.

[2] Leaseurope's 2009 Annual Survey of the European Leasing Market

[3] Survey on the Access to Finance of SMEs in the Euro Area, ECB, October 2010

received in the responses to the Leases ED (and other relevant EDs) when considering and forming views on effective dates and transition methods for all the standards covered by this consultation.

In its different forms, leasing is used by almost all businesses as either a means to finance the use of assets or obtain flexible access to assets without bearing asset risk. In the latter case, this use of lease documentation is often similar to a form of outsourcing where the lessee acquires a service from the lessor who takes care of all its asset related needs. It is extremely common for IFRS preparers to have significant numbers (thousands, tens of thousands) of contracts such as these throughout their business. Most of these contracts are currently not managed on a centralised basis, but instead are entered into and dealt with at a de-centralised level as part of general operating expenditure.

The sheer volume of contracts involved, together with the conceptual shift that all leases are considered to be financings, will generate significant costs for preparers. The more than 760 comment letters submitted to the IASB/FASB on the Leases ED nearly all expressed concern surrounding these costs.

We have briefly summarised the main types of costs that businesses will face below and invite the reader to consult our comment letter on the Leases ED[4] for a more extensive description of the issues that companies will face under the current proposals.

I. Lessees

Preparers will be faced with complex judgement calls when determining whether they have a lease contract or a service contract given the lack of clarity of the proposed definition of a lease. As many different types of contracts involve the use of assets and may potentially qualify as leases, this exercise could be extremely burdensome, particularly for firms with high volumes of low-value contracts. The assessment of whether a contract is a lease is likely to require the involvement of external advisers in some cases, leading to additional costs. This applies not only to contracts that will be entered to into the future but also to existing contracts. Indeed, entities will be required to re-examine significant numbers of existing transactions to establish whether or not they are leases or contain leases. Simply finding and reviewing this documentation will be a costly task in itself.

Companies who make use of lease documentation to effectively outsource asset related needs will be faced with either purchasing or creating and then managing asset registers and accounting for these assets. Even these relatively simple aspects of accounting will be problematic and costly for these entities as they will have enter into these contracts precisely to avoid the costs associated with setting up and running such systems.

Businesses will have to analyse the service components that are part of lease contracts. Currently, one of the major benefits of a lease is that lessees do not have to consider such aspects. Instead they receive a single invoice encompassing all the costs related to the use of the asset, including services. In the future this will change, and companies will have to seek detailed information on these components, possibly from various sources.

[4] Our comment letter to the Leases ED can be consulted via the following link: http://www.leaseurope.org/uploads/documents/positions/pp101215.pdf

Businesses who rent equipment to align their revenue and expense patterns will no longer be able to do so and will have to deal with burdensome book/tax timing differences.

Requiring firms to make assessments of their most likely lease term, contingent rental payments and payments under residual value guarantees will create significant burdens. Many companies will have opted for contracts with such features because of the flexibility and simplicity they offer and simply do not possess the data or the resources to make the assessments that will be required under the new standard. This is true for companies of all sizes and is a particular problem when it comes to those firms who have many small leases that will need to be dealt with in this way. Requiring reassessments of these estimates will lead to even more costs for lessees.

It should be noted that whilst lessees may be able to manage some of the complexities noted above at the level of a single lease contract, a much more significant form of complexity and thus costs arise in the organisational process required in entities to collate, verify, assemble and present reporting on the many leases that are managed in varying locations around the company. These leases will all be different from one another and in many cases cannot be aggregated and dealt with by using portfolio approaches.

As an illustration of the burden that preparers would incur in applying the new standard, our members have undertaken a preliminary analysis of the number of steps an entity would have to go through to account for their leases in the future, in comparison to what is required under the existing standard[5]. They estimate that in the case of the new standard, preparers would have to go through more than 75 individual steps, requiring access to various documentation, experts or other information sources, for each of their individual lease contracts. In comparison, a lessee would have to deal with approximately 30 steps under existing guidance for a finance lease and around 10 steps in the case of an operating lease.

