

## **European Leasing Association Comments on IASB Preliminary Views on the Future Treatment of Lease Accounting**

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Leaseurope, the trade association representing leasing and automotive rental in Europe, has just published its response to the International Accounting Standards Board (IASB) discussion paper describing how leases should be accounted for in the future.

Today, some leases or rental contracts, known as operating leases, are accounted for as straightforward operating expenses while others, when they are classified as finance leases, are reflected on lessee balance sheets. However, under the new proposals for lease accounting, businesses will in the future be required to account for all of their lease and rental arrangements on their balance sheets.

While standard setters claim that existing lease accounting is broken and that leases are structured to achieve off-balance sheet treatment, no real attempt has been made to analyse the extent and nature of the use of leases by preparers reporting under IFRS. Tanguy van de Werve, Leaseurope's Director General points out that "the global leasing industry granted new leases worth approximately USD 760 billion in 2007. Yet only a fraction of these would qualify as operating leases under IFRS. Leaseurope therefore considers that an exercise to quantify operating leases and identify the assets for which they are prevalent must be carried out as a matter of priority. The wide spectrum of arrangements that use the contractual form of a lease cannot all be heaped into the same bag. Standard setters must clearly demonstrate whether today's model is effectively broken and for which types of leases."

In addition to an increase in firms' assets and liabilities, the proposed changes will have other significant consequences. Income statements will be affected and the future approach is likely to create immense complexity and considerable costs for the preparers of accounts. For instance, businesses will be required to "look through" any options that may be associated with their leases by defining probabilities related to their most likely term of usage of the asset. They will also have to reassess these decisions at each reporting date.

Although no firm will be immune to this complexity, it will be those companies who have small ticket leases, very far removed from the structured, high value transactions at the core of the lease accounting debate, which will be the hardest hit. Mark Venus (BNP Paribas), Chair of Leaseurope's Accounting Committee explains that "the vast majority of leases granted by European leasing firms represented through Leaseurope's constituents are for low value items such as cars, photocopiers, IT and telecom equipment and other straightforward assets. These are very different to the real estate or aircraft leasing contracts that standard setters are focused on. The new proposals are likely to be applied to all leases in the same way and this will impose unwarranted costs on the many businesses that use leasing as an effective and flexible solution for obtaining the use of an asset. These companies are not concerned with achieving a certain form of financial statement presentation."

In its response to the IASB discussion paper, Leaseurope calls for a full cost/benefit analysis of the new proposals to be performed. Rüdiger von Fölkersamb (Deutsche Leasing), Chairman of Leaseurope, stresses further that "an effects analysis is an indispensable step in the standard setting process. Only once this has been done will standard setters be in a position to design a new standard which addresses any identified flaws of today's model in an effective and proportionate manner. A new approach to lease accounting should not be so complex that it risks overshadowing the real economic benefits of the leasing product. This is particularly important in the current economic climate where many businesses are struggling to find ways and means to be able to have access to the assets they need to conduct their business. Leasing can often be a vital source of funds for these companies."

## **Note to the editors**

### **→ Accessing Leaseurope's comment letter**

Leaseurope's full response to the IASB discussion paper on leases, including an executive summary, can be found at:

<http://www.leaseurope.org/uploads/documents/positions/pp090707.pdf>

### **→ The importance of the European leasing market**

In 2007, European leasing companies represented through the 48 member associations of Leaseurope granted new leasing volumes worth in excess of EUR 340 billion, making the European leasing market the largest in the world. These leases were used to finance equipment, vehicles and real estate throughout Europe and Leaseurope estimates that in 2007, the European leasing industry financed around 20% of all new European investments and slightly under 30% of investment in moveable assets. Of the EUR 340 billion new leases granted in 2007, approximately 86% were granted to finance various types of equipment and vehicles, with automotive leases making up almost 50% of all new business. In particular, a significant share of Europe's SMEs, the backbone of the European economy, use leasing as a source of external funds. One survey estimates 51% of all SMEs have made use of leasing or rental<sup>1</sup>.

### **→ Why do businesses lease?**

- Leasing provides businesses with the possibility to finance up to 100% of the purchase price of an asset without having to offer any supplementary guarantees
- Firms can better manage their working capital by spreading payments over the life of the asset and budgeting exercises are made easier as lease payments are regular and often for a fixed amount
- Leasing gives firms the opportunity to renew their assets, thereby ensuring that they can benefit from the latest available technologies and remain competitive
- Lessees can use the leased equipment without having to worry about considerations linked to ownership, such as residual value risk or the disposal of the asset when it is no longer used
- Leases are often accompanied by a range of optional services, including the insurance and maintenance of the leased asset. In this sense, a lease embodies an efficiently priced contract where all asset-related requirements can be outsourced to the lessor
- Leasing is easy to set up. It provides simplicity and process optimisation to the lessee who does not have to deal with accounting issues related to subsequent measurement of the asset such as impairment or perform reconciliation with its fixed asset register
- In some jurisdictions, taking on a lease will enable the lessee to benefit from investment incentives that the lessor can reflect through its pricing which it might not otherwise be able to benefit from

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<sup>1</sup> SME Access to Finance, Flash Eurobarometer 174, TNS Sofres/EOS Gallup for the European Commission, October 2005