Leaseurope

The Voice of Leasing and Automotive Rental in Europe

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- FOR IMMEDIATE RELEASE -

European businesses should be mindful of excessive complexity in newly published IASB proposals for lease accounting

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The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) have just released a discussion paper setting out their preliminary views on how leases should be accounted for in the future.

Leaseurope, the association representing leasing and automotive rental in Europe, welcomes this clear signal from the Boards that lease accounting is an important issue and that public consultation early on in the standard setting process is essential to achieve high quality financial reporting for leases.

The long-awaited paper focuses on putting all types of leases on firms' balance sheets. "It is important businesses appreciate that these changes do not just concern some big ticket leases, such as aircraft leases, which are frequently referred to by standard setters", notes Mark Venus (BNP Paribas), Chairman of Leaseurope's Accounting Committee. "The changes will also affect firms who choose to lease or rent basic equipment and vehicles. These make up the bulk of all leases. The global airplane fleet consists of some 19 000 jets, only a portion of which are leased. Yet the top 100 leasing companies in Europe alone wrote 4.7 million leases in 2007 to finance mostly assets such as cars, commercial vehicles, machinery, PCs and photocopiers." As a result, the European leasing industry is concerned that standard setters are considering a disproportionate approach when it comes to these types of leases in particular.

Businesses should also be aware that the proposed changes will have much wider-reaching consequences than just an increase in their assets and liabilities. Income statements will be affected and the future approach will create immense complexity for the preparers of accounts.

For instance, many simple leases contain options providing the lessee with the flexibility to extend the lease beyond an initial term. Under the new proposals, lessees will be required from the outset of the contract to estimate their most likely lease term which could be either the initial term or another, longer term including the optional period. Moreover, lessees will be required to reassess these decisions at each reporting date.

But just how do firms determine such estimates, particularly in an uncertain economic environment? "This looks like another example of standard setters coming up with a standard that will lead to increased volatility and procyclicality in financial reporting", adds Mark. "The burden for lessees should not be underestimated and the inevitable diversity of approaches that they will adopt when making these estimates could very well lead to financial statements being less understandable and comparable than before."

The European industry would not like to see a standard that is so complex it may overshadow the economic benefits of the products it provides. This is particularly important in the current economic climate where many businesses are struggling to find financing. Leasing can often be a viable alternative source of funds for these companies.

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More information on the proposals and their implications can be found below.

Note to the Editors

- **What is the new approach to international lease accounting?**

The new approach to lease accounting, often referred to as the right of use approach, differs substantially from today's standard which is based on an analysis of the risks and rewards inherent in the lease. Under the right of use model, a lessee would always recognise an asset, the right to use the leased item, and a corresponding liability on its balance sheet, whereas under the current standard, a lessee recognises the leased asset only under so-called finance leases.

- **What are the implications for businesses who lease or rent equipment or property?**

Users of financial statements already make adjustments to take into account uncapitalised lease payments. On this basis it is unlikely that the new approach will make a significant difference to these users' assessments of a lessee's financial position.

Firms should be aware however that with more assets on their balance sheets, they may be required to hold additional capital. Particularly in the current economic environment, this may have a significant impact on business activities.

- **Is the new approach limited to simply putting more leases on the balance sheet?**

No, the review involves several additional changes to "simply" requiring more assets on the balance sheet. The way these are measured will be substantially different to today's operating lease approach, affecting lessees' income statements. Moreover, the treatment of extension, purchase and termination options, contingent rentals and residual value guarantees will be radically changed. These changes are likely to create a level of complexity for preparers of financial statements that is disproportionate to any gains in information for the users of accounts. Moreover, there is a risk that the economic benefits leasing offers to businesses will be obscured. In Europe, leasing is responsible for financing on average around 27% of all equipment investment and is a vital source of funds for many companies.

- **How will lessor accounting be affected?**

Standard setters have been considering lessee accounting issues separately from those for lessors. Although there is some very high level discussion of lessor issues in the recently released discussion paper, the future treatment of lessor accounting is at this stage highly uncertain. It is the European leasing industry's view that this is regrettable and will be generative of inconsistencies in accounting standards.

- **A paper setting out the European leasing industry's preliminary views on changes to lease accounting can be found at:**

http://www.leaseurope.org/uploads/documents/positions/pp090116.pdf

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About Leaseurope

As a Federation, Leaseurope brings together 47 associations throughout Europe representing either the leasing, long term and/or short term automotive rental industries. The scope of products covered by Leaseurope's members ranges from hire purchase and finance leases to 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 European leasing market.

In 2008, new leasing volumes worth in excess of €316 billion were granted by the firms represented through Leaseurope's members. Together, these firms finance on average around 27% of all European investment (excluding investment in property). Moreover, they are responsible for the leasing and rental of some 17 million vehicles throughout Europe.