With the use of leasing being so wide spread, firms will need to make fundamental changes to their decision making processes, financial reporting systems and internal controls, amongst others. Results of a survey of European preparers[6], conducted between May and August 2010, show that to cope with the new leases standard lessees will need to make significant changes to reporting and closing processes, budgeting processes and IT systems in particular. These changes will also have to be accompanied by appropriate training programmes of staff involved.

According to the same survey, the vast majority of lessees currently do not have the necessary information and resources in place to be able to implement the standard, or only have these in place to a limited extent. European preparers are thus clearly far from being ready to apply a new standard and will therefore need a lengthy lead-time to prepare for implementation.

[5] See for instance the Finance and Leasing Association (FLA) comment letter to the Leases ED.

[6] "Are you ready for the new leases standard? Preparers' Views on new Lease Accounting: European Impact Survey 2010", PWC Accounting & Valuation Advisory Services

Lastly, it should be noted that many businesses are likely to be both lessees and lessors and thus will have to implement the new proposals and bear the related costs on both sides of their activities.

II. Lessors

The ED describes two accounting models for lessors that are very different from today's accounting. Both of these fail to represent the economics of leases, distorting their balance sheets and P&L statements and, in many cases, understating their profitability. This implies that lessors would be required to set up costly new reporting systems and processes to apply models that are fundamentally flawed.

We disagree with the models proposed in the ED and have submitted our recommendations for a way forward on lessor accounting to the Boards. We believe that this approach would address many of the concerns surrounding the complexity and costs of the proposals.

The cumulative result of the distortions created by the lessor accounting proposals may be that shareholders of leasing companies cease to see leasing as an attractive business proposition. If many lessors reduce their operations or cease to operate as a consequence of applying the proposed lessor accounting model, the result will be that the European economy will be deprived of a vital source of funds and European investment will suffer as a consequence.

Smaller firms in particular could have a much harder time financing their investments. These are firms with limited sources of external funding to begin with and, without the benefit of the collateral that leasing naturally incorporates, their borrowing may become more costly and/or more difficult to obtain. Particularly in the current climate where businesses are still struggling to find ways and means to finance and use assets, it is crucial that their access to leasing is not jeopardised.

Question 3. Effects on the broader financial reporting system

I. Accounting standards for SMEs

We have significant concerns that the extremely complex requirements being proposed for the treatment of leases would discourage the use of leasing by SMEs were these proposals to form part of the standards that they are required to apply.

Although the proposed standard may apply initially only to a relatively small number of publicly traded entities, it is likely to be only a matter of time before its concepts are applied to all reporting entities, whether directly by the IASB through IFRS for SMEs, or indirectly by national standard setters. The responsibility to take account of SMEs' interests therefore sits firmly with the Board because it will inevitably affect small companies[7]. As described above, leasing is a key tool for these businesses to be able to obtain the use of assets and their access to the product should not in any way be undermined by complex accounting requirements.

[7] We note that the European Commission's "Small Business Act" promotes the "think small first" principle in developing new legislation.

II. Regulatory capital requirements

The proposed changes to accounting for leases are expected to have significant impacts on banks' regulatory capital requirements. In this respect, banks will be affected as they are both important lessees (of property and equipment) and lessors (17 of the top 20 European leasing firms are bank-owned).

As lessees, banks may be required to hold additional capital for the new right of use assets that will arise as a result of the new Leases standard. The regulatory capital treatment of these assets is currently undefined but could amount to 100% of the new assets if they are treated as intangibles. Even if they are treated as tangibles, the amount of capital involved would be significant.

As lessors, any bank required to apply the performance obligation model would be required to retain the leased asset (physical asset) on its balance sheets and simultaneously recognise an asset for its right to receive rentals from the lessee (receivable). Although the bank's risk profile will not have changed in any way, this artificial grossing up of assets could lead to banks having to hold twice as much regulatory capital as they do today.

III. Other effects

The effects on tax reporting requirements will vary from country to country but are likely to be significant, with most IFRS jurisdictions possibly having to make changes to their fiscal legislation. By way of illustration, the UK's HMRC has estimated that following its amendments to the UK tax code, businesses would experience tax compliance costs of £100 million on initial adoption and an additional £50 million per year on an ongoing basis. Without the legislative changes, HMRC estimates that these costs would have been twice as high.

The Boards should also bear in mind that the development of new concepts will influence and permeate into many other areas of legislation. As an example, current drafts of new EU legislation for VAT for financial services already refer to the concept of right of use, even though the IASB/FASB proposals themselves are far from being finalised.

Other types of reporting that will be required to change include public sector accounting. National accounts, on which key macro-economic indicators such as GDP and investment levels are based, will also need to be reviewed as these reporting systems are currently based on the existing IAS17 concepts.

The Board should take these broader effects into account in the development of new accounting requirements. International standards cannot be developed in isolation and without regard to their wider implications. We consider that it is essential for an impact analysis of the leases proposals to be conducted and used to inform the development of the project before the standard in finalised, in line with the European Commission's call for a full effects analysis to be developed as soon as possible in the life-cycle of a project[8].

[8] European Commission's Contribution to the IASCF Constitution Review, 22 June 2009

Question 4. Transition methods

The current proposals for leases will imply that all lessees of operating leases will experience significant losses on transition. Our response to the Leases ED includes a proposal for addressing this issue (i.e. linked measurement of a lessee's right of use asset and obligation to make lease payments). Alternatively, lessees should have the option to adopt full retrospective application.

We support the simplified retrospective approach applying for lessors in the context of the de-recognition model, with the exception that we think it is less burdensome for lessors to recognise residual assets at the present value of the future value of the asset at the end of the lease term rather than at fair value. This approach overcomes the difficulties associated with establishing current fair values of second hand assets. It should be noted that lessors will have information on the original asset value and its future expected value.

Question 5. Overall implementation plan

We support the view expressed by EFRAG in its Draft Comment Letter[9] on this Request for Views that the Revenue, Insurance, Financial Instruments, Fair Value Measurement and Leases standards should be subject, as a package, to a single effective date approach.

Assuming these standards are finalised by their target completion date, their effective date cannot be before 1 January 2015 at the very earliest to allow preparers (and users) to prepare for their implementation.

The development of new software packages cannot begin in earnest before final standards are published, analysed and understood in detail. Following this initial learning period, software development and testing could easily take a full year, if not more. This would be followed by preparers entering into tender and selection processes before moving on to implementation phases. Very few companies are likely to be able to complete such a process in less than a year. Consequently, anything less than a full two years between finalisation of the standards and initial application (first comparative period) will simply not give companies sufficient lead-time.

Nevertheless, the above indications of timing should be considered as an absolute minimum as they do not factor in any buffers for unforeseen delays or other issues that may arise during the implementation phase. Given the pervasive and complex nature of these standards, a buffer period should be included in the implementation timetable.

Moreover, should there be a delay in the Board finalising any one of the projects listed above, the effective date for the group will have to be postponed accordingly. For instance, given the current status of the Leases project, it seems highly unlikely that it will be completed by June 2011.

For these reasons, we consider that an effective date of 1 January 2016 would be a more realistic approach.

[9] EFRAG's Draft Comment Letter is available at www.efrag.org.

Question 6. Early adoption

N.A.

Question 7. IASB and FASB requirements

We are supportive of convergence between IASB and FASB standards and in this context believe that the same effective dates and transition methods between both sets of standards would be logical. However, when establishing effective dates and transition requirements, the IASB should bear in mind the specific characteristics and needs of its constituents and convergence should not necessarily be the driving factor in making these decisions.

Question 8. First time adoption

We agree with EFRAG's tentative view that early adoption could be considered for first-time adopters for practical reasons. However, early adoption in certain jurisdictions should not have the effect of forcing existing IFRS preparers to apply the new standards sooner